



August Market Commentary

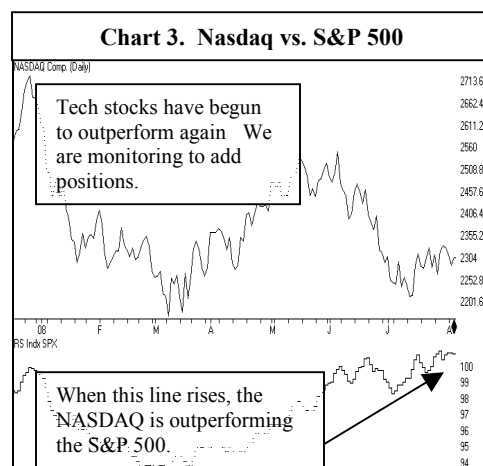
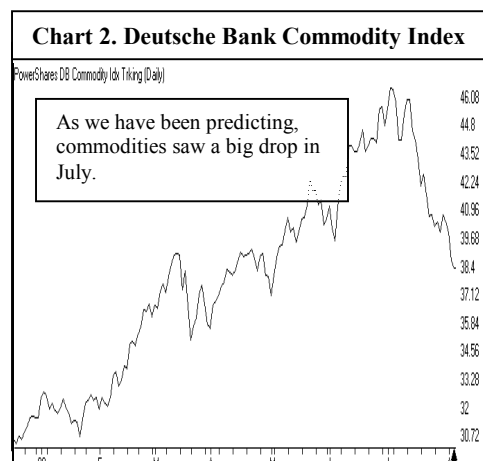
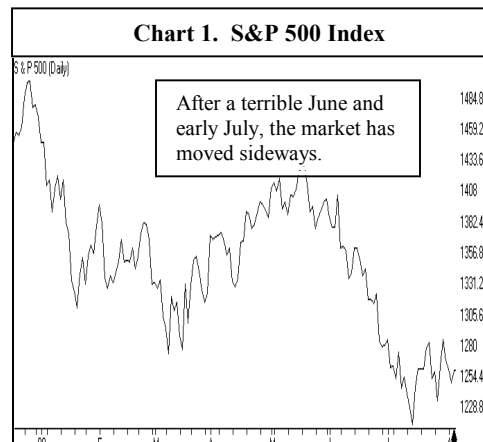
After the strong negative returns generated by the world's stock markets in June, the month of July was a mixed bag for investors; losses were small, but volatility was high. For instance, the S&P financial index dropped 14% in the first half of the month, before rallying 25% in the second half.

Over the past few months, we have reiterated the problems weighing on the markets. Rumors of bankruptcies in the banking sector, Fannie and Freddie's continued woes, high oil prices, inflation concerns and slowing economic growth, have all lingered over the markets causing angst among investors. We have been very conservative in our portfolios over the past few months waiting for some of these issues to begin to clear. Rather than reviewing these problems once again, we want to look at some of the encouraging developments of late.

Policy responses to the credit crunch have helped ease the financial squeeze. For an economy to extricate itself from a financial crisis, history has shown three things are needed: a cheap currency, a positive yield curve, and the recapitalization of bank balance sheets. This usually takes two to three years for all of these developments to materialize. But, with surprising speed, all three of these conditions are now being met in the US. The US economy is being boosted by the weak US dollar. Even though the dollar has rebounded some of late, it is still down about 12% over the past 18 months. This has sparked record exports, which is helping pick up the slack from weakening domestic consumption. This boost to manufacturing should help keep the US out of an outright recession. With the Fed deciding to leave rates at 2%, and giving no outright signal for imminent hikes, the yield curve is poised to stay positive. While we believe the next move the Fed makes will be a rate hike, it appears this will not happen for a while. This will give banks more time to rebuild their balance sheets. This is important because banks will not lend money, even if rates are low, if their balance sheets are destroyed.

We are also finally witnessing the anticipated roll over in oil prices. From the June highs, oil prices are down more than 18%. We have argued, over the past couple of months, that fundamental data simply did not support the continued rise of oil and commodity prices. Most importantly, the short-term pressures of Chinese demand, one of the biggest drivers of the latest surge in prices, is rapidly abating as well.

With the latest pullback in commodities, inflationary pressures are also weakening. In addition to central banks printing money and banks loaning money, the US current account deficit has been a major factor in global liquidity.





Interestingly, we are witnessing a period of an improving US deficit, which implies a weakening global liquidity environment. Overall, with restrictive central banks, contracting bank loans, a weakening US current account deficit and the latest pullback in commodities, we are not overly concerned about inflation in the developed world.

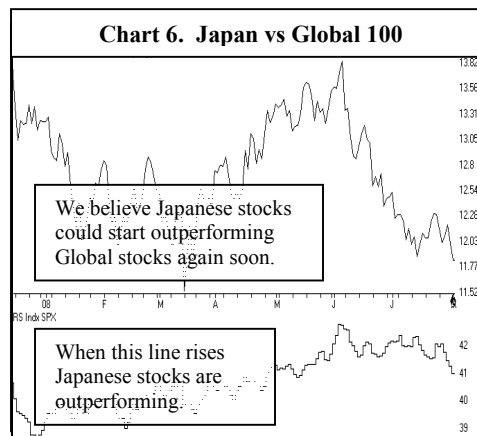
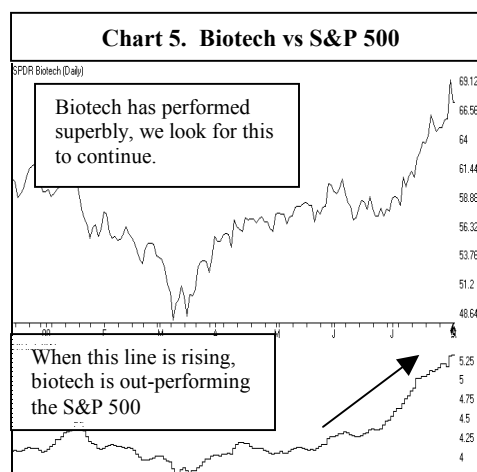
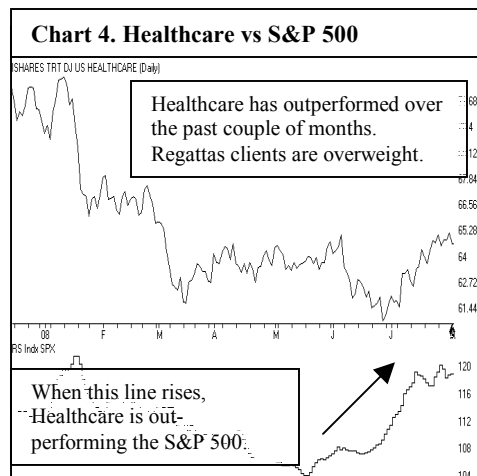
These latest developments show that the investment backdrop is not that dire. Thus the large sell offs we have witnessed this year could end up being seen as a great investment opportunity. Aside from volatility in the financial and commodity sectors, there are sectors that are doing relatively well, namely technology, healthcare and consumer staples. In July we added two of our favorite sectors, biotech and healthcare, to some of our portfolios. Both of these have performed very well on the up and down days. We have also been monitoring tech and consumer staples for possible inclusion in the near future.

We continue to see the US as having the most attractive investment opportunities. As we mentioned last month, we have been watching Japanese stocks very closely. Japan is one of the few countries that is not facing inflationary pressures, therefore the Bank of Japan should be able to keep rates low for some time. We initiated a small position in Japan in July and are monitoring conditions for us to possibly increase our holding. Asian equities are another area that could perform superbly should oil prices continue to decline. Asian countries have been battling alarming inflation due to the increases in commodity and food prices, which has weighed heavily on their equity markets. If oil continues to fall, beaten up equities such as China and India could take off again.

With this being said, we continue to maintain a cautious stance. Our largest holding in our portfolios, by far, is cash. Protecting our portfolios from further losses is our main concern. We continue to monitor your portfolio and the markets daily to take advantage of any positive developments.

We sincerely thank you for your continued patronage and support!

The Regatta Research Team



Disclosure

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