Schaper, Benz & Wise
INVESTMENT COUNSEL, INC.

Economic and Market Summary

October 2007

It was a strange summer. Financial news has been dominated by headlines describing the sub-prime mortgage market meltdown, collapsing hedge funds, housing market recession, the weakening dollar, disrupted merger and real estate deals, multi-billion dollar write-offs by large investment banks and an unprecedented liquidity crisis in European and American short-term funding markets. These concerning developments led to substantial central bank injections of funds, two half-point cuts in the discount rate from 6.25% to 5.25% and a half-point cut in the federal funds rate from 5.25% to 4.75%. We have warned in past letters that the massive expansion of "alternative" investment strategies, financial leverage and "derivative" investment securities in recent years could lead to systemic breakdowns in financial markets. We are now in the midst of a systemic breakdown in the asset-backed, securitized credit market. So far the damage has been confined to investors in certain classes of asset-backed "derivative" securities and to the investment banking, brokerage and loan origination infrastructure that supported the development of these markets. What's strange is how little impact all of this turmoil has had on the economy and how the stock market, after a mild correction early in the third quarter, roared to record highs in early October. It reinforces how futile market-timing can be and supports the belief that our macro analysis should be complementary to our industry and company specific research and focused on discerning broad, underlying economic and market trends rather than on forecasting.

On that note, most economies throughout the world are experiencing healthy growth. After a period of softness late last year and early this year, U.S. economic growth rebounded in the second quarter to +3.8% and appears to have remained firm at about +3% in the third quarter. The primary drivers of growth are booming exports, wage and salary growth and a rebound in business investment spending. Notably absent from the list of economic drivers is consumption, the largest component of GDP, which decelerated during the second quarter to +1.4% and is likely to remain sluggish going forward. Slowing job growth and tightening credit conditions are impeding on the capacity to spend. We expect Real GDP growth of +2-2½% over the next year or so.

Inflation remains a concern. Energy, industrial materials, agriculture and other commodities prices continue to climb. Wage and benefit growth is accelerating. Weakness in the U.S. dollar could also be inflationary. Businesses facing these rising costs, in many cases, are unable to raise prices or improve productivity enough to forestall pressure on profits. Slower profit growth could lead to slower domestic investment spending, which would weaken one of the legs supporting U.S. economic growth. Unless commodity prices reverse or productivity growth reaccelerates, we expect to see worsening inflation at the consumer level, slower corporate profit growth, or both.

Bond yields do not sufficiently compensate investors for the inflationary risks that exist. Our strategy toward bonds is to focus on high quality issues and short maturities. While we remain bullish on stocks for the long-term, unsettled credit and real estate markets along with intensifying inflationary risks argue for a more cautionary approach toward stocks in the near-term. We remain convinced that tumultuous markets eventually reward investors in well-managed, financially sound and fundamentally strong companies capable of generating consistent levels of profitability and growth.

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To request our SEC Form ADV Part II, please contact Michael L. Wise, Chief Compliance Officer, at the address below.

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