

MONEYLETTER *Hotline*

Welcome to the *MONEYLETTER* Hotline for May 2, 2007

Many on Wall Street are bewildered by the stock market's performance over the past two days. Friday's selling, particularly the steep drop in the Nasdaq, seemed to clinch the case that finally the housing-led weakness was catching up to the market. The word stagflation was gaining wider circulation. Surprise! In the last two days as the first reports about April activity were released, they pointed in the opposite direction. If this is stagflation, then we need a second helping. New orders pointed to a pick-up in manufacturing, and the Fed's favorite inflation gauge said inflation was a whisper away from the Fed's comfort zone. No wonder the market rallied and went on to new rally highs. We all know the old cliché, one month does not a trend make. Still, the reversal of the manufacturing weakness last month was powerful, and was supported by anecdotal reports from manufacturing itself. We would give a 70% chance to the probability that we are seeing a rebound in that sector. We would lower the probability for inflation, we just need a little more evidence. The market rally is just doing what stock markets do. When the outlook changes, and it has, the market responds. We think the market has it right, at least for now. There is no change in our recommended allocations.

New Fund Ratings – For domestic stock funds, three funds are now rated Buy: Janus Research, Matrix Advisors Value and Federated Kaufmann Fund. Three funds are now rated Sell: FBR Small Cap, Wells Fargo Advantage Small Cap Growth and Heartland Value. For international stock funds, four funds are now rated Buy: T. Rowe Price New Asia, MSCI EMU (ETF), Janus Overseas and Quant Emerging Market, Ordinary. Oakmark International Small Cap is now rated Sell. There are no other changes.

FBR Small Cap is in the Moneyletter Conservative Portfolio. We will replace it with Janus Research.

The Economy – With the expectation of a pick-up in manufacturing, the economy will be coming closer to the Federal Reserve's expectations for the first half, moderately slow growth in the 2.0% range. Even if we are heading there, after last quarter's much weaker results, there is one sticking point. There is no sign of labor market slack, and that raises the issue of wage pressure and inflation. This is where the Fed's focus will now shift. We see the chances rising of higher interest rate ahead, some months down the road.

The Stock Market – The better economic news here should be a tonic for world markets, which have been concerned about weakness here. At the same time, the economic news, especially from Europe has been very encouraging. The global economy marches on. It is why we advocate a strong tilt overseas.

The Select Portfolio – There is no change for this portfolio.

The next Hotline is scheduled for Wednesday, May 9th, at 7pm.