KEATING INVESTMENT COUNSELORS, INC.
REGISTERED INVESTMENT ADVISORS FOR INDIVIDUALS, RETIREMENT PLANS, TRUSTS AND FOUNDATIONS

Investment Strategy
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The stock market, over the past year, was a story of two halves. In the first half of the year the market experienced exceptional profitability for most companies and excessive liquidity was brought on by private equity groups and hedge funds. This led to a record number of buyout deals and all time highs in the major indices. By the middle of the summer the Dow Jones Industrials had advanced 19% and the S&P 500 gained about 15%. Since then the markets have been thrown about by fear stemming from the worst housing market in decades. It has caused banks to freeze lending even among each other and has led the Federal Reserve to try unprecedented tactics to jumpstart the economy back into normalcy. This has left most, if not all, participants in the market leaving 2007 with negative feelings. However, as the year ended, the markets advanced, although fear surrounding the housing market remains. The Dow Industrials finished the year up 6.4% and the S&P 500 gained 3.5%. These are not remarkable gains by most measures but it was not the negative returns most people perceive from 2007.

Looking into 2008, the market will continue to focus on the credit situation for at least another quarter or two. There are still issues to work out and further asset write downs will come to light. Nevertheless, we believe that the worst may be over and, although the market may continue to lack direction in the short term, the market should persist in moving higher over the next year. In addition, we will continue to hear about the deteriorating housing market for years to come. Many new homeowners will lose their homes and be forced back into renting. Housing prices should continue to decline for some time as the market corrects from extremely high valuations and overproduction. These issues will have a drag on the economy but, overall, US employment remains strong as the world economy enters a new era of widespread prosperity.

The risk of recession has been increasing over the past few months as consumers grow increasingly uneasy about the economy. Recessions are usually caused by negative sentiment among the public resulting in a pull back in consumer spending. We began to experience this pull back at the end of the year as holiday sales were weak across most retailers. The general public perceives that they are less wealthy than they were last year as housing prices decline and an uncertain economy lies ahead. We believe that if a recession does arise that it will be short and moderate. The period from 1990-1991 has shown to have many parallels to today's environment as a financial crisis is coupled with a declining housing market and high energy prices, along with a war in the Middle East. As you will recall, that period was followed by a short, mild recession.

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However, today is different in that the world economy is now much less dependent on the U.S. for sustained growth. Worldwide prosperity has driven record amounts of trade as these developing nations are now not just producing but consuming goods. The weakening dollar has made U.S. goods much more competitive against European made goods across the globe. A common misperception is that the U.S. dollar has weakened against Asian currencies. In reality, the European currencies and the Canadian Dollar have strengthened versus the U.S. and Asian currencies. We believe the dollar will begin to strengthen throughout the year as the economic situation in Europe is much more dismal than in the U.S. This may cause U.S. exports to decline, but, more importantly, it will be a positive for consumer confidence and may help drive purchases in the near term.

A positive on the horizon has been the emergence of sovereign funds, or foreign government run investment pools. They have become extremely powerful in countries with positive trade balances, such as oil producing nations in the Middle East and heavy manufacturing countries in Asia. These countries have historically bought U.S. treasury bonds with the excess cash they generated from trade surpluses. These countries are now looking for higher returns and have allocated hundreds of billions of dollars to be invested in equities, higher yielding bonds, real estate, and other alternative investments. We believe this money will flow into large U.S. companies as these are the best value to foreign investors while providing the low risk, liquid positions desirable by governments. We have already begun to witness this movement with many of the large, capital-strapped banks getting cash infusions from exactly these funds. These funds will act as a backstop to U.S. equity prices and will help to moderate any downturn in the stock market.

We are positive on the future prospects of large multinational U.S. companies in the world economy. We expect the markets to continue forward but at a modest clip. We continue to believe, as Jeff did, that the Asian markets are due for a significant correction. The Chinese market, we feel, is the next major bubble on the horizon. It is the case of too much money chasing too little opportunity. The Chinese government is determined to postpone this correction until after the 2008 Olympics. When the correction occurs, we believe money will flow back into domestic markets from emerging markets. The push into emerging markets has been a very strong trend over the past five years and we believe a reversal of this is likely to occur. All of these factors should lead to higher valuations next year despite the continued drag from the housing market and credit crisis.

While the US economy is slowing, a recession is not expected as the Fed has

shown a willingness to intervene as needed. Within the past eight days the Fed has lowered the federal funds rate 1.25%, down to 3%. Recall that over the summer the federal funds rate was at 5.25%. The lowering of rates drives consumption as borrowed money becomes cheaper. It also acts to increase profitability for lending institutions. The CEO of Washington Mutual recently estimated that for every ¼% cut to the Fed rate, the company generated $150 million extra in profit each year. Within a few quarters these banks will become more profitable than they were before this financial crisis began.

The government has also stepped in with plans to propel economic growth. The House of Representatives recently passed a stimulus plan endorsed by the President that would give a $1,200 tax return to households with additional money for each child. As we expected, the political parties have acted quickly to help consumers during an election year. The government is also considering a change in tax law that will allow banks to keep some of their liabilities and mortgage related write downs off of their balance sheet. This will cause the banks to appear better capitalized than they really are. The combination of the Government and the Federal Reserve focusing on a possible recession will damper any downturn.

Large cap, high quality stocks continue to be the place to invest in this uncertain environment. Holding these stocks during the recent volatility has proven to be beneficial as the average stock is already down substantially from their recent highs. Large, multinational companies currently present exceptional value in an up market and also have the scope and diversity to weather out a down market. For 2008, we believe we will narrowly miss a recession, and by year end markets will be back at all time highs.

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Keating Investment Counselors, Inc.