COUNTERPOINT
The Quarterly Commentary of Jurika, Mills & Keifer

Review and Outlook:
January, 2007

2006 ended with reports of Saddam Hussein's execution and major bonuses for Wall Street's top investment bankers. In many ways, these two stories characterized the divergent chain of events on the world stage between global conflict and global growth.

The news tape was marked by the deteriorating situation in Iraq, diplomatic crises with North Korea and Iran, an extra-strength dose of corruption and scandal in Washington, terrorist threats, immigration reform, and the loss of both houses in Congress by the Republicans to the Democrats. Also, and significantly, it was marked by a major reversal in the price of oil and other commodities at mid-year and a change in Federal Reserve Policy from a tightening to a neutral bias. Finally, it was punctuated by an extraordinary number of mega mergers and acquisitions, fueled by investment banks, private equity firms and hedge funds with over a trillion dollars of capital burning a hole in their pockets.

For the stock market, 2006 was a play in two acts. Act I, which spanned from January through mid-July, was lackluster at best and offered a bumpy ride from point to point. The **S&P 500** and **Dow Jones Industrial Average** were both flat or down slightly for the period and the tech-heavy **NASDAQ Composite** was off 7.4%. By July, there was a fair amount of pessimism about the economy, inflation, and a bursting housing bubble.

There were also a number of wonderful bargains to be had, especially in the realm of large capitalization stocks, which we wrote about in our July 1st ***Commentary*** entitled "Sleeping Giants."

New Beginnings:

A new firm with a 25-year history.

As we begin the New Year, we celebrate the transformation of our firm from what was primarily a family office into an SEC registered investment firm serving sophisticated individual and institutional investors.

This transformation began early last year with the formal articulation of our investment approach, which we call *Counterpoint*, and included the launch of our no-load mutual fund on November 30th.

Jurika, Mills & Keifer is built on the same set of professional and investment values and principles that were at the core of our old firm, Jurika & Voyles. Our new venture is also driven by a similar mission to build a firm of outstanding quality, but with some significant differences from the past.

With a perspective on the investment markets and the investment business spanning 40 years, we have seen and learned a great deal. We endured market booms and busts, enjoyed successes and failures, and built and run a large money management firm from the ground up. We have also made numerous mistakes along the way. These provide the most valuable lessons of all.

Less is more.

One of the greatest lessons is that less can be more and, conversely, that more often becomes less. *(Continued on page 3)*

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Act II began with a major reversal in trends and sentiment. Oil prices fell, inflation fears subsided, interest rates declined, and the Federal Reserve softened its rhetoric, even as North Korea and Iran hardened theirs. The plunge in housing prices slowed, and the U.S consumer showed continued resilience, along with an aversion to Republicans and an appetite for fashion and consumer electronics. The change in sentiment was supported by a frenzy of deal activity which made 2006 the biggest year to date in deal activity. According to The Wall Street Journal, worldwide deals totaled $3.8 trillion, eclipsing the prior record of $3.4 trillion set in 2000. With so much money chasing deals, stock prices headed north, and the Dow, S&P and NASDAQ had a great year in just six months time, gaining more than 15%. For the full year, the Dow, S&P and NASDAQ posted total returns of 13.6%, 16.3% and 9.5% respectively.

International markets fared even better, especially emerging markets, with China, the *Google* economy, leading the pack with a 130% return. India was up over 45%. **The Morgan Stanley EAFE** (Europe Asia Far East) index returned a formidable 23% for the year. Despite a Middle East in greater turmoil than in recent memory, and more areas of conflict around the world, the prospect of continued global economic growth and abundant amounts of capital seeking opportunity, led to an unusually strong year for investors worldwide.

Looking forward:

As we look forward to 2007, we come back to the divergent forces of global conflict and global growth, both of which have enormous potential to reshape the world order, and both of which exist in a world that is a zero-sum game. Growing economies require scarce resources, including oil. The supply of oil depends on some measure of geopolitical stability and new investment. One can't exist without the other. China finances our deficits so that we can buy Chinese goods and support their growth. Everything, ultimately ties together.

Another axiom is that capital will tend to flow from areas of excess regulation to areas of deregulation. Our politicians are famous for over regulating the barn after the cattle have already left, while failing to anticipate the next problem. The burdens of Sarbanes Oxley regulation have caused many public companies to consider going private, leading to the boon in private equity. The onerous regulations on investment management firms and mutual funds have caused capital and talent to flow to hedge funds. The many laws and restrictions in our economy make it increasingly attractive for companies and capital to locate themselves elsewhere in the world.

Another important axiom is that too much money chasing too few opportunities tends to end badly… *Maybe not today, maybe not tomorrow, but someday*… to paraphrase Bogey in Casablanca. The world seems awash in liquidity, and it seems as if everyone wants to invest in emerging markets, hedge funds, private equity, and venture capital. There are many smart people with many billions of dollars at their disposal looking for a way to make an outsized return on their investment. The people who gave them this money to invest have high expectations. In our experience, when you give smart people too much money to invest, they start to make dumb decisions. Competition for deals drives up the prices of all assets and increases the assumptions required to make the investment pencil-out. Over time, assumptions become increasingly optimistic and deals become increasingly questionable if not risky. This has been true time and time again, in real estate, in venture capital, and it will be so again. It is human nature, to take a good thing too far and never before have so many people been so well compensated for doing so. Stay tuned.

So, although we believe that the U.S. economy is generally sound and should continue to chug along in 2007 with moderate growth, we are less enthusiastic about overall valuation levels, which we believe now reflect an overly optimistic outlook growth and deals. There are some pockets of reasonable value, usually with some controversy attached, but they are fewer and farther between.

Over the long term, we think the US economy will continue to lose competitive advantage to less regulated and faster growing economies in Asia and elsewhere with political systems more aligned with economic growth and innovation than the preservation of the status quo. For this reason we believe that international economies - especially emerging and newly developing economies – will keep growing, although not without some bumps in the road. We see this as a major shaping trend that will play out over the next decade and will reshape the allocation of market capitalization relative to GDP around the globe. In the near-term however, we believe that international investment has gotten far ahead of fundamentals and in some cases, such as China, is approaching speculation. For that reason, we have advised reducing the overall allocation to international stocks.

Across the domestic stock market we still favor large capitalization stocks, which sell for the most reasonable valuation levels. Many have the added benefit of offering significant international exposure at a fraction of the price of buying it offshore. We particularly like the technology sector which should enjoy strong demand in the coming year.

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For this reason we have become very focused in how we manage our new firm and invest our portfolios. Unlike many firms that try to be all things to all people, we do not. We feel that this can lead to mediocrity and tends to divert the focus of a firm from investing to asset gathering.

We are confident that we have designed our firm to allow us to spend the maximum amount of time on investing, and to minimize all factors that distract from this pursuit. We have one investment strategy, which we offer in two levels of concentration. One is a subset of the other. In both cases, we focus on making relatively few investments with a long-term time horizon. This allows us to leverage our research efforts. Great investment opportunities don't come along everyday, and when they do, we want to make them count. While diversification mitigates risk, it also mitigates opportunity.

Our *Counterpoint* strategy has been honed over many years of working and investing together.

We invest as rational business owners and focus on quality and valuation relative to risk and opportunity. We combine core holdings in higher quality companies with opportunistic holdings in companies that may have fallen out-of-favor as a result of near-term problems, challenges or disregard. In both cases, we look for businesses with durable and valuable business franchises that give them the ability to build shareholder value over

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time, and to withstand near-term problems and challenges along the way. We think and act independently and are willing to make significant investments contrary to consensus opinion where we discern value and opportunity.

In December, we signed an agreement with Conifer Securities in San Francisco to handle all of our back-office and trading functions. Conifer offers highly sophisticated capabilities in all areas of trading, portfolio accounting and administration, compliance and technology, along with disaster recovery. They have a very experienced and professional team and serve a variety of investment firms in The Bay Area, New York and Boston. The Conifer relationship improves our own capabilities while freeing up our time to concentrate on our investments and investors.

Again, less is more.

We stand ready to serve you. Please let us know if we can be of assistance.

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