CYPRESS
ASSET MANAGEMENT, INC.

MARKET COMMENTARY **July, 2007**

The S&P 500 reached the half way mark of 2007 up almost 7%, the best first half performance in four years. Despite the ongoing and well publicized downturn in the U.S. housing market and related concerns over the health of the consumer and the sub prime lending market, stocks continue to be supported by a strong global economy. In fact, the global economy and the industrialization of the world's developing economies is the primary driver of growth both for your portfolio and for American industry. The world's developing economies now account for about 30% of world GDP, up from 18% in 1992. Taken as a whole, according to ISI Group, the developing economies are growing at roughly 6%, or better than twice the rate of the industrialized nations. Moreover, China, India and Brazil – which collectively account for more than one third of the developing economies – have been growing at an annual rate of roughly 10%, 8% and 4%, respectively, over the past four years. These growth rates are of course not sustainable indefinitely, but solid long term growth prospects are supported by genuine movement towards more free markets in these developing countries. The shift towards more capitalist economies and some progress in the recognition of property rights and rule of law – principles which undergird almost all successful long term economies – all support the case for higher long term global growth rates.

Growth and industrialization in the developing world have reached a kind of critical mass. This phenomenon gives an unprecedented boost to global growth, puts upward pressure on energy and commodity prices, while at the same time exerts downward pressure on labor costs, manufactured goods, and even services. The developing economies account for 85% of the world's labor force and they are now involved in almost every aspect of global commerce, from Nike tennis shoes to state of the art production of steel, semiconductors or medical equipment, and now even include technical support and the outsourcing of professional services.

So while domestic growth may be moderating and somewhat uneven, global growth is resilient. Led by the BRICs (Brazil, Russia and Eastern Europe, India, and China) the ongoing and dramatic industrialization of the developing world remains the predominant trend in the world economy and in world financial markets. There will be significant pitfalls and downturns along the way, but the long term potential rewards for investors could be quite substantial.

Market Balance Sheet

POSITIVE	NEUTRAL	NEGATIVE
Interest Rates		
Economic Growth/Industrial Production	Budget Deficit/Surplus	Geopolitical Stability
Economic Growth/Consumer Spending		
	Liquidity (Monetary Growth)	
Fiscal Policy		Energy Prices
Valuation	Inflation	
Profit Growth/Margins	Dollar	Regulatory Environment
Productivity	Employment	
Demographics	Free Trade Protectionism	

POSITIVE

Interest Rates

Still relatively low and favorable to equity valuations. Inflation expectations are moderating with the economy. Also of note is the inverted yield curve with long rates still below the 5.25% Fed Funds rate. We believe that the next move by the Fed will be to lower rates, probably late in the second half of this year or sometime next year.

Economic Growth

Should remain healthy while moderating to the 2% – 2 1/2% range for the next few quarters.

- Profits and corporate liquidity remain strong, and support both
  1) increased business investment and higher employment
  2) strong dividend growth and share repurchase.
- The slowdown in domestic economic growth has been accompanied by an increase in defaults in the highest risk mortgage lending area called sub prime loans. There will be losses associated with defaults, foreclosures and asset write-downs. There may even be some spill over in the consumer segment of the economy. To date, however, the sub prime issues, which are a small fragment of the giant fixed income market, appear to be generally focused in more obscure financing vehicles and not systemically widespread.
- As we previously noted, the economic growth driver has shifted from the consumer to capital spending and industrial production, and toward innovation, small business, and more entrepreneurial activity.

Fiscal Policy

Taxes on dividends and capital gains at lowest levels in over 60 years. Two year extension of the tax cuts on dividends and capital gains through 2010 could be threatened by a new administration.

Valuation

Very reasonable at about 16 times estimated 2007 S&P 500 operating earnings. Moreover, stocks are significantly cheaper than bonds, where the bellwether 10 year U.S. Treasury currently yields about 5.0%, and is thus valued at roughly 20 times "earnings" (its coupon).

Profit Growth/ Margins

Profit growth slowing to 5% range over the next few quarters; profit margins continue at very high levels aided by ongoing gains in productivity, but could come under some pressure from a rise in both employment and raw material costs.

Productivity	Continues to drive profit growth and keeps the U.S. economy the most competitive in the world; will moderate somewhat as economic expansion matures and we move closer to full employment.
Demographics	Baby boomers in the sweet spot of wealth and investing cycle, hungry for growth and income.

NEUTRAL

Liquidity (Monetary Growth)	Money growth is a mixed picture domestically, but global liquidity is very strong. Global broad money (e.g. MZM) has accelerated to almost 10% on a year over year basis according to ISI Group.
Inflation	Cyclical inflationary pressures are becoming a subsiding concern. We believe any pick up in inflation will prove temporary, as the global economy exerts relentless pressure on prices. In particular, China remains the dragon slayer of inflation, exerting downward pressure on U.S. wages and manufacturing. Low global bond yields and a slightly inverted yield curve in the U.S. also indicate inflation is contained.
Dollar	The dollar has stabilized, but a return of dollar weakness could lead to higher short term interest rates in order to lend support to the dollar. The weaker dollar helps U.S. multinationals, but our trade deficit remains stubbornly high despite the competitive advantages of a lower dollar. It is also worth noting that about 30% of our trade deficit is due to imported oil (net energy imports are currently running at an annual rate of around $300 billion). This is a structural deficit, which has exploded in the last couple of years due to the declining dollar and doubling of global oil prices.
Employment	The employment picture remains quite healthy, with 49 consecutive months of job growth. The 4.5% overall unemployment rate is low by historical standards, and is essentially at a six year low. Still, employment growth has been less robust than in typical recoveries, and the pace of job growth is likely to moderate further over the course of the year.
Free Trade/ Protectionism	Free trade and free market oriented reforms were given a boost by recent election results in France, Japan, Canada and Mexico.
Budget Deficit	Currently running at less than 1.5% of GDP and in an improving trend due to surge in federal tax receipts. Still, we would like to see more spending restraint. Bigger issue is the persistent growth of medical care costs and the long term liability of retirement in our aging society.

NEGATIVE

Geopolitical Stability	Iraq continues to be plagued by terrorism and sectarian violence. The global terrorist threat will be with us for some time as will the issue of a nuclear Iran. Although event risk remains significant, investors are becoming more accustomed to dealing with terrorism, scandals and unforeseen events.
Energy Prices	After a significant decline late in 2006, oil prices have rebounded to over $70/Bbl, while North America natural gas prices have actually declined to below $7/Mcf due to persistent high storage levels. Without a global economic slowdown it is difficult to make a convincing case for a sustained collapse in energy prices. Additionally, in order to be economically viable, most non conventional hydro carbons (e.g. Canadian Tar Sands, coal to liquids, biofuels) need a sustained price of $45 - $50 per barrel of oil.
Regulatory Environment	Federal and state investigations continue to impact individual corporations and entire industries; recent concerns focus on the area of stock options and executive compensation. Changes in Congress also raise the possibility for increased regulation and tax policy changes for certain industries.