

BRADY INVESTMENT COUNSEL LLC

CORE GROWTH  
COMPOSITE  
INVESTMENT STRATEGY  
REVIEW AND OUTLOOK

---

QUARTERLY  
REPORT FOR THE PERIOD ENDING  
MARCH 31, 2007

---

1Q 2007

TEL. 630.845.1125 FAX 630.845.3397  
EMAIL: DAVID.BRADY@BRADYINVESTMENTCOUNSEL  
WEBSITE: WWW.BRADYINVESTMENTCOUNSEL.COM

# INVESTMENT REVIEW AND OUTLOOK FOR THE PERIOD ENDING MARCH 31, 2007

## CORE GROWTH COMPOSITE SUPERIOR LONG-TERM PERFORMANCE CONTINUES

---

### INVESTMENT RESULTS

---

**Over the past one- and three-years, The Brady Investment Core Growth Composite (BIC) achieved annualized returns of 12.4% and 12.3%, respectively. This compares positively to annualized results of the Russell 1000 Growth Index (RLG), which gained 7.1% and 7.0% over comparable periods. For the first three months of 2007, BIC achieved a total return of -0.2% compared to a 1.2% gain for the RLG. BIC's short-term results were impacted by our investment focus on large cap companies. Although large caps have outperformed small over the past year, which is a trend that we expect to continue, the 1Q investing environment clearly favored small caps.**

---

### 1Q 2007 PERFORMANCE ANALYSIS

---

The 1.4% performance differential between the Brady Investment Counsel Core Growth Composite (BIC) and its benchmark Russell 1000 Growth Index (RLG - \$559) during the 1Q 2007 is the result of our large cap company investment bias at a time when small caps outperformed. BIC's \$26 billion median market cap is over four times the RLG's \$5.7 billion median cap. During the quarter mega caps as measured by the Russell Top 50 Index (RTF) were down 1.9% while the small cap

Russell 2000 Index (RUT-\$801) gained 2.0%. This equates to a 3.9% performance gap favoring the small cap benchmark.

As additional proof of how difficult it was for large cap investors, nine of the Russell 1000's 1Q Top-10 performers have a market cap below the BIC's \$26 billion median. The one exception is Texas Utilities (TXU - \$29 billion market cap), which benefited from a private equity buyout offer made in February, 2007. Further, seven of the RLG's Top-10 performers have market caps below \$10 billion. The 1Q 2007 was a definitely a good market for small cap investors.

However, certain large caps did manage to perform well during the 1<sup>st</sup> quarter. Our holdings in Dow Chemical (DOW -\$46), Alcoa (AA-\$34) and Cardinal Health (CAH - \$73) each added to BIC's investment performance. Holdings that detracted from the Composite's performance were blue chips such as Amgen (AMGN-\$56), Motorola (MOT-\$18) and Citigroup (C-\$51).

---

## **PORTFOLIO FUNDAMENTAL AND TRADING ANALYSIS**

---

The Core Growth Composite's portfolio-level fundamentals are solid. Normalized EPS (smoothed for peaks and troughs) are projected to increase at a 14% average annual rate over the next three-to-five years. The P/E based on our normalized 2007 estimate is 19X. Our top holdings include MSFT, Johnson & Johnson (JNJ - \$60) and Wal-Mart (WMT - \$47).

BIC's largest sector exposures are to Technology and Healthcare. Both are projected to produce superior earnings growth in 2007 and 2008. We expect that the stock prices of the companies making up these two sectors will follow. In addition, we have been finding attractive risk-adjusted opportunities among our Consumer Cyclical holdings. Other individual positions added to include AMGN, Microsoft (MSFT-\$28) and Network Appliance (NTAP-\$37). Positions sold during the quarter were Sun Microsystems (SUNW-\$6), Xerox (XRX-\$17) and Avaya (AV-\$12). Finally, we remain underweighted in the Energy, Telecommunications and Utilities sectors.

---

## **MARKET ENVIRONMENT AND OUTLOOK**

---

Over the past 12 months the large cap Russell 1000 Growth Index (RLG) is up 7.1% versus up 5.9% for the small cap Russell 2000 Index (RUT); yet, large cap stocks remain near historic low valuation levels relative to small. The S&P 500

Index (SPX-\$1,421) is trading at 15X projected 2007 EPS versus 24X for the RUT. Given the valuation advantage, we forecast that large caps will continue to produce superior risk-adjusted returns relative to small caps. These performance cycles are typically long and run between two and five years depending on how quickly the valuation advantage disappears.

Of concern, there have been signs that the US economy is slowing, particularly in the housing and sub-prime lending industries. We are also disquieted by the potential for inflation brought about by the overall high level of resource utilization. The labor market is running at full employment, productive capacity utilization rates are high and nonresidential investment spending is not keeping up with demand. This combination is worrisome as it can lead to stagflation if unchecked.

We forecast the Fed recognizes the risk to growth and potential for inflation in an economy where demand exceeds supply and will react by cutting interest rates later this year. Their aim will be to stimulate capital investment in order to add to productive capacity and improve its efficiency. The newly formed fixed plant and equipment will not only yield productivity advances, it will compete with labor, thus, keeping the pressure for wage increases under control. The end result will be a growing economy with ample supply of goods and services compared to the supply of money available to pay for them.

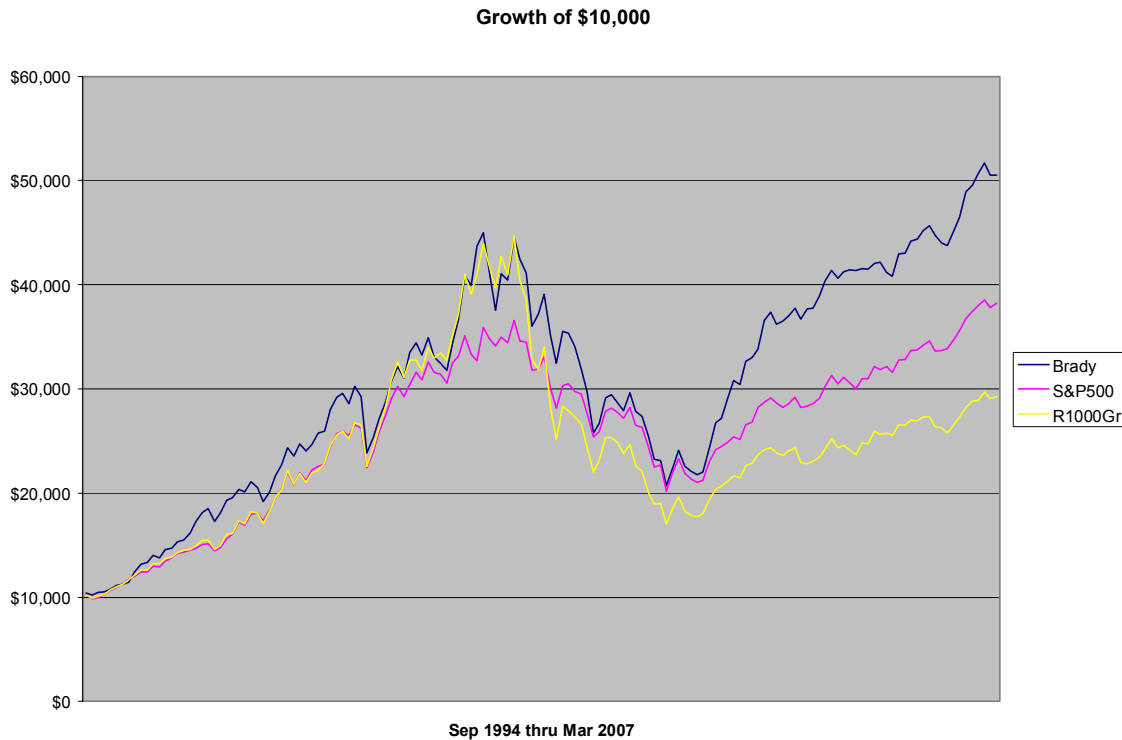
One year from now we forecast that the Fed Funds rate will be between 4.25% and 4.75%, or 50 to 100 basis points below today. In the near term, the Fed will delay cutting rates in an effort to let the air out of the housing bubble, which was built between 2003 and 2005 on speculation driven by the record low lending rates. Although based on our recent surveys, the law of supply and demand is already well at work here by taking due care of inflated housing prices in markets that are overbuilt.

Our 2007 market projections are unchanged: The S&P 500 Index will finish the year at \$1,570 versus the \$1,421 March 2007 closing level. This will be driven by 8%-10% EPS growth and a modestly lower market capitalization rate due to lower interest rates. The biggest EPS gains will come in the 4Q and will be driven by increases in the Technology and Health Care Sectors.

---

## LONG-TERM PERFORMANCE

---



---

## DISCLOSURE AND COMPLIANCE STATEMENT

---

Brady Investment Counsel LLC is an independent investment advisor established in 2003. Brady Investment Counsel LLC manages a variety of equity and balanced accounts for US individual clients. Additional information regarding the firm's policies and procedures for calculating and reporting performance returns is available upon request. The Russell 1000 Growth Index is an appropriate

benchmark for pure equity style performance analysis. Performance is presented gross of management fees and withholding taxes but net of certain trading expenses. A complete listing and description of all composites is available on request. The standard management fee for accounts is 50 basis points (0.50%). The minimum account size is \$500,000.

The Core Growth Composite currently includes seven accounts. From March 2003 and to present, the Core Strategy returns are Brady Investment Counsel LLC equity composite returns before fees but after certain trading expenses.

Prior to March 2003, the Core Growth returns are the results before expenses but after certain trading costs of the Stein Roe Young Investor Fund. David P. Brady was the lead manager of the Stein Roe Young investor Fund between September 1994 and March 2003. Mr. Brady has employed a similar investment strategy of buying high quality growth stocks for each of the aforementioned investment products over the entire investment performance reporting period. **The Core Strategy and the Stein Roe Young Investor Fund returns are combined and provided as supplemental information only.** Past performance is not a guarantee of future results. Brady Investment Counsel LLC reserves the right to change previously reported total return figures without notification should significant discrepancies be discovered.

The Brady Investment Counsel LLC investment strategies are appropriate for investors with a long-term time horizon only. Contact Brady Investment Counsel LLC for a discussion of the risks when evaluating historic combined portfolio results or if you have other questions concerning the calculation of our investment returns. Brady Investment Counsel LLC clients should primarily consider and rely on an understanding of their personal investment constraints and objectives, among other things, before selecting Brady Investment Counsel LLC as an investment advisor.

The information presented in this document is for informational purposes only and should not be construed as investment, legal, tax or other advice. It does not constitute an offer to sell, or the solicitation of an off to buy any product. The information in this document is CONFIDENTIAL. It intended for the use of the person to whom it is given and may not be reproduced or redistributed.