L M Capital Group, LLC

2nd Quarter, 2007

Investment process:
Global macroeconomic / Fundamental

Total firm assets:
$2.95 billion

Domestic Fixed Income Commentary

John Chalker, *Co-Founder & Managing Director*

The domestic fixed income market ends the second quarter much like a small boat in a confused sea. The Federal Reserve lighthouse is not signaling the need for a change in course, but clearly, a storm appears to be brewing just over the horizon. Many waves approach from several directions and the course to a safe haven for bond investors is unclear. Our Matrix and Trend Identification Score points towards a neutral position regarding duration, with an emphasis on credit quality as the corporate allocation is reduced and reassigned to the Treasury and MBS sectors, excluding CDO and other MBS derivatives.

As we peer over the choppy waters, it appears that inflation would be calm were it not for persistently higher energy and basic commodity prices constantly pressured by overseas demand from Brazil, Russia, India and China, the BRIC countries. And we would note that overseas growth is not influenced by the Fed's monetary policy.

On the domestic front, the housing sector continues to weaken, as home sales slow and inventories rise. This situation was further aggravated by the roughly 50 basis point rise in 10 year Treasury rates during the second quarter. Yet housing's prolonged slump appears to have had a minimal impact on consumer spending or the economy in general, as economists expect a strong snapback in GDP growth from the 0.7% rate of the first quarter. Add to this conundrum the growing concern that a financial crisis related to the sub-prime mortgage market and some highly leveraged hedge funds may precipitate another Long Term Capital type crisis, and you begin to understand why portfolio positioning becomes more difficult for the fixed income manager. Does the Fed lean towards raising rates and battling inflation in view of the strong economy? Or does the Fed prepare to lower rates to prevent a possible financial or liquidity crisis?

These questions arise in the context of rising interest rates around the globe. Central banks in Europe and Australia are pressured to raise interest rates in response to stronger economies or inflationary fears. This puts downward pressure on the dollar; and although not within the purview of the Fed, it certainly factors into economic policy.

Hence, our investment process seeks to steer us through these choppy waters by maintaining a near neutral portfolio duration and emphasizing credit worthiness by reducing our allocation to the corporate sector. We strive to avoid the rogue waves brought about by a financial crisis, the LBO of one of our corporate holdings, or the investment in unseasoned derivatives.

Commodity Market Review & Forecast

Basil Bourque, ***Managing Director - Roundstone Advisors***

The commodity markets are off to a good start in 2007. The S&P Commodity Index – Geometric is up more than 9% year-to-date, led by the energy and grain sectors. Halfway through the year, the summer driving season is upon us, the corn and wheat harvests are approaching fast, and Congress continues to enact legislation calling for even more required biofuel and ethanol use. All of these factors will play major roles in determining how the commodity markets finish up the year.

The energy sector posted a good first half of the year, with natural gas, gasoline, and heating oil futures all posting double digit gains. Oil Refineries have been unable to increase their capacity utilization to accommodate the increased demand during the summer driving season. This, as well as several maintenance problems and large-scale accidents, have caused an excess buildup of crude oil and a shortage of gasoline. Gasoline prices have surged as a result, while crude has been supported by increasing demand, attacks on Nigerian oil facilities, and political unrest and tension in the Middle East.

Government mandated requirements for ethanol and biodiesel have been the major factors affecting the grain markets this year. A record 12 million more acres were planted to corn this year versus last year in order to meet required ethanol mandates. Large increases in corn, wheat, and soybean acres will likely be needed next year just to maintain minimum stocks and comply with alternative fuel laws. Wheat prices have surged recently due to droughts in the Ukraine, China and Australia which have significantly reduced the projected world wheat crop. High corn, wheat and soymeal prices, as the main feed for livestock, have weighed on cattle and hog prices. Cattle and hog prices peaked in March and producers are still working through excess supply left from last year.

The softs sector has been the hardest hit in 2007, with sugar, coffee and orange juice experiencing significant declines. Sugar and coffee prices have fallen sharply since last year because of large world production surpluses and good yields from bumper crops in Brazil. Cotton has faired a bit better as alternative fuel mandates led to less cotton acres planted in favor of more corn and soybean acres. Orange Juice prices have been dropping due to good rainfalls and no hurricanes so far this year. Cocoa prices have risen because of tightening global supplies, rising demand, and political tensions in the Ivory Coast. Tight supplies, stronger than expected global growth, and strikes at several mines led to a strong rally in base metals in 2006. This year has seen continued global growth and tight supplies for copper leading to a jump in prices. Precious metals prices have recently eased due to building stockpiles.

The forecast for commodities prices remains firm with strong international economic growth, excess liquidity and a weak U.S. dollar providing support.

Mr. Bourque is a Co-Founder and Managing Director of Roundstone Advisors, LLC. Roundstone Advisors works with LM Capital Group as a sub-advisor and portfolio manager on the LM Capital Enhanced S&P Commodity Index Strategy.

Emerging Markets Economic Commentary

Luis Maizel, *Co-Founder & Senior Managing Director*

Emerging market debt suffered along with other fixed income instruments in the second quarter but spreads held their own reflecting the newly acquired respectability of the category.

As the economies of the emerging countries keep getting stronger behind the surge in commodity prices and the growth in domestic consumption, there has been an accelerated repayment of older, high coupon debt along with new issuance in local currencies which has considerably diminished the supply of attractive, dollar denominated paper, resulting in a subsequent drop in interest rate levels.

Today, more than ever, investing in EMD requires a vast knowledge of the markets, the socioeconomic forces driving prices and an accurate risk return analysis as investors continue to ignore country risk in the search for incremental yield.

Ecuador has become very volatile as the leftist, President Correa, questioned the legality of all debt issued in the last 40 years, thus raising the possibility of a default in the oil producing country. Venezuela's President Chavez continues to nationalize foreign properties in Venezuela, proving that politics trump economics in countries where the rule of law doesn't hold.

I traveled to the Far East to appreciate first hand what is happening there. The Chinese transformation from a closed communist country to an aggressively growing entrepreneurial society is amazing but it makes you wonder what will happen as such a big schism develops between the "haves" and the "have nots". With 450,000,000 people living well below the poverty line, you have to question what will happen when government subsidies are reduced and when the perception of an inability to acquire the bare necessities of life permeates among a huge number of people that now understand they can achieve a higher standard of living higher standard of living.

Mexico continues down a slippery slope where President Calderon has brought peace but little action. The fight against the drug dealers continues without major results and domestic manufacturing remains weak.

I believe that EMD will grow as an independent asset class and will gain even more fans as long as there are no political surprises from the increasingly populist governments.

2nd Quarter Organizational Highlights

Business Development Team Expands

LM Capital is pleased to announce that John Busby, an experienced marketing executive in the U.S. institutional asset management industry, has joined the firm as a Senior Vice President, Marketing and Client Service. John will be responsible for marketing LM Capital's asset management products to corporate pension funds, public retirement systems, foundations, endowments, and investment consulting firms throughout the U.S.

"I am very pleased that John has chosen to join our company and we welcome him to our team," commented Luis Maizel, Co-Founder and Senior Managing Director. "John has the experience, knowledge and industry presence to make a very strong contribution to the achievement of our growth objectives, while adding substantial value to our client relationships."

Prior to joining LM Capital, John was Director of Marketing and Client Services at Patterson Capital Corp. He began his career in 1985 with PaineWebber, joined Wells Fargo in 1999, and served as Vice President at Fisher Investments from 2001-2002. John is a graduate of the University of Texas at Austin. He resides in Manhattan Beach with his wife Debbie and daughter Kendall.

Firm Ownership Update

LM Capital Group recently reviewed its ownership structure and made changes to strengthen its succession plan. During the 1st quarter 2007, LM Capital extended equity ownership offers to additional key employees to ensure their future participation in the firm. This will increase the number of investment professionals with equity ownership and help ensure a smooth succession for the future. The new structure is comprised of the following professionals: Luis Maizel, John Chalker, Mario Modiano, Tobias Gorodzinsky, Richard Deary and Rachel Wilson.

Contact Information

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