

Campbell Capital Management

9400 S. Dadeland Boulevard, Suite 111, Miami, FL 33156

<http://www.camcap.com>

Tel 305.670.3140 • Fax 305.670.3142 • Email clay@Lasalle-St.com

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Dear Money Management Client:

We are happy to finish 2006 with the enclosed portfolio statement. It was another good year for equity investors who maintained bullish opinions about synchronized global economic expansion and market based economies.

Last year's big debate concerning whether falling home values would ultimately affect consumer sentiment and spending carries over to the new year. Analysts have been making a case that popping of the real estate asset bubble would lead to a sharp, painful correction in home prices. The result would be an end to the six year mortgage equity withdrawal boom, which has been credited for consumer spending and a robust economy. At the end of the year, 7 out of 10 investors were betting that the Federal Reserve would be lowering interest rates in the first quarter of 2007 to offset slowing economic growth.

With just two weeks into the new year, there's been a complete reversal of opinion regarding the chance of lower interest rates. A stronger economy is now anticipated because just released payrolls and average hourly earnings climbed smartly. The fear of falling home prices is giving way to the joy of more disposable income. And when you consider crude oil prices are down another 20% this year, consumers are using relief at the pumps to make other purchases.

So far the Federal Reserve has coordinated interest rate policy masterfully. Inflation remains just a touch on the stubborn side, and for that reason they've kept the yield curve slightly inverted (where long term interest rates are lower than short rates). Previous periods of inverted yield curves have inevitably resulted in recession, but the Fed is betting this time will be different because all rates are at such a low level. The Fed is just as "data dependent" as the rest of us and won't be making any changes in policy until push comes to shove, probably a long time from now.

We don't really believe anyone has a handle on how the economy will perform this year. The housing market is too important and in too much trouble not to be an issue. Knowing the mortgage equity "ATM" withdrawal window is now closed means consumers need to find other sources of funds for their purchases. Some of those funds obviously come from the recent growth in employment and wages, but the importance of mortgage equity withdrawals to Gross Domestic Product over the past several years means employment and wages have their work cut out.

In spite of our concerns, the US economy proves time and again to be quite adept at working through its problems. We've found over the years that overindulgence in the occasional bearish mood costs us money. It so happens that usually the things you haven't thought about are the things that hit you over the head and cause the most pain. So with that thought in mind let's set the record, the three biggest risks to our economy over the distant horizon are; rising interest rates, rising oil prices, and a sharply weaker US dollar. We know all three will eventually find their way into our economy and we can promise it won't be good, but as we said, those are problems for the future and now that we've aired them it's not likely they'll cause us much pain.

We remain committed to a conservative investment philosophy, which emphasizes the preservation of capital. If you have any questions or would like to discuss your portfolio, please do not hesitate to call.

Very truly yours,

Clay Campbell

SEC Disclosure

As you know, Campbell Capital Management is registered as an investment adviser under the Investment Advisors Act of 1940. We are required to update the information in our Form ADV periodically, to ensure that it contains up-to-date information about our company. If you would like to receive a free copy of our most recent amendment to Part II of our Form ADV, please call or write us at the address below.

Please send your request to:

*Campbell Capital Management
9400 S. Dadeland Blvd. Ste 111
Miami, Florida 33156*

The sharp decline in oil prices is bullish for stock markets, energy industries aside. The US dollar has been steady recently. So I maintain that there is no imminent crisis for equities. Instead, the bullish window is likely to remain open for at least a few more months.

Firstly, there was a severe 21-year bear market which drove prices for many commodities to their lowest levels, in real terms, in living memory. For industrial metals, this process meant that a generation of mining personnel's expertise and experience, retired and was not replaced. Similarly, a portion of mining and refining capacity was either closed or allowed to deteriorate.

Demand for all commodities and industrial resources, began to grow at a steady rate following the 2001-2002 recession. The main factors behind this demand were a synchronised global economic expansion for the first time in over a decade, which now included countries with huge populations, led by China and India, which at long last were embracing capitalism and booming as a consequence. Helped by globalisation and reinforced by higher growth in commodity exporting countries, this launched a wave of infrastructure development likely to last for at least a generation. And as these economies develop, their rapidly growing middle classes begin to consume all the products that developed countries have long taken for granted.

The slump in housing continues to represent the greatest threat to the US economy, and the latest reports are not encouraging, although not all the news has been bad. Housing starts fell 14.7% in October (latest data available) and are down over 27% from yearago levels. Building permits were off 6.7% in October. New home sales fell 3.2% in October, with the median price falling slightly to \$248,500. The unsold inventory of new homes is estimated at 558,000 or a seven-month supply. The one bit of good housing news was in sales of existing homes, which rose 0.5% in October. The unsold inventory of existing homes is estimated at 3.85 million units, or a 7.4-month supply. The median price for existing homes dipped slightly for the second month in a row to \$221,000. The median price of \$221,000 is 3.5% below the level in October 2005.

So I am a nervous long-term optimist. And if I had been overly influenced by the bears during the last 40 years, I daresay I would be poorer today. And when I have overindulged in my own occasional bearish moods, it has cost me.