HEADWATER INVESTMENT CONSULTING, INC.

Quarterly Review & Outlook

1st Quarter 2007

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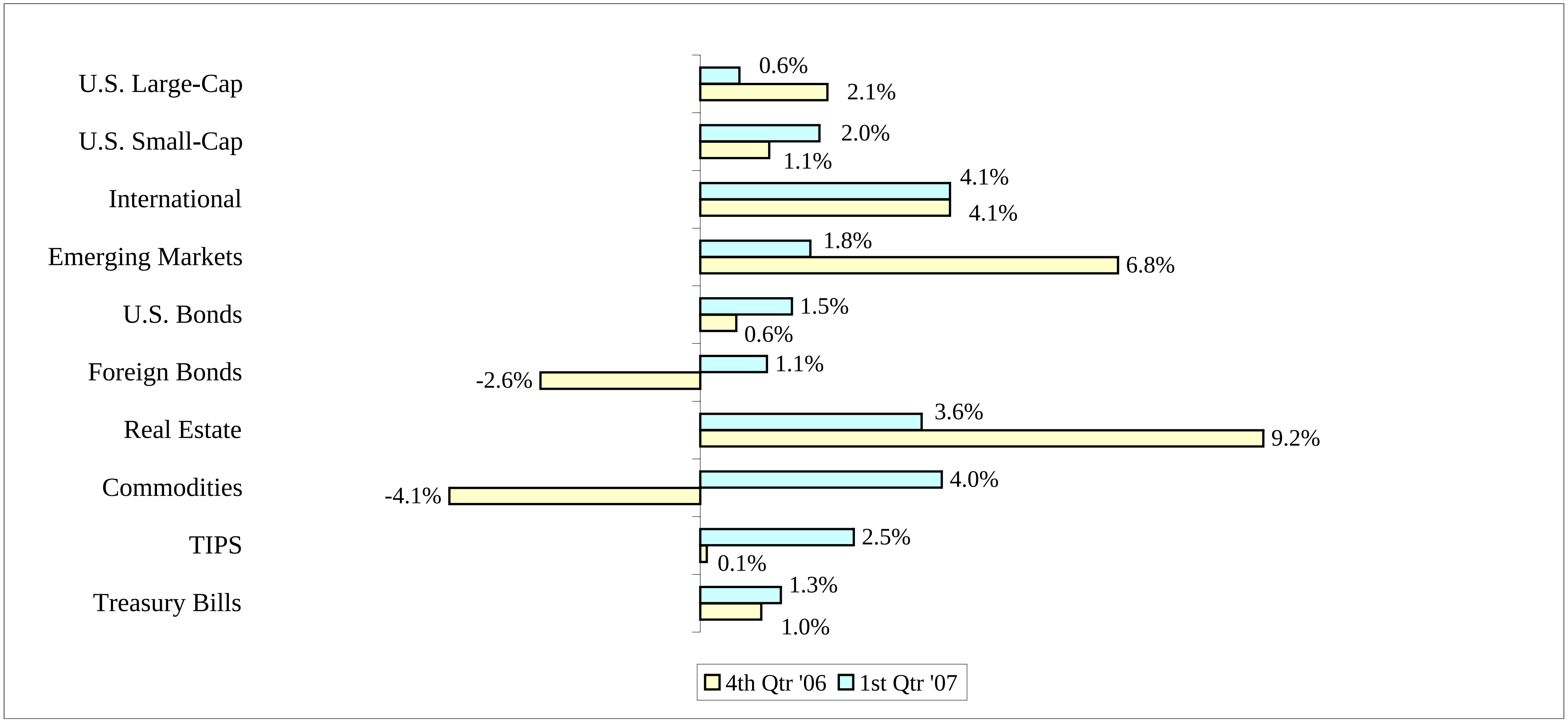
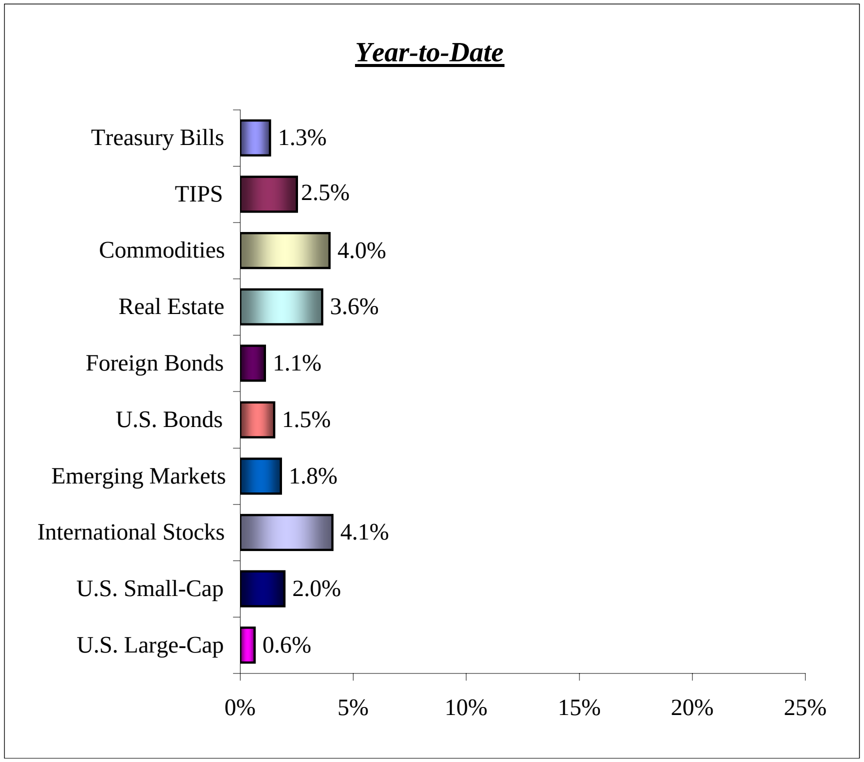
MARKET UP-DATE

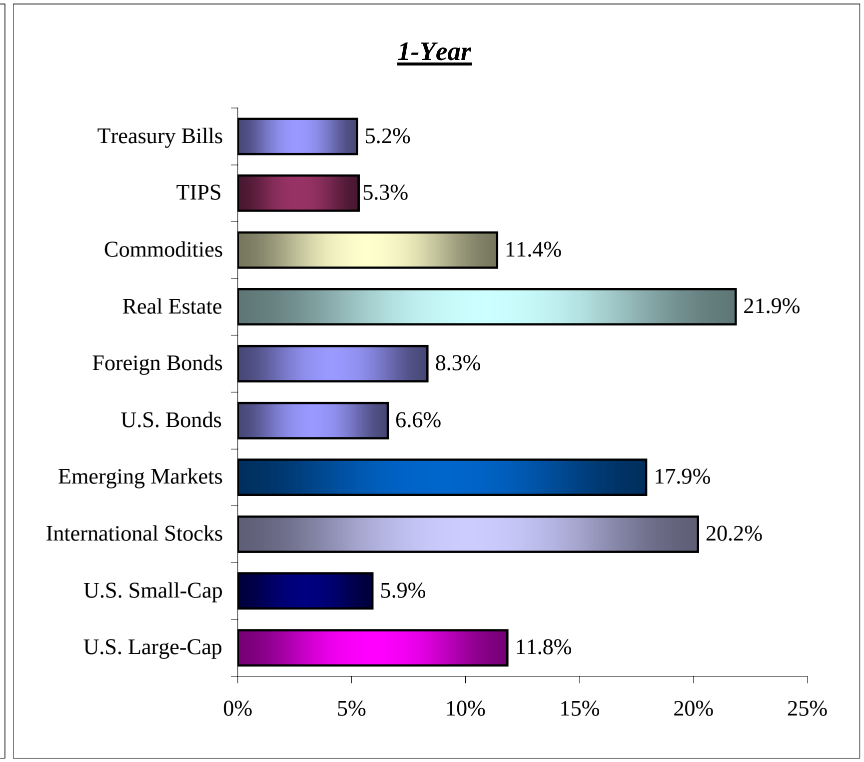
Despite some erratic swings in the global stock markets, the 1st quarter ended with about every investment category (asset class) in positive territory. However, gains were modest – the US stock market as measured by the S&P 500 is up only slightly, about .6%; the US bond markets are up a little more, about 1.4%; International stocks continued to lead the way, gaining 4.2%; US large cap stocks eked out a gain just over .5%; and bonds rose 1.4%.

Looking forward, the stock market will continue to be fickle. The economy in general and the housing market in particular appear to be softening. On the upside, inflation still seems to be tame, interest rates remain stable, and the economy continues to grow, although at a slower pace. Personal investors should keep their portfolios positioned with a mixture of different investments structured to lessen risks in uncertain markets such as we have had so far this year.



ASSET CLASS PERFORMANCE





Index Performance as of: 3/31/2007

	YTD	1 Mo	3 Mo	1-yr	3-yr	5-yr	10-yr
U.S. Large-Cap	0.6%	1.1%	0.6%	11.8%	10.1%	6.3%	8.2%
U.S. Small-Cap	2.0%	1.1%	2.0%	5.9%	12.0%	11.0%	10.2%
International Stocks	4.1%	2.6%	4.1%	20.2%	19.8%	15.7%	8.3%
Emerging Markets	1.8%	3.7%	1.8%	17.9%	24.5%	21.5%	6.1%
U.S. Bonds	1.5%	0.0%	1.5%	6.6%	3.3%	5.4%	6.5%
Foreign Bonds	1.1%	0.3%	1.1%	8.3%	2.7%	10.2%	5.4%
Real Estate	3.6%	-2.6%	3.6%	21.9%	24.1%	22.8%	15.6%
Commodities	4.0%	5.0%	4.0%	11.4%	25.9%	17.0%	9.9%
TIPS	2.5%	0.2%	2.5%	5.3%	3.0%	7.4%	6.9%
Treasury Bills	1.3%	0.4%	1.3%	5.2%	3.6%	2.7%	3.8%

QUARTERLY TOPIC: REAL ESTATE…TIME FOR A DEEP BREATH

Everything has a cycle. The past few months have brought significant and definitive indications that the boom in residential real estate prices has come to an end. With the end of the boom comes both the revelation of a scandal and worry that declining home prices will lead to recession. Inflated expectations, aggressive investment, and eventual price declines & scandal are the classic signs of an asset price bubble & bust. Now is a good time to take a deep breath, review what is going on, and re-evaluate the relative attractiveness and reasons for owning real estate.

The evidence that real estate prices are cooling are all around us. The price of new homes fell 10% in the 4th quarter of 2006, existing home sales are slowing, and publicly traded home builders have issued gloomy market outlooks. Pockets of strength remain, but overall the housing market has definitely cooled off. In addition to this natural cooling, a dark cloud hangs over the mortgage industry. Sub-prime lenders, the bankers and brokers who lend money to people with bad credit, are being investigated for predatory lending and fraud. The true economic impact of the sub-primes won't be know for a number of months. The more immediate damage stems from a general potential loss of confidence in the real estate market and those who are supposed to facilitate transactions.

Whether a cooling real estate market and troubled sub-prime lenders will send the economy into recession is an open question. The good news is interest rates are still very low, growth in personal income continues, and the job market is tight with unemployment at around 4.5%. Home values are generally tied to these factors. The problem might be that values have far overshot income and need to come back to the average. In addition, any sign that inflation is a threat and the Federal Reserve will have to think seriously about raising short term interest rates. Thus, the economic outlook is rather ambiguous.

Of greater importance is for buyers to understand one thing – a home can be an excellent purchase due to the quality of life gained, not due to any inherent advantage it holds over other potential investments. From 1963 through 2006 the price of new homes has risen at an annual rate of 5.9% per year, little more than ultra-safe Treasury bills. In terms of real returns (after inflation), stocks significantly out-performed real estate over the same time period…5.95% versus 1.35%. Unfortunately, the human tendency is to put undue weight on recent history and extrapolate that into the future. A few years of blockbuster home price appreciation has lead to skewed and unrealistic expectations. Stocks experienced the same phenomenon in the 1990's.

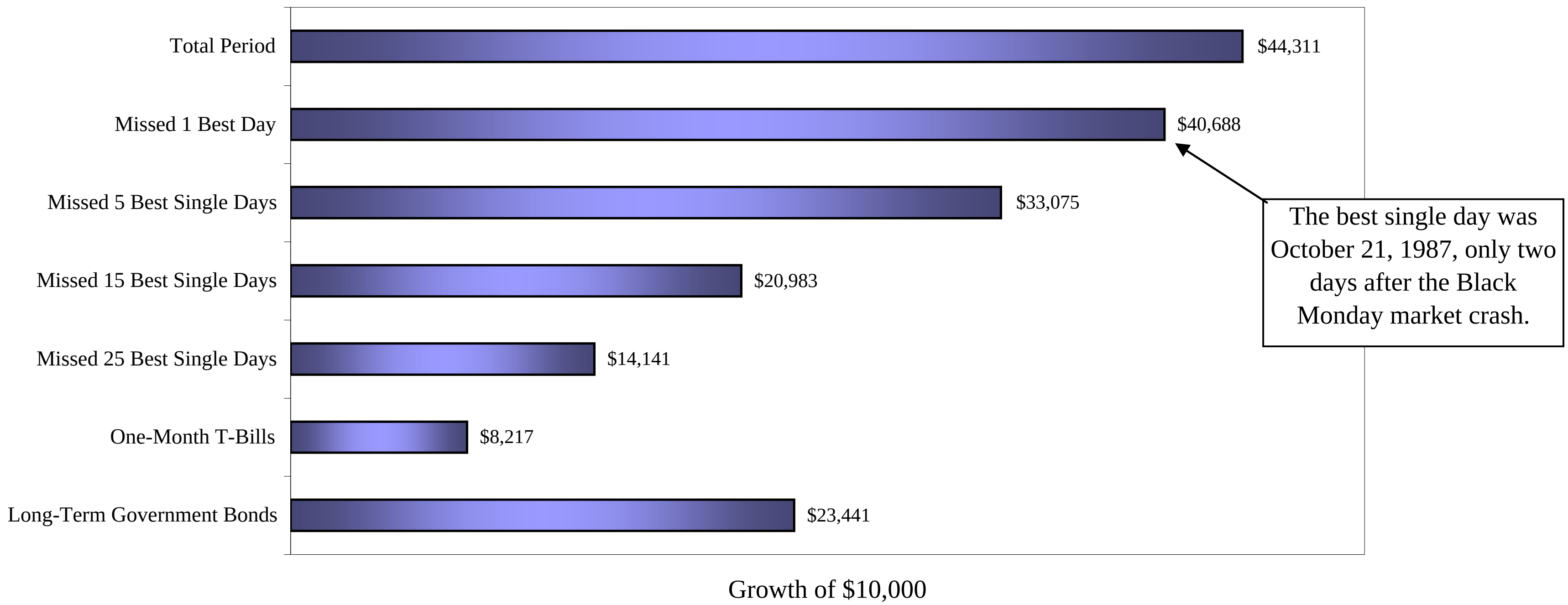
In addition to the poor relative rates of return, home ownership is expensive, and the costs are often underestimated. Annual maintenance costs have been estimated to run approximately 1% of the value of a home. Throw in property taxes, home-owners insurance, and the occasional major repair (such as a new roof) and the actual return to home equity diminishes rapidly. As the Wall Street Journal's Jonathon Clements states it, "you aren't investing in real estate – you're consuming it."

We are now at a point where prices are more likely to decline or moderate than rise by double-digit rates. Inflection points such as these are disruptive. They expose people who have over-extended themselves financially and/or have preyed upon those caught up in the mania. Once the hype subsides, homes will remain a viable asset to own due to both the tangible benefits – tax deductions and price appreciation, and intangible benefits – stability, security, and pride of ownership. Fortunately, everything has a cycle.

THE RISK OF MARKET TIMING

Performance of the S&P 500 Index

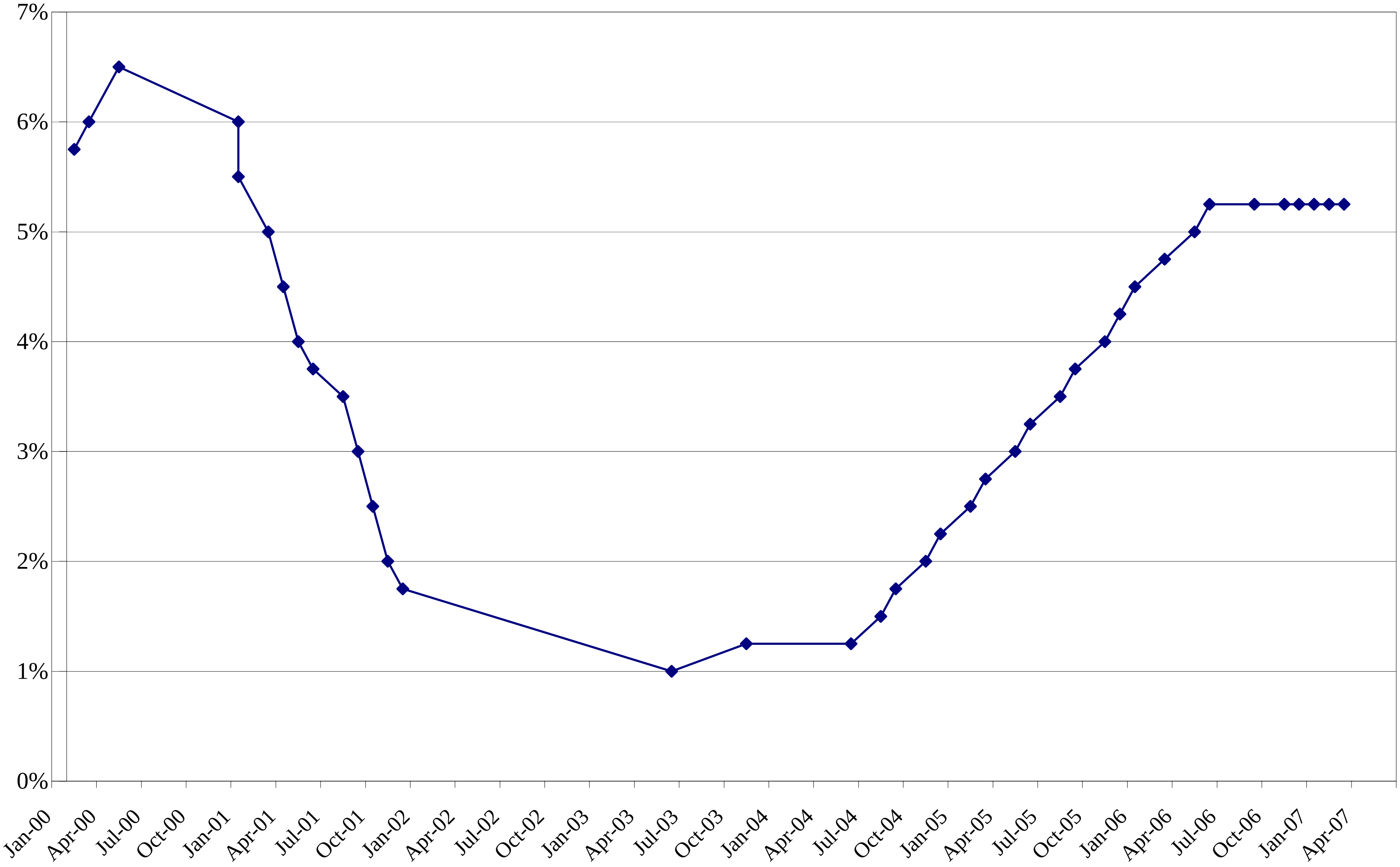
January 1970 - December 2005 (9,122 Total Days)



* The best one-month return, October 1974, happened immediately after the worst one-year period.
* The occurance of strong positive returns has beeen especially unpredictable. Investors atempting to wait out an apparent downturn ran a high risk of missing these best periods.

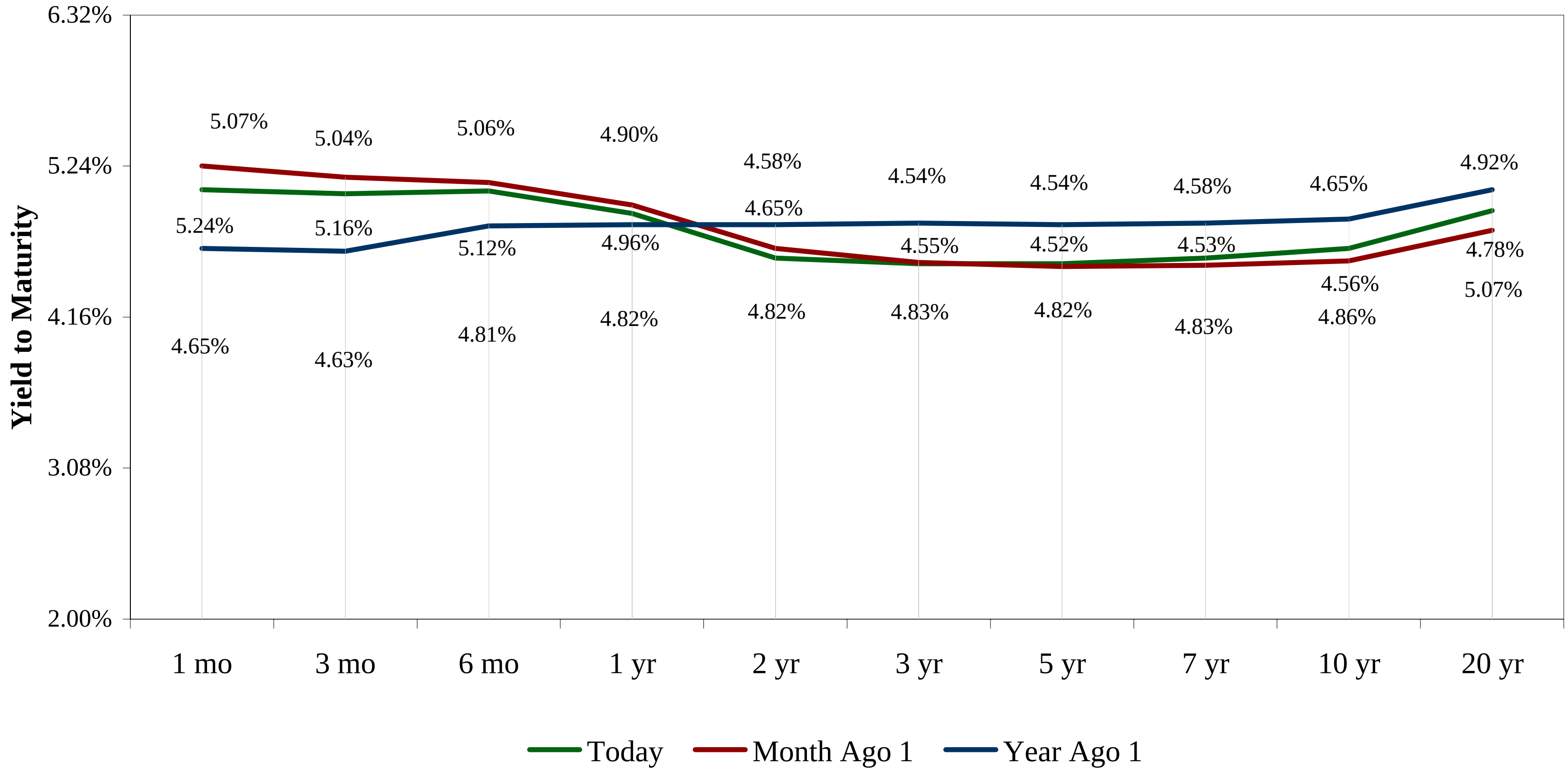
	Total Period	Missed 1 Best Day	Missed 5 Best Single Days	Missed 15 Best Single Days	Missed 25 Best Single Days	One-Month T-Bills	Long-Term Gov't Bonds
Annualized Compound Return	11.1%	10.8%	10.2%	8.8%	7.6%	6.0%	9.2%
% Differential to Total Period	0.0%	-0.3%	-0.9%	-2.3%	-3.5%	-5.1%	-2.0%

Federal Funds Rate: 2000 - April 2007



Treasury Yield Curves

	1 mo	3 mo	6 mo	1 yr	2 yr	3 yr	5 yr	7 yr	10 yr	20 yr
March 31, 2007	5.07%	5.04%	5.06%	4.90%	4.58%	4.54%	4.54%	4.58%	4.65%	4.92%
February 28, 2007	5.24%	5.16%	5.12%	4.96%	4.65%	4.55%	4.52%	4.53%	4.56%	4.78%
March 31, 2006	4.65%	4.63%	4.81%	4.82%	4.82%	4.83%	4.82%	4.83%	4.86%	5.07%



CAPITAL MARKET HISTORY: OVER 10 YEARS OF RETURNS BY ASSET CLASS

These are Annual Returns

Year	Inflation	Money Market	Total Bond Market	Foreign Bonds	Large Co. Stocks	Small Co. Stocks	International Stocks	Emerging Markets	Real Estate	TIPS
3/31/07	0.6	1.3	1.5	1.1	0.6	2.0	4.1	1.8	3.6	2.5
2006	2.6	5.1	4.3	6.9	15.8	18.4	26.3	29.2	36.1	0.4
2005	3.4	3.3	2.4	-9.2	4.9	4.6	13.5	30.3	14.0	2.8
2004	3.3	1.4	4.3	12.1	10.9	18.3	20.3	22.5	3.1	8.5
2003	1.9	1.1	4.1	18.5	28.7	47.3	38.6	51.6	36.1	8.4
2002	2.4	1.7	10.3	22.0	-22.1	-20.5	-15.9	-8.0	3.6	16.6
2001	1.6	3.7	8.4	-3.5	-11.9	2.5	-21.4	-4.7	12.4	7.9
2000	3.4	6.3	11.6	-2.6	-9.1	-3.0	-14.2	-31.9	31.0	13.2
1999	2.7	4.9	-0.8	-5.1	21.0	21.3	27.0	64.1	-2.6	2.4
1998	1.6	5.0	8.7	17.8	28.6	-2.6	19.9	-27.7	-17.0	4.0
1997	1.7	5.3	9.7	-4.3	33.4	22.4	1.8	-14.0	19.7	- - -
1996	3.4	5.3	3.6	4.1	23.0	16.5	6.1	-3.9	37.0	- - -
1995	2.5	5.8	18.5	19.6	37.6	28.5	11.2	-6.9	12.2	- - -
1994	2.6	4.5	-2.9	6.0	1.3	-1.8	7.8	-8.7	2.7	- - -
Average	2.5	4.1	6.3	6.3	12.5	11.7	9.3	7.1	14.5	7.1
Risk	0.7	1.7	5.7	10.8	18.8	17.4	18.1	29.7	16.9	5.3

DISCLOSURES & DEFINITIONS

* Statistical data is gathered from Morningstar Principia and/or the fund manager's web site. All information contained in this document is compiled from sources believed to be reliable and current.
* Indices are not available for direct investment. Their performance does not reflect the expenses associated with the management of a portfolio.
* As with any investment, the holder of each fund is subject to various risk factors. These factors can be explained on a fund by fund basis.

* The performance data shown represents past performance, which is not a guarantee of future results. Current performance may be lower or higher than the data cited.

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Large-Cap Stocks - A U.S. large company stock index measured by the S&P 500. It is made up of a group of 500 of the most widely traded stocks in the U.S., as chosen by Standard & Poor's.

Small-Cap Stocks- Measured by the Russell 2000 which is the dominant small-cap index in the U.S. The index is comprised of the smallest 2000 stocks in the Russell 3000 Market Index.

International Stocks- An international stock index measured by the MSCI EAFE. It is comprised of stocks from developed markets in Europe, Australia, Asia, and the Far East.

Emerging Markets - An international stock index that tracks non-developed markets throughout the world. It is measured by the MSCI Emerging Markets Index.

U.S. Bonds - A measure of the Total U.S. Bond Market by the Lehman Aggregate Bond Index. It takes into account corporate, government, mortgage and asset backed securities.

Foreign Bonds - Measured by the T-Rowe Price International Bond Fund. The fund is comprised of primarily investment grade bonds from around the world.

Real Estate - Measured by the Wiltshire REIT Index which is a composite of Real Estate Investment Trusts traded on U.S. exchanges.

Commodities - Performance is represented by the PIMCO Commodity Real Return Strategy Fund, which uses the DJ AIG Commodity Index as a benchmark.

TIPS - Performance is represented by the Vanguard Inflation Protected Securities Index Fund. TIPS are government bonds that have adjustable coupon payments based on the rate of inflation (as measured by the CPI).

Treasury Bills - Short-term government issued securities with maturities less than 90 days. Because they are government issued, T-Bills are free from default risk.