

# BEACON STREET CAPITAL, LLC

INVESTMENT MANAGEMENT

## *Institutional-level Money Management for Individuals*

July 1, 2007

### Highlights

- Assets under management now exceed \$25 million from new clients and asset appreciation.
- Our S&P500/Select strategy has outperformed the S&P500 Index by 357 basis points year-to-date.
- Volatility for our portfolios remains significantly less than their benchmark indices. This dramatically improves the impact of compounding on long-term returns.

### Second Quarter 2007 Newsletter

As investors began to reward growth potential in large cap stocks both the DJIA (+8.53%) and the S&P500 Index (+6.28%) hit new record highs in the first two months of the just finished quarter before leveling off into a trading range in June. By way of comparison our Dow Jones/Select strategy increased +8.93%, out performing the DJIA by 40 basis points and the Russell 1000® Growth Index by 207 basis points. Our S&P500/Select strategy performed better than both of its benchmarks as well.

Much of the recent upward move has been driven by strength in the global economy which, after many years lagging the U.S. economy, is now more an engine of growth than is the U.S. Many large cap U.S. stocks receive much of their revenues internationally and this is helping their performance in the recent period of lagging growth compounded by a substantially weaker U.S. dollar.

Equity markets are fickle as investors react constantly to external data. For example, investor sentiment in the first quarter rapidly changed from positive to negative as fear of a slower U.S. economy and higher inflation gained traction; but in the second quarter sentiment reversed again, turning positive as the economy appeared to be moving back towards sustainable growth. At Beacon Street Capital we avoid being influenced by these swings in investor sentiment by relying solely on our quarterly measures of internal growth potential. These measures provide us with greater insight into the factors that drive company earnings and give us a signal as to what to buy and when to sell. Although our method is a road less traveled, we stick to what we know rather than what the markets perceive to know. This discipline has benefited our clients and us over the long-term.

Best Regards,

*BEACON STREET CAPITAL, LLC*

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<sup>1</sup>All results are un-audited and net of fees. Composite returns began November 2001 for the S&P500/Select and March 2002 for the DowJones/Select, are asset weighted and net of fees. Returns prior to November 2001 and March 2002 are total returns for model portfolios managed by Beacon Street Research, Inc., an affiliated company, on a real-time basis using the same methodology and manager, with stocks selected from those comprising the Standard & Poor's 500-Stock Index and Dow Jones Industrial Average. Past performance is no indication or guarantee of future performance.

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Investor sentiments in the second quarter moved to the positive side as economic readings showed higher growth after a noticeable slowdown in the first quarter. Merger and acquisition activity and the related boom in private equity driven corporate buyouts also had a positive impact on rising equity values. Unlike in the past where the U.S. economy was the driving force behind global expansion, non-U.S. economies are in general experiencing growth rates higher than we are experiencing in the U.S. This not only has helped to pull the U.S. economy along, but has also contributed greatly to the growth of U.S. based companies with a global footprint.

Although the price of oil moved back above \$72 a barrel, readings on inflation moderated somewhat in the second quarter encouraging investors that the Fed will remain on hold, but the housing market continued to record bad news as both housing starts and sales of existing inventory remained in a downtrend. Losses among sub-prime mortgage lenders continued to spread and collateralized debt obligations containing sub-prime mortgages were put on watch for downgrades by the rating agencies. Even with these difficulties in the housing and housing finance markets most indicators from the just ended quarter now point to an expanding economy. There have been noticeable up ticks in job growth, non-manufacturing activities and in retail sales, all giving hope that a recession should be avoided in the second half of 2007 and the first part of 2008.

Adding fuel to this notion of an expanding economy is the fact that corporate earnings grew at a +8.3% rate in the first quarter, easily surpassing the subdued estimates of an increase of only +3.5-4.0%. Projections for the just ended quarter hover in the +4.0-4.5% but are moving higher as the economy improves, coupled with the recent rise in oil prices which should give a lift to earnings in the energy field. Consequently, the soft landing and moderate growth many were projecting before the slowdown in the previous quarter now appears to be back on the agenda. This scenario remains in sync with the continued improvement in growth potential we see for many companies.

**Exhibit 1:  
DowJones/Select**

**Top Ten**

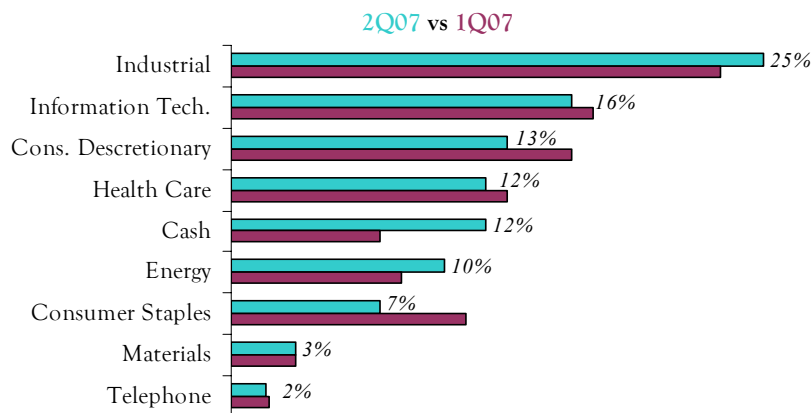
McDonalds Corp	9.5%
Caterpillar Inc	8.5%
Honeywell Int'l	8.3%
Boeing Co	8.0%
IBM	7.2%
Microsoft Corp	7.1%
United Technologies	7.1%
Intel	6.8%
Procter & Gamble	6.6%
Home Depot	6.4%

**Exhibit 2:  
S&P500/Select**

**Top Ten Holdings**

Valero Energy	2.3%
Apple Inc	2.2%
National Oilwell Varco	2.2%
Weatherford Int'l	2.2%
Caterpillar Inc	2.1%
Lab Corp of America	2.1%
McDonalds Corp	2.1%
CSX Corp	2.0%
Honeywell Int'l	2.0%
Lockheed Martin	2.0%

**Exhibit 3: S&P500/Select Sector Weighting**



## Second Quarter 2007 Newsletter

The changing perceptions by investors and analysts of the economy and corporate earnings growth explains the volatile nature of the stock market, including the dramatic decline we discussed in our First Quarter 2007 Newsletter. This is why we focus on internal growth potential for the individual companies that make up the market, and do not attempt to project earnings or guess at where stock prices should be at any given point in time. Consequently, we look forward to the next round of financial reports issued by our universe of companies and will make our investment decisions accordingly as we move to the second half of 2007.

*Herron P. Weems*  
*Managing Director*

### Performance Summary

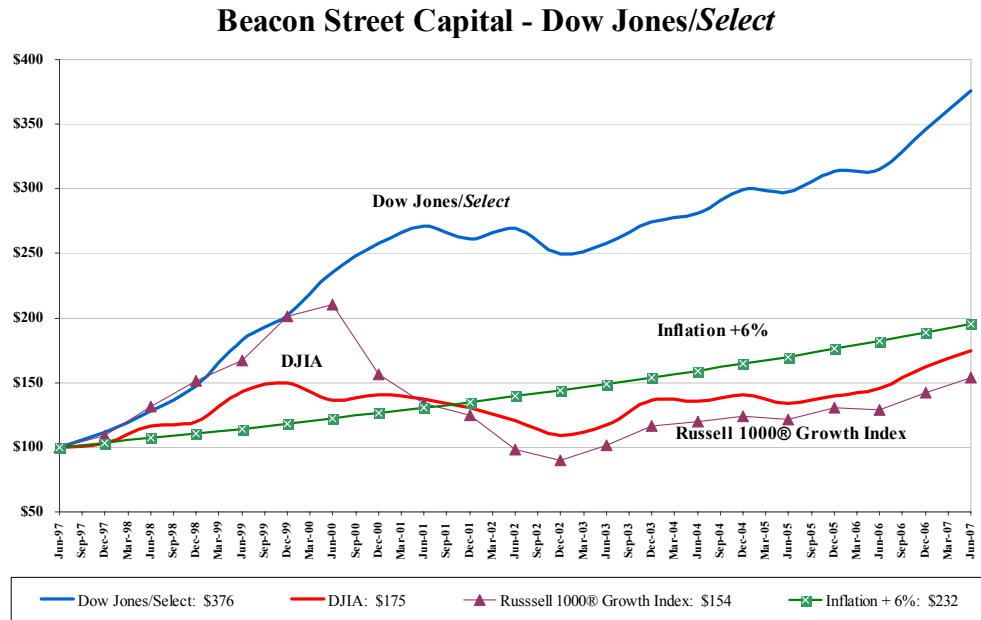
The positive trends we saw in our measurements of growth potential in the first quarter continued in the second quarter for many of the stocks we follow, and as a result our portfolios are nearly fully invested and we experienced little turnover in the second quarter. Our performance showed a strong recovery after the first quarter market correction.

**DowJones/Select:** During the quarter there were no changes made to the portfolio. We currently own 14 stocks in this strategy and are essentially in a fully invested position with cash representing only 1.3% of the portfolios. Of the top performing stocks in the Dow Jones Industrial Average this quarter, we owned Intel (INTC, +24.2%), Honeywell International (HON, +22.2%), Caterpillar (CAT, +16.8%), McDonald's (MCD, +12.7%), International Business Machines (IBM, +11.7%), United Technologies (UTX, +9.1%), Boeing Co. (BA, +8.2%), Home Depot (HD, +7.1%), Microsoft (MSFT, +5.7%), and AT&T (T, +5.3%). Our only loser for the quarter was Procter & Gamble Co. (PG, -3.1%), while Wal-Mart Stores (WMT, +2.5%), Johnson & Johnson (JNJ, +2.3%) and Walt Disney (DIS, +0.5%) were slightly positive and had little effect on returns.

The second quarter and longer-term performance can be seen in Exhibits 4, 5 and 6.

Exhibit 4: DowJones/Select Net Return versus Benchmark					
	2Q07	YTD	1Year	3Yr. Avg.	Inception
<b>DowJones/Select</b>	8.93%	8.84%	19.34%	10.22%	14.17%
<b>Dow Jones Ind. Avg.</b>	8.53%	7.59%	20.59%	8.72%	5.74%
<b>Russell 1000® Growth Index</b>	6.86%	8.13%	19.04%	8.70%	4.39%

Exhibit 5: Value of \$100 Invested July 1, 1997 to June 30, 1997



**Exhibit 6: Growth and Volatility July 1, 1997 – June 30, 2007**

	Growth of \$100	Variability of Returns (Std Dev)	Percentage of Months at a Loss
<b>Dow Jones/Select</b>	\$376	11.29	39%
<b>Dow Jones Ind. Avg</b>	\$175	15.00	43%
<b>Russell 1000® Growth Index</b>	\$154	18.98	45%

**S&P500/Select:** During the second quarter we purchased five new stocks and sold eight, leaving a total of 60 stocks in the portfolio. We also trimmed our position in Apple (AAPL) as it had become a larger position than we were comfortable with due to price appreciation. Most of the sales, including AAPL, occurred toward the end of the quarter as the market moved higher and we elected not to commit new funds to the market at that time pending upcoming financial reports. This increased our cash position to 12% from 8%, giving us a higher allocation primarily in industrial and energy stocks. Of the new purchases in the quarter Ensco International Inc (ESV, +12.9%), Rockwell Collins Inc (COL, +7.1%), Sherwin Williams Co (SHW, +1.9%) and Raytheon Co (RTN, +1.2%) performed the best from the date of purchase through the end of the quarter while Marriott International Inc (MAR, -7.3%) under performed.

The second quarter and longer-term performance can be seen in Exhibits 7, 8 and 9.

**Exhibit 7: S&P500/Select Net Return versus Benchmark**

	2Q07	YTD	1Year	3Yr. Avg.	Inception
<b>S&amp;P500/Select</b>	7.25%	10.53%	18.70%	10.85%	14.11%
<b>S&amp;P500 Index</b>	6.28%	6.96%	20.59%	11.67%	7.13%
<b>Russell 1000® Growth Index</b>	6.86%	8.13%	19.04%	8.70%	4.39%

Exhibit 8: Value of \$100 Invested July 1, 1997 to June 30, 2007

Beacon Street Capital - S&P500/*Select*

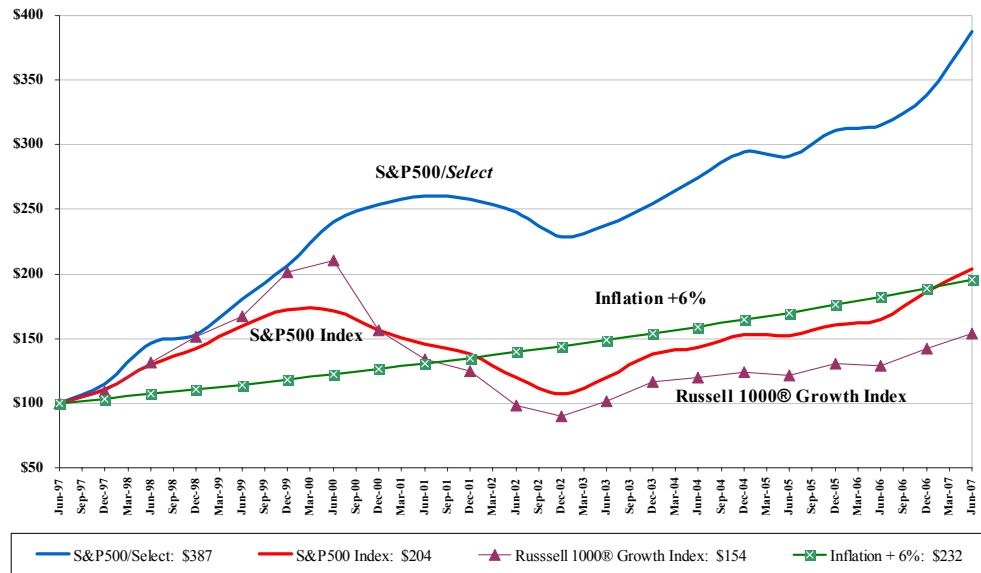


Exhibit 9: Growth and Volatility June 30, 1997 – June 30, 2007

	Growth of \$100	Variability of Returns (Std Dev)	Percentage of Months at a Loss
S&P500/ <i>Select</i>	\$387	11.25	35%
S&P500 Index	\$204	15.06	38%
Russell 1000 Growth Index	\$154	18.98	45%

**Portfolio Risk:** Market risk, or volatility, is another factor that has a major impact on the compounding of returns. Exhibit 10 compares the risk and reward characteristics for the past five years of our DowJones/*Select* and S&P500/*Select* composites with the Russell 1000 Growth Index. This information is provided by Informa Investment Solutions, Inc. and is available through Fidelity Investment’s manager search application.

Exhibit 10: Risk Statistics	DowJones/ <i>Select</i>	S&P500/ <i>Select</i>	Russell 1000 Growth
Annualized Std. Deviation (5 Yr.) <sup>1</sup>	7.35	7.83	11.74
Sharpe Ratio (5 Yr.) <sup>2</sup>	0.74	0.91	0.60
Information Ratio (5 Yr.)	-.23	-.02	N/A
Beta <sup>4</sup>	0.45	0.51	1.00
Alpha (5 Yr. Average) <sup>5</sup>	2.30%	3.56%	N/A
R-Square <sup>6</sup>	.61	.67	N/A
Tracking Error <sup>7</sup>	8.23	7.61	N/A
Annual Turnover (5 Yr. Average)	26%	53%	N/A

## Growth vs Value

Two critical variables drive performance over time: earnings growth and the direction of price earnings multiples (P/E ratios). Within that framework Wall Street categorizes stocks as being either “growth” (high P/E ratios due to high earnings expectations) or “value” (low P/E ratios due to lower expectations of earnings growth), and long-term performance depends on the length of each bull and bear cycle. In a bull market growth stocks typically outperform value stocks as expectations for future earnings gains become elevated. In a bear market, those earnings growth expectations are greatly diminished causing growth stocks to under perform value, as value stocks have already priced in low expectations. This leaves investors with a choice between high growth and high risk, or low growth and lower risk. The Russell 1000® Growth Index (comprised of growth stocks) and the S&P500 Index (a blend of both growth and value stocks) best illustrate this conundrum in the table in Exhibit 11 and looking back to the chart in Exhibit 8.

In 1998 and 1999, the Russell 1000® Growth Index far outperformed the S&P500 Index in the last months and years of that bull market. But in the bear market that began in 2000, the Russell 1000® Growth Index greatly underperformed the S&P500 Index as value stocks in the S&P500 gave price support to that overall Index. In contrast our S&P500/*Select* captured growth stock returns during the bull market of the late 1990s and held on to the majority of those returns during the bear market that followed. This was accomplished by the ability to quantify internal growth potential where the

### Exhibit 11: Growth & Value Comparative Data

Calendar Year	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007*
Russell 1000® Gr.	39%	33%	-22%	-20%	-28%	30%	6%	5%	9%	8%
S&P500 Index	29%	21%	-9%	-12%	-22%	29%	11%	5%	16%	7%
S&P500/ <i>Select</i>	33%	35%	23%	2%	-11%	11%	16%	6%	9%	11%

\*Actual to June 30, 2007

market is least efficient, giving us a competitive edge in selecting our version of growth stocks regardless of whether Wall Street was classifying them as growth or value. As you can see looking back at Exhibits 6 and 9, the difference is significant to our *actively* managed portfolios. It’s the best of both worlds. Stocks with positive growth potential drove the performance of our portfolios in the bull market, while the classic value stocks with positive growth potential provided support in the bear market. In addition, the reduced volatility (Standard Deviation) from this combination has enhanced the compounding effect on our long-term performance – something less available from a *passively* managed Index due to the greater volatility.

To a large degree, equity returns are continuing the process of reversion to the market mean following the unsustainable gains of the 1990’s. In that decade

portfolios benefited from a combination of earnings growth and the expansion of P/E ratios. In this decade we have had healthy earnings growth but P/E ratios in general have contracted to near the long-term market average. Therefore it is even more important to separate the wheat from the chaff and ferret out growth potential whether in “growth” stocks or “value” stocks.

## About the Firm

Beacon Street Capital provides affluent individuals and business professionals in the Southeast with a conservative, consistent, long-term approach to managing money that has generated excess returns with reduced volatility. Our strategy reflects sound investing principles, delivered with a sophisticated level of financial services. We believe our clients deserve nothing less.

We select for our clients individual equity securities that show positive internal growth potential and financial strength. These securities are held and actively monitored in a separately managed account held by an independent custodian, and we provide detailed quarterly updates.

Whether growing assets for retirement or building a family estate, we believe that wealth properly managed is wealth with a future. Please contact us to explore how we can help you with this process.

*Terry E. Burke*  
*Chief Executive Officer*

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### Definitions:

<sup>1</sup> *Standard Deviation*: A measure of volatility, or the range of a portfolio's performance. The more an investment's return varies from its average, the higher the standard deviation. Unlike *beta*, which measures volatility relative to the market, standard deviation is a measure of total risk, or the total variation of the return. The lower the standard deviation the lower the risk, or volatility of the portfolio.

<sup>2</sup> *Sharpe Ratio*: A measure of risk-adjusted return. The Sharpe Ratio incorporates the standard deviation and the excess returns over 90-day Treasury bills to measure the reward per unit of risk. The higher the ratio over 0.0 the better the investment's historical risk-adjusted performance.

<sup>3</sup> *Information Ratio*: One of the most important tools for measuring the performance of an active manager against an appropriate benchmark. It is the ratio of excess returns to standard deviation of excess returns of the portfolio, and is used to estimate the return added by the manager for each 1% of risk added by the manager. A 5-year average *Information Ratio* over 0.50 is considered “good”, over 0.75 “very good”, and over 1.00 “exceptional”.

<sup>4</sup> *Beta*: Measures volatility in relation to the benchmark (or market). A portfolio with a *beta* of 1.5 means that the portfolio return is expected to move 1.5 times the benchmark return. If the benchmark return is 10%, the portfolio return is expected to be 15%. If the benchmark return is -10%, the portfolio return is expected to be -15%. A low *beta* represents lower volatility, which is often associated with low returns; a high *beta* represents higher volatility, which is often associated with high returns. It is unusual to have a combination of high returns and low volatility. However, a good manager picking outstanding stocks can provide excess returns without adding excess risk. This is call “adding *alpha*”.

<sup>5</sup> *Alpha*: Measures the return added by the manager. It is the excess return over the benchmark return, adjusted for volatility.

<sup>6</sup> *R-Square*: Measures the correlation between the portfolio return and the benchmark return, or how well they fit from a statistical standpoint. A correlation of a 1.00 means a perfect fit and any number over .70 means the *Alpha* and *Beta* measurements are meaningful.

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<sup>7</sup> *Tracking Error*: The standard deviation of the excess returns. The lower the tracking error the lower the risk.

<sup>8</sup> *Russell-1000® Growth Index*: This Index is more representative of the overall large capitalization market and thus more representative of our investment style. It is also widely used by institutional consultants, such as *Informa Investment Solutions Inc.*, which tracks and reports our performance through its *PNS Manager Database*, when seeking investment managers for their clients.