Economic Update

Broadleaf Partners, LLC

A Narrower Market

May 17, 2007

Over the course of this year, the markets have done extraordinarily well and investors have been rewarded for staying the course. We've been particularly bullish and have been a strong advocate of buying on the pullbacks. However, in more recent weeks and even days, we cannot help but notice a somewhat cautionary trend. Market breadth has narrowed, indicating to us that the health of the market in the short-run may not be as strong as it seems on the surface.

Before we move on, breadth is a term used to explain the participation of individual stocks and industries in a stock market's gains. This quarter in particular, has seen a narrowing level of participation. While the Dow Jones Index of thirty companies continues to set many all-time highs and the S&P 500 flirts with highs, other groups like the NASDAQ and several smaller cap indices have not kept pace.

This more recent disconnect may at least partially relate to the increasing popularity of two hot investment trends; extreme levels of private equity funded mergers and acquisitions and investors' love affair with emerging markets. With respect to the emerging markets, we believe investors have it right and that the long-term trends remain very favorable, though perhaps frothy at the moment. We remain somewhat suspicious, however, of the intensity of mergers & acquisitions activity, as it seems largely liquidity induced and eerily reminiscent of technology trends at the end of the past decade or the housing market only a few years ago.

When private equity firms open new funds, raising billions as they have been in relatively short order, there is the tacit understanding that they need to deploy those funds in new deals or risk having to return it to their clients. When money is cheap, as it is now on a global scale, it is often easier to buy growth than create it. Unfortunately, when the liquidity stops, the underlying cracks often appear and the real hard work must begin.

These hot trends may also tend to benefit a few sectors more than most, which may explain the recent narrowing of the markets, particularly among the materials, industrial and energy sectors. The secular, long-term growth themes for these sectors certainly exist, resting on the foundation of industrializing world economies. To a certain extent, private equity is also playing a worthy role in the restructuring of many American industries to compete in this global economy. Nevertheless, we believe the scales may be tipping too far, as evidenced by the enormity of media coverage of such deals, the occasional exorbitant and out of touch displays of personal wealth, and now, perhaps, the narrowing of the market.

We want to be clear, however, that we are bullish on the markets. We have not been surprised by and have expected the market's advance in the face of a slowing economy, as we see multiple expansion as the normal and expected outcome of a Fed on hold. The danger in an environment of scarcer growth prospects, however, is that more and more money chases a narrower group of hot ideas.

Our preference is to participate in the industrialization of the rest of the world, but also to balance it with the understanding that most long-term wealth has been created on the backs of new ideas and innovations – organic and internally grown – than by merely playing the M&A game, moving corporate assets about the chessboard of world capitalism.

In recent days, a private equity fund paid $7 billion for an eighty percent stake in Chrysler, which Daimler had paid $37 billion for nine years ago. I suspect we may see much of the same in another nine years. Time will tell.

This story, of course, is nothing new and has been played hundreds of times before. And it may persist for some time, as it often does. While the narrower market has caused us some short term concerns, it has also provided us with some near term observations on where we might best spend our incremental investment dollar.

Kindest Regards,

Doug

Doug MacKay
President & CIO
dmackay@broadleafparnters.com
Office: 330-650-0921

Jeff

Jeff Travis
COO & Director of Research
jtravis@broadleafpartners.com
Office: 330-650-0921