Quarter Notes
FIRESTONE CAPITAL MANAGEMENT, INC.

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Carlos Made Principal, Congratulations

Firestone Capital Management is pleased to announce that Carlos A. Carbonell, CFA, has become a principal of the firm.

ADV Annual Offer

Each year the SEC requires that we notify clients when we are updating our ADV Part II. If you would like a copy of the updated form, please call the office. We will be happy to send one out to you.

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2006 Ends on a High Note, What's Ahead for 2007?

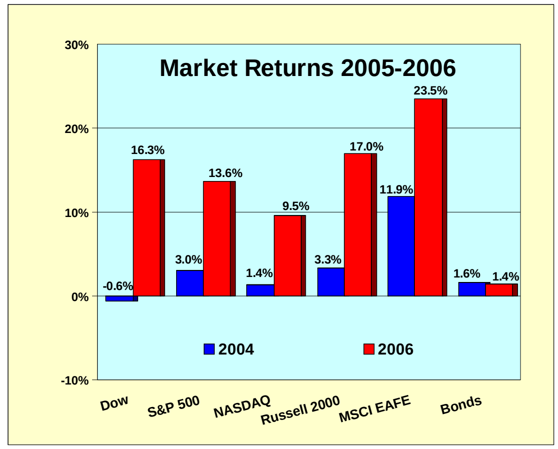
Returns from stocks for 2006 were stronger than most investment professionals forecast a year ago. The Dow industrial average climbed 16.3%, its best performance since 2003 . By year's end, the Dow had topped 12,500, setting a new record high and finishing the year just below its all-time high. The broader S&P 500 index was up 13.6% for the year, and the technology-heavy NASDAQ index gained 10%. The Russell 2000 index, which tracks smaller companies, beat the large-company indexes for the eighth year in a row with a return of 17%.

One of the main issues which drove the markets this year was excess liquidity in the form of cheap money worldwide. This created a readily available pool of investment capital, fueling mergers and acquisitions activity, as well as private equity firms taking public companies private. Outstanding corporate profits kept price/earnings multiples reasonable despite rising share prices. Excess corporate profits provided the capital for corporations to buy back their own shares.

Looking in the Crystal Ball

After a banner year with outsized returns in nearly all asset categories, investors might be cautious about what lies ahead. There are concerns about a number of issues facing the US including the War in Iraq, mounting international trade deficits, and consumer and government spending. We continue to consume more than we produce and spend more than we save.

The US dollar has fallen over 10% against the Euro and other currencies over the last year. There is evidence that the housing bubble is deflating, with October figures



showing the fewest housing starts in six years. November permits were down to levels not seen since 1997. Further, the domestic political climate is changing, with the takeover of both houses of Congress by the Democrats. What does all this mean for the future?

Not everyone foresees doom and gloom. While home prices have come down from their peaks, a housing bust does not appear imminent. Homes might be worth less than they were last year, and this reduction might have slowed the withdrawal of equity via refinancing, but household balance sheets are not in bad shape. People still have jobs and the growth of assets in investment portfolios has offset some of the decrease in housing values.

Another reason things don't look so bad is that corporate balance sheets are strong. Corporations have either retired or restructured their debt at lower interest rates and by some standards are in their best shape in the last fifty years. Unless interest rates rise sharply, choking growth and increasing costs, profits are likely to remain strong. Stocks are actually not expensive and could rise in the coming years.

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We Wish All Our Readers a Healthy, Happy and Prosperous New Year

Side Bits

Do You Feel Rich? The wealthiest 1% of the world's population have assets of $500,000 or more. *Financial Times.*

Better Get Ready 43% of retirees who admit they did little to prepare financially for retirement found their "golden years" to be unsatisfying. *Pension Research Council*

Tax Trivia $150,000 of taxable income will cost a joint-filing couple $30,933 in federal income tax in 2007. The same $150,000 would have been taxed at $38,156 in 1997 and $47,690 in 1987. *Source IRS*

Structured Notes Offer New Choices

Structured notes are bond-like investments whose returns are linked to the performance of a stock index or of some other equity. The notes come in many forms, but typically they are investments that offer principal protection (full or partial) with a return based on a percentage gain in an equity or a basket of equities. They usually have a fixed term of five to seven years, but other maturities are available. Thus, structured notes have some attributes of bonds and some attributes of equity investments.

The issuers of these notes are usually large, highly-rated financial institutions. While they do not have US government guarantee that CDs have, the risk that the issuer will default is low. Unlike mutual funds, exchange traded funds (ETFs), or marketable CDs and bonds, most structured notes are issued without a secondary market. This attribute of low liquidity means investors need to expect to hold structured notes to maturity. Trying to exit the note prior to maturity could result in significant loss. In addition, the investor would forfeit part of the upside return of the equity driver built into the note.

Structured notes have other disadvantages. Because the structure and tax consequences of these notes is complex, projecting returns can be difficult. One of the issuing institutions has gotten an IRS ruling that 80% of an investor's capital must be at risk for captial gains rates to apply. Otherwise, the returns are taxed as ordinary income. In addition, the dividends paid by the equities in the underlying index are not paid out to the investor holding structured notes.

The simpler forms of structured notes, which have a 100% principal guarantee and reasonable upside potential from a broad market index, may have a place in some portfolios. They are not especially attractive to our clients because over the 5-7 year life of these notes, a traditionally diversified portfolio of stocks, bonds and tactical positions is unlikely to lose principal anyway. In addition, the diversified portfolio maintains liquidity, dividends, and some control over when, and if, to realize capital gains.

Inflation Outlook

When the producer price index was released for November, the news was not good. A 2% rise in the index for the month made it appear that the Fed was going to have to get aggressive (again) and raise interest rates. On closer examination, only a few volatile components had caused the 2% increase. Goods whose prices had dropped significantly in the preceding month were just stabilizing back towards levels seen earlier in the year.

The Fed is still nervous about inflation, which it believes to be a bigger threat than the risk of recession. Judging from the bond market, inflation is probably not a big risk, as yields on the 10-year Treasury note are staying around 4.7%. The yield curve is still inverted, with short-term yields approaching 5% or more. This demonstrates that there is little expectation for further increases in interest rates. The bond market may actually be forecasting a slowdown in the economy.

What Lies Ahead

(Continued from Page 1 Column 2)

Growth in the US economy is expected to slow slightly from the robust 3.5% in 2006 to 2.6% for 2007. A soft landing for the economy is still forecast. This is positive for equities with price-to-earnings (P/Es), both current and forward, at or below their historic averages. There is still a lot of inevestable cash on the sidelines.

The political changes in Washington are likely to cause little or no change in investment strategies. The markets have already dismissed the change as not much of a threat. On a longer-term basis, the changes in Congress might ultimately result in an increase in the minimum wage, changes in tax policy, and pressure on pharmaceutical companies. As long as the political climate remains free-market, and we resist the imposition of protectionist legislation, the US should enjoy the fruits of growing worldwide economic activity and productivity.