

Murphy Capital Management

Mid-Year Update

July 2007

Our year-end 2007 letter expressed gratitude for a fine year in 2007 and some market apprehension for the first half of 2008. When we made that observation, we were using \$100 a barrel oil, a stalling housing market, a stretched consumer and a weak dollar as the basis for this concern. Certainly we had not foreseen \$140 a barrel oil, the meltdown of Bear Stearns and raising corn and grain prices when making this prediction.

The result was the single largest first half market decline in 16 years. Double-digit declines for the S&P 500, the Dow Jones Index and the NASDAQ were humbling, to say the least. Fortunately we escaped some of this pain by holding a heavier concentration in energy stocks, a lightened representation in the financial stocks, and a broader international exposure. However a down market never makes one feel good.

Where are we now and what should we look for in these choppy markets? We have a Federal Reserve that has been most accommodating and will continue to err on the side of liquidity to stabilize the domestic and corporate sectors. The dollar is showing some signs of stability. Corporations are lean and mean. Bad debt has been written off, payrolls streamlined, balance sheets fortified and P/Es are low by all historic standards. Having said all of this, pessimism is very high.

We all know about housing, high food and gas prices, shaky banks and brokerage firms not to mention the upcoming election. In spite of all of these factors, the only true way to enhance long term wealth creation continues to be by setting asset allocation ratios consistent with your risk tolerances and sticking to them in both good and bad times. Market timing clearly does not work, it simply causes investors to sell assets when they are low and buy them when they are high. Just like your house, your stocks are only worth less if you actually sell and take the lower price.

We are cautiously optimistic that food and oil prices will finish the year lower than current levels. We think the big banking surprises are already priced into the markets. While we do not forecast a quick reversal in the housing market, we think we are closer to the bottom, and will bump along at these lower levels until more supply dries up. We like stocks over bonds at current levels and continue to focus on franchise value, cash generation, pricing power, new product development and dividend component in our stock selection process. We are using any market weakness to trade up on quality when and where possible.

Let us remember that the energy, food and housing crisis will set the stage for the creation of products and industries that capitalize on these dislocations. Fuel cells and new types of batteries will be created, safer and more well thought out financial mortgage products will be introduced. Products for enhanced food production and new farming

ideas will flourish and new and improved ways to work and commute will evolve. New and safer nuclear power plants will be proposed, wind farms will proliferate, demand for electric and hybrid cars will climb and improved products for telecommuting will surface. Certainly all of this will not happen overnight but the basis for capital creation in these new and emerging industries is already in place.

We continue to advocate for a consistent approach in the management of your assets with an emphasis on quality innovation and diversification to create long-term wealth.

Very truly yours,

John J. Murphy
Partner

Peter J. Lewis
Partner