Investment Report and Market Commentary

BRAGG
FINANCIAL ADVISORS

First Quarter 2007

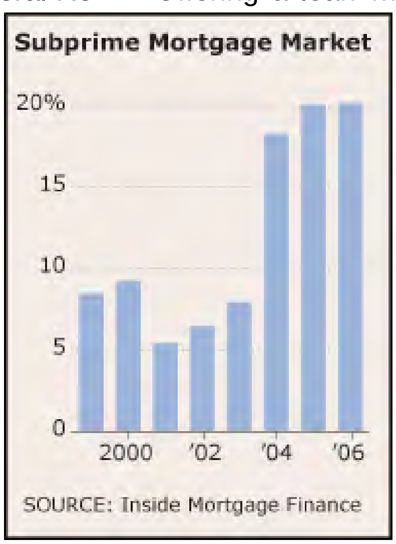
Market Index Total Returns as of March 31, 2007

Market Index	First Quarter	1 Year	3-Year Annualized	5-Year Annualized
Standard & Poor's 500 (Large Cap)	0.6%	11.8%	10.1%	6.3%
Standard & Poor's 400 (Mid Cap)	5.8%	8.4%	13.4%	10.7%
Russell 2000 (Small Cap)	1.9%	5.9%	12.0%	10.9%
MSCI EAFE (Foreign)	4.1%	20.2%	19.8%	15.8%
Lehman Bros. Aggregate Bond	1.5%	6.6%	3.4%	5.4%
Lehman 3-Year Municipal	0.9%	3.9%	1.9%	3.1%

Equity markets were mixed to flat in the first quarter of 2007 following a strong run in the second half of 2006. Economic growth slowed in the quarter as a weak housing market put pressure on consumers and businesses. Despite the drag from housing, employment remains very strong. The economy created 4.7 million jobs in the last 24 months and the jobless rate is now hovering around 4.5%, significantly lower than the postwar average unemployment rate of 5.7%. Interest rates remain low; the Open Market Committee of the Federal Reserve left rates unchanged during the quarter but has indicated that it is still concerned about inflation. This concern is primarily a result of tight labor markets, slowing productivity and the fact that many manufacturers are operating at the upper end of their capacity. Corporations continue to report strong profits; the final quarter of 2006 marked the 19th consecutive quarter of double-digit profit gains for US corporations.

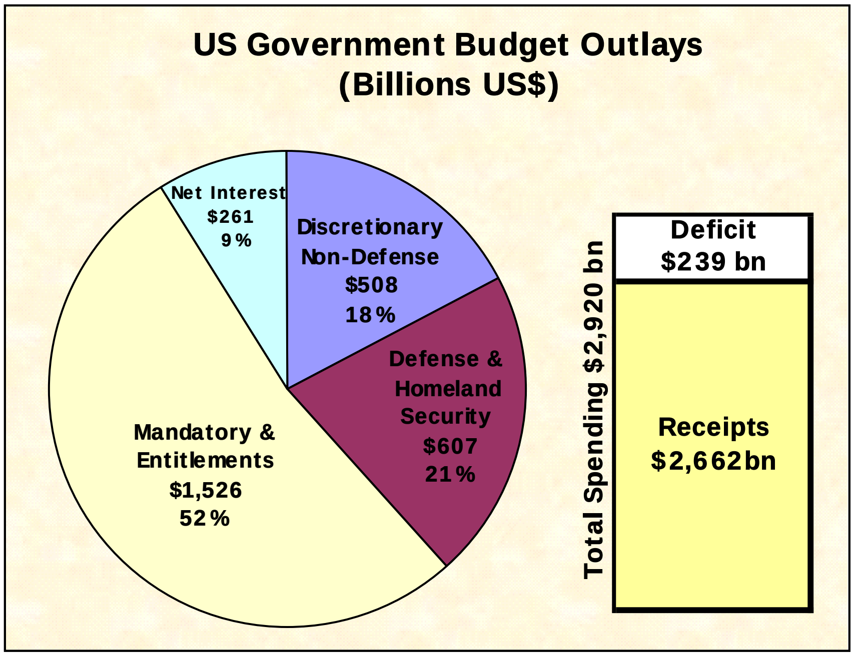
Housing Market Woes

While stocks roared out of the gate to celebrate the new year, by mid-February they began declining and finished the quarter close to where they began the year. Most of the decline was blamed on the weak housing market and specifically what is called the sub-prime sector of the overall mortgage market. Sub-prime refers to loans made to borrowers who generally have a lower probability of making their mortgage payments. As interest rates have remained low, record numbers of folks became first time homebuyers, lured by adjustable-rate mortgage products that promised extremely low *initial* mortgage payments. In an attempt by lenders to qualify more borrowers, some of these products have been structured with payments so low that the loans actually never amortize; the minimum required monthly payment does not even cover the interest cost and therefore the principal balance actually *increases* over time if borrowers pay no more than the minimum payment. Offering a loan with these characteristics to an already weak borrower is obviously a recipe for disaster. The chart to the left shows the dramatic increase in sub-prime loans over the last few years. Defaults within this sector have risen dramatically as the economy has slowed and as housing prices have stagnated and even declined in many parts of the country. Whether the housing market will continue to weaken and whether the pain being experienced by some borrowers will leak over into the broader economy and actually drag us into a recession is unknown. But the result of this uncertainty is a jittery stock market. As earlier stated, the overall health of the economy is good but just as the tech bubble's bursting in the late nineties dragged the economy into recession in 2000, the housing bubble is a new worry on the horizon. The good news for stock investors is that

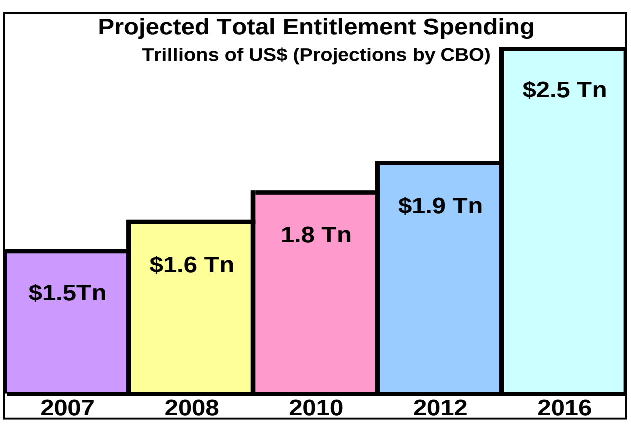


while the economy may in fact be flirting with a recession, stock valuations as measured by price to earnings or price to cash flow multiples are nowhere near the extremely high levels of early 2000. At the peak of the bubble in March of 2000, the S&P 500 was trading at a multiple of 31 times the previous year's earnings while today it is trading at approximately 17.5 times earnings, much closer to the fifty-year average.

Spending Spree



Past editions of this quarterly report have addressed the looming issue of federal government spending. The charts included on this page were derived from the Congressional Budget Office (CBO) website. While our current budget deficit is not at a worrisome level at less than 3% of GDP (Gross Domestic Product—a measure of the country's total output), the *projected* deficits and the overall debt service we are facing in the *future* are problematic at best. As the chart above clearly shows, entitlement programs—primarily Social Security, Medicare and Medicaid—make up over 50% of our federal budget today. Fast forward nine years to 2016 (chart below) and see that the CBO projects that entitlement spending alone will have increased by over 65% from $1.5 trillion to $2.5 trillion. When you start talking in trillions of dollars, it kind of seems like funny money but as the charts make clear,



these issues are nothing to laugh about. In nine years, we of course will have higher tax revenues resulting from an expanding economy. However, barring a miracle, there will be a huge shortfall if lawmakers do not take significant action. The actions will involve reducing promised benefits and increasing taxes. Depending on which political party is in power, we will have more of one than the other. Regardless of your party affiliation, this problem belongs to all of us and the way it is handled certainly has implications for the economy and for investors.

Very Optimistic

After reading about the weakness in housing and the challenges facing our elected representatives, you might think we are bearish. Not at all. We have great confidence in man's ability to progress and overcome obstacles. This desire to move forward is best illustrated by our amazing economy and the hurdles it has cleared over the last 230 years. The best way to participate in this phenomenon is to own stocks for the long term. We do however think it is productive to talk about the risks that have the potential to interfere with our prosperity from time to time. In addition to the ever-present risk of global terrorism, the issues we have discussed today certainly have that potential.

Welcome Jenny Sperry

We look forward to introducing you to our newest associate, Jenny Sperry. Jenny joined us in March as a Client Service Specialist. Jenny is a graduate of Yale University and previously worked with Bank of America. Before entering the financial services industry, Jenny played the oboe in the Charlotte Symphony Orchestra for 16 years. Jenny is married and has two lovely daughters. We know you will enjoy working with her.

We appreciate your confidence in our firm.

Sincerely,

Benton S. Bragg, CFP, CFA
President, Bragg Financial Advisors, Inc.