

UPDATE

July 2008

Investment Management News

ABOUT OUR COMPANY

Company Profile:

Concord Investment Counsel is an Irvine based, fee-only investment management company specializing in Domestic Equity and Domestic Fixed Income Management. Our prudent investment philosophy is ideal for conservative investors seeking growth, income, and risk management.

Investment Strategy:

Concord invests in mid- to large-cap growth oriented companies with strong leadership, superior products, and sustainable growth plans. Our investment strategy incorporates both growth and value methodologies.

Company Goals:

- High Alpha
- Low Tracking Error
- Average Volatility
- Excellent Client Communications
- Comfortable Relationships



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US Economy Amazingly Resilient

The US economy has turned out to be far more resilient than most economists expected. The economy in the 1st half likely grew at 1-1 ½% (GDP) instead of the recession that was widely expected. The American consumer is still spending despite sentiment that is at a 28 year low. Tax rebates seemed to have had a meaningful impact as most checks were likely spent instead of saved. Home equity continues to be a source of capital as home equity lines grew on average at all commercial banks in March, April and May.



Mitch Pletcher
President & Chief
Investment Officer

The rise in gasoline prices has been annoying but the real pain for consumers has actually come more from rising prices for health care and food than energy. Over the last 10 years consumption on necessities has risen considerably and has left less room for durables and leisure. Durable good spending has been in a steady decline recently and the outlook is not bright. Spending on necessities, however, has been trending higher.

The economic durability that we have been enjoying lately would seem unlikely to continue. The obstacles ahead are unavoidable. The most significant is the lack of credit in the market today. The lost capital at most of our major banks has brought about a new risk averse way of thinking. Banks are unwilling to take on even minimal risk and so are most of the major investors that support our bond markets. Most underwriters are unable to raise money for nonconforming loans.

Housing is still in a downturn and foreclosure rates are tilting higher. Household wealth is lower with stocks now down 20% from their highs. Corporate capital spending could get squeezed as profit growth slows. There are, however, several areas of our economy that are strong and helping us throughout this obstacle course of problems. Most involve commodity or infrastructure demand globally.

The energy sector is enjoying record profits as peak oil concerns have turned investors, speculators and users into buyers. Oil company employees are enjoying their best compensation environment since the 80's. The agriculture sector is likewise red hot with food demand growing globally at the strongest pace ever. Seed manufacturers and fertilizer producers are well positioned for what likely will be a secular story of high growth. Capital goods and industrial companies are benefiting from strong global demand for infrastructure, particularly in emerging markets.

The strength in the globe has been the backbone of the hope for continued growth in America. The housing debacle is the main anchor on the US economy and likewise is a US problem, not a global problem. Emerging economies are enjoying their best upturn likely in history and there is a middle class developing within these areas that are strong consumers. While continued strong to moderate growth in the globe seems reasonable, there are several reasons to be cautious.

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US Economy Amazingly Resilient

By Mitch Pletcher

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Inflation is tilting higher in the globe with over 50 economies reporting 10% or higher inflation. Foreign central banks are now in the process of tightening, and the deflationary forces outside of the US have now transitioned from tailwinds to headwinds.

So far 2008 has been a very difficult year for investors. Domestic stocks, foreign stocks, bonds and real estate are all mostly losers so far this year. The asset class that has benefited from these capital out-flows has been commodities, with most indices producing high double digit returns. The stock market rally in March fizzled after oil crossed \$110 per barrel and trends in housing worsened. Financial stocks have lead the market lower, and the resilience in the foreign markets has faded.

The outlook now is a bit cloudy with so much trouble in housing bucking a resilient US consumer and global strength.

Slower growth is likely ahead with a 1-2 quarter recession possible. A sharp rebound in equities is unlikely in the near term but will undoubtedly occur once signs of a bottom in housing become visible. The health of the financial sector will be the key to the rebound in the economy as consumption is tied heavily today to available credit. This sector will eventually lead the market higher as well.

In the meantime, current trends will likely persist.

We remain optimistic.

SECTOR REVIEW

06/30/08

Best Performers	Quarterly % Change	Worst Performers	Quarterly % Change
Platinum & Precious Metals	29.42	Travel & Tourism	-19.64
Home Construction	15.19	Gambling	-20.35
Railroads	10.05	Airlines	-21.75
Trucking	8.04	Full Line Insurance	-23.24
Steel	4.94	Internet	-25.65
General Mining	4.15	Investment Services	-26.80
Delivery Services	3.19	Health Care Providers	-28.05
Home Improvement Retailers	2.95	Mortgage Finance	-30.12
Exploration & Production	2.35	Consumer Electronics	-40.19
Farming & Fishing	0.81	Mobile Telecommunications	-40.21

Source: The Wall Street Journal

MARKET DIARY

06/30/08

Equity Returns	Quarterly Change	YTD Change	Quarterly Change	YTD Change	
US Large Cap Core	-7.78%	-11.49%	Mid Cap Core	-6.91%	-6.51%
US Large Cap Growth	-6.84%	-10.14%	Small Cap Core	-7.67%	-9.18%
US Large Cap Value	-9.01%	-13.02%	International	-8.28%	-10.83%

Returns are mutual fund averages from Lipper as reported by The Wall Street Journal. Performance includes dividends.

CIC Asset Allocation Growth	-3.10%	-9.92%	S&P 500	-3.23%	-12.83%
CIC Growth	-2.47%	-14.25%	DJIA	-7.44%	-14.43%
CIC Diversified Equity	-4.42%	-15.15%	Nasdaq	0.61%	-13.55%

The data above for Asset Allocation Growth, Focused Growth and Diversified Equity are CIC model portfolios and not composites of client accounts. Performance data for equity indices and CIC model portfolios listed here exclude dividends and are gross of fees. The information and data contained in this newsletter were obtained from sources considered to be accurate. Their accuracy and/or completeness cannot be guaranteed.

CIC Managed Assets

Balanced Portfolios

Asset Allocation for Growth

A dynamic blend of stocks, bonds, and cash for moderate investors with a bias toward growth balanced by income-producing investments.

Allocation as of 06/30/08:

US Stocks	41.8%
Int'l Stocks	14.2%
Bonds	40.4%
Cash	3.6%

Asset Allocation for Income

A portfolio of stocks, bonds, and cash for moderately-conservative investors seeking income and growth with relative stability.

Allocation as of 06/30/08:

US Stocks	31.8%
Int'l Stocks	9.2%
Bonds	50.7%
Cash	3.7%

Equity Portfolios

Growth

A portfolio of large- and mid-cap US stocks that are industry leaders with strong brands and timely products.

Diversified Equity

A global, all-cap equity portfolio following economic trends across capitalization and geographic ranges.

Focused REIT

A portfolio of companies whose primary business is owning and leasing real properties.

Fixed Income Portfolios

Strategic Total Return Bond

A diversified portfolio of mid- and long-term bonds, actively managed for yield, capital preservation, and strategic capital gains.

Ultra Short-Term Bond

A short-duration bond portfolio offering active management for yield, safety, and liquidity.

Research Spotlight: Costco Wholesale

As home prices slip lower and the unemployment rate inches higher, the U.S. economy looks increasingly at risk of experiencing its first consumer-led recession in nearly two decades. Add in higher monthly outlays for gasoline, food and healthcare and household spending budgets are quickly becoming less discretionary. Many retailers and consumer goods manufacturers are seeing their profits pressured in this environment, while others are surviving or even benefiting from the required shift in consumer spending patterns. For Costco, with its heavy consumer staples mix, relatively affluent customer base and consistent execution, business is pretty good in spite of the tough economy.

Costco doggedly serves its 48 million members with a determination to deliver value and innovative products unmatched in the world of retailing. It has accomplished this by consistently flouting industry norms. It charges customers a base yearly fee to shop in its stores, which offer quality goods at low mark-ups. Consequently and by design, its margins are among the slimmest in retailing. The privileges also extend to employees, who are paid very well and receive generous health benefits. The very long-term strategic focus of customers first, employees second and shareholders third has generated fierce loyalty among both shoppers and staff, and ultimately rewarded long-term investors as well. The fanatic, unconventional approach to pursuing this vision is simple and successful, but isn't always supported by Wall Street. There is a constant cry for Costco to boost profits by increasing margins with product mark-ups. Yet as a matter of corporate policy, Costco refuses to mark up any product by more than 15% above its cost. The compensation and medical benefits for employees are often criticized, but Costco has an unbelievably low employee turnover rate of less than 6%.

By securing its customers' loyalty and trust, Costco is able to leverage that relationship in ways that other retailers aren't. For one, the company spends very little money on marketing. It is also able to selectively stock its shelves with focused inventory (as opposed to Wal-Mart's overflowing aisles), generating higher inventory turnover which compensates for lower margins. Its shoplifting rate is the industry's lowest at just 0.2% annually. Its generic Kirkland brand is also highly regarded by customers. Kirkland comprises 14% of sales, enjoys higher margins, and has room to grow as a percentage of sales. Ancillary businesses like pharmacy, optical, and gas have been very successful as "stores within the store" while boosting customer visits.

Costco is led by maverick CEO and founder Jim Sinegal, whose overall demeanor and work ethic are markedly contrasted by today's overpaid chief executives. He is to Costco what Warren Buffett is to Berkshire Hathaway. At 70 years old, he brings an owner's passion to the company. He's on the road 40 to 45 weeks a year and aims to visit each store twice a year. He has no severance or golden parachute in his contract, which runs less than a page. He insists the Costco board evaluate his performance annually. Sinegal has talked casually about holding the job for another five years, and while he hasn't selected an heir apparent, Costco has a strong group of managers who share his passion and vision.

Costco has all the markings of a consistent, genuine growth story. The company has said its 515 store base can comfortably grow to 1000. Long-term sales, earnings per share and membership growth have all steadily averaged 11-12% annually. While maintaining its commitment to low prices, Costco has managed to improve its operating margins of late by enforcing a stricter return policy for electronics and opportunistically sourcing products in distressed categories like women's apparel. The company owns 78% of its stores, has no debt and generates 5% of its pretax income from interest on \$2B in net cash on its balance sheet. Costco is not immune from the coming challenges posed by the fatigued and overspent American consumer. The company's formula works, however, and Costco investors know it is not going to be tinkered with.

The beginning of the 2nd quarter saw stabilization of the credit markets. The flight to high quality Treasury bonds dissipated after three quarters of market panic. But the relief rally came to an abrupt halt as worries about housing, the credit markets and the economy resurfaced at the end of the quarter.

Recall that the Federal Reserve ended the first quarter by adding liquidity to the U.S. financial system by opening the discount window to brokerage firms, and also engineered the buyout of Bear Stearns by J.P. Morgan Chase to prevent the former from filing for bankruptcy. These actions helped ease fears in the credit markets, and the stability carried over into April and May. The Fed also lowered the Fed Funds rate another 25 basis points in April. As confidence rose, investors headed back into risky assets and out of high quality Treasuries. But, by the second half of the quarter, the Fed's focus was shifting toward inflation concerns due in part to the rapid climb in oil and food prices. This made bond investors fear future interest rate hikes, even though the Fed left rates unchanged at their most recent meeting in June.

Treasury prices fell sharply early in the quarter, but investors returned to Treasuries by the end of the quarter due to renewed fears about recession. Yields on the short end of the curve rose more than the long end of the curve resulting in an overall flattening of the yield curve during the quarter. The yield on 2-year notes finished at 2.6%, up from 1.6% at the start of the quarter, but down from intra-quarter highs of 3%. 30-year bond yields rose from 4.3% to 4.5% for the quarter. Treasury yields are still very low relative to historical levels and suggest that bond investors see minimal inflation on the horizon. This stands in sharp contrast to the inflation that consumers believe they are experiencing.

The quarter saw a modest rebound for junk bonds, as spreads tightened by a full percentage point. Ultimately, high-yield bonds returned approximately 1.5% for the quarter. Investment grade corporate bond returns were down for the quarter and performed roughly in-line with Treasuries. Mortgage-backed securities performed slightly better than investment grade corporate and Treasuries.

The second quarter showed that there are few places to hide in the financial markets, fixed income included. While credit spreads tightened early in the quarter, they quickly widened during the second half of June as troubled themes once again played out in the economy. Investors still don't have a strong appetite for spread product in this uncertain economic environment.

Diversifying into commodities

Thus far in 2008, stock indices are down, and sharply. Bonds have fared better, but neither comes close to the performance of commodities. Over the last 12 months, the S&P GSCI (a commodities index that tracks 24 commodities including energy, metals, livestock and agriculture) is up over 75%.

Like many investments, commodities tend to be cyclical in nature. Unlike other investments, commodities cycles tend to be long lasting and there has not been a good commodities cycle since the late 1960's ending in 1982.

For the past 20 years we have been in a commodities bear market; however we believe that a new cycle has begun. Additionally, a well diversified portfolio that includes commodities may experience less volatility without sacrificing long term performance. With that in mind, we have decided to add the Dow Jones-AIG Commodity Index (DJP), a commodities ETF, to our asset allocation portfolios.

As stocks have fallen this year, commodities are up. If oil and other commodities were to fall, it would be reasonable to believe that the stock market would improve. We believe that for additional diversification, commodities are an asset class worth holding.

	Index Name	MTD	QTD	YTD	1 Year	3 Years	5 Years	10 Years
Large-Cap Equity	Russell 1000® Growth	-7.20	1.25	-9.06	-5.96	5.91	7.32	0.96
	Russell 1000® Value	-9.57	-5.32	-13.57	-18.78	3.53	8.92	4.91
Mid-Cap Equity	Russell Midcap®	-7.99	2.67	-7.57	-11.19	6.84	13.07	8.10
Small-Cap Equity	Russell 2000®	-7.70	0.58	-9.37	-16.19	3.79	10.29	5.52
International Equity	MSCI Eur/Asia/Far East	-8.18	-2.25	-10.96	-10.61	12.84	16.67	5.87
Int'l Emerging Equity	MSCI Emerging Markets	-9.97	-0.86	-11.76	4.63	27.14	29.75	15.23
Fixed Income	Lehman Aggreg Bond	-0.08	-1.02	1.13	7.12	4.09	3.86	5.68
Commodities	S&P GSCI	9.22	28.65	41.42	75.98	19.74	21.30	15.50

Percent returns ending 06/30/08. Source: Russell Investments, Barclays Global Investors

Our Investment Process

By Brian Thomas, Senior Analyst

Expectations Measurement & Analysis

Once our investment team completes the process of putting a company through a deep qualitative review, a carefully assembled picture emerges of the growth outlook for the business. We assess not just how fast the company is growing now, but also how sustainable the current rate of growth is, whether it is likely to be accelerating or decelerating, and what threats to the growth are likely to emerge. Clarifying the outlook for growth with precision is essential because these are the factors that determine how investors come to value a company's business and by extension its stock.

Correctly assessing the growth outlook is only half the battle, however, as this information tells us how the company *should* be valued by the market but not where expectations for growth actually are. We may discover a high growth company where expectations are even higher than we perceive to be sustainable. In our effort to find companies whose growth exceeds market expectations by a sizable margin, this sort of investment would represent more risk than opportunity. Similarly, a more modest growth story may have expectations for no growth at all and result in a more attractive investment than the higher growth company. Our investment process is engineered to uncover these unbalanced relationships between growth and expectations. Correctly measuring expectations therefore becomes as important as measuring the growth.

So how do we accurately measure expectations? P/E ratios are a quick and often used barometer, but even a forward P/E is biased by its use of consensus forward earnings estimates of analysts. These estimates are frequently off the mark and decrease in their reliability as you move out in time. Besides, we wouldn't go to the trouble of distilling the growth rate of the company in our own work if we intended to rely on analyst estimates. Our solution begins with the assumption that investors will not value a company higher than its expected rate of growth. Basically, investors will move a stock toward an implied PEG ratio* of one. Without getting too detailed, by fixing the PEG at one we can algebraically solve for the growth rate using only the stock's price and the last four quarters' EPS. We call this number our "price implied growth rate" or PIG, and is what we hold up against our "Concord growth rate" or CGR. Now even though our PIG has nothing to do with analyst estimates, we know that movement in those estimates invariably influences investor expectations. We therefore also calculate the "Street growth rate" or SGR, simply by looking at analysts' estimates for the coming four quarters.

The most important relationship that results from this expectations analysis is the PIG vs. CGR. Important insights are achieved, however, when we hold all three numbers up against one another. It is these insights that allow us to calculate the investment opportunity in a stock and move it on to our buy list.

* PEG ratio=price to earnings multiple/EPS growth rate