BCN ADVANTAGE: 2007 ANNUAL REPORT

January 2008	BCN Advantage Act/Mgmt	100% Invested Buy/Hold	50% Invested Buy/Hold	100% Cash
Total Return:	7.15% [1 2 3]	13.57% [1 2]	9.34% [1 2]	5.12% [1 2]
Jan ' 97 = $100,000 [4]	$338,190	$305,413	$231,365	$148,349
Beta (2007):	0.25	1.00	0.50	0.00
Risk Adjusted Return:	7.15%	13.57%	9.34%	5.12%

1 Performance results are based on the Federated Kaufmann Fund (21.4% for 2007), the Vanguard Index 500 Fund (5.4% for 2007), the Dodge & Cox International Fund (11.7% for 2007) and an average money market return of 5.12%. The results may not reflect the actual performance of BCN Advantage clients. Past performance does not guarantee future results.
2 Performance results show the year-over-year change to net asset values and do not include the reinvestment of dividends (if any) other than interest earned from the money market fund.
3 Performance results are net of BCN Financial management fees.
4 BCN Financial Inc. is the registered investment advisor. Performance from January 1997 to June 1998 was provided through Quest Securities as the registered investment advisor.

2007 BCN Advantage Signals

	Date	Market	Cash
1	01/01/2007	25%	75%
2	04/01/2007	25%	75%
3	07/01/2007	25%	75%
4	10/01/2007	25%	75%
5	12/31/2007	25%	75%
	Present	25%	75%

A Long Year's Journey
Last year's annual report ended with a question: "Is this 1995-1999 all over again, the last time the Fed ended a series of interest rate hikes? Or will the markets finally surrender to historical precedent? Our job is to identify the real trend – early – ahead of the crowd." Well, we were certainly "ahead of the crowd." This is by far the most defensive we have ever been, and the longest period we have gone without a market move. But the key question has finally been answered: The DJIA has declined 2,065 points (-15%) from its Oct 9th 2007 closing high of 14,164.53. The S&P 500 has declined 240 points (-15%) from its Oct 9th 2007 closing high of 1,565.15. And the Nasdaq has declined 519 points (-18%) from its Oct 31st 2007 closing high of 2,859.12.

The Highest Risk Market Since Q1 2000
Our interim reports didn't just say the markets were due for a correction. We declared flatly that this is the "highest risk market we have seen since Q1 2000." In 2007, the markets experienced severe downturns in February, August and November. The first was the "carry-trade" shakeout, which lasted just a month. The August meltdown was much worse, when "sub-prime" fears finally went mainstream. At the mid-August low, just 30% of stocks stood above their key 200-day moving averages – the lowest reading since October 2002. Many analysts believed the August correction had formed a major market BOTTOM; that problems stemming from the mortgage crisis and ensuing credit crisis were now fully "priced in." We strongly disagreed. Emergency action by the Fed (3 rate cuts amounting to a full percentage point), an announced sub-prime bailout by Treasury, and understated "write-downs" by the major banks stopped the bleeding, but only temporarily, and only enough to cloud the investment horizon.

The House of Cards is Tumbling Down
The seeds were sown in the aftermath of the dot-com collapse. To stimulate growth and employment, the Fed lowered interest rates to 1% and maintained that rate for an extended period. Credit standards were lowered, allowing undocumented loans and zero down payments. The result was an unprecedented housing boom that saw

households extract hundreds of billions of dollars from their homes through cash-out refinancing, home equity loans and outright sales. At one point such equity extractions were running at an annualized rate of nearly $800 billion. Consumer spending, accounting for 70% of GDP, supported an economic recovery that boosted growth in the U.S. and around the world. Mortgages were sold and packaged into collateralized debt obligations (CDOs) consisting of tranches of quality – and given AAA ratings. The CDOs ended up everywhere, including hedge funds, pension funds and money market funds all over the globe. When the housing bubble inevitably broke, holders of both sub-prime and alt-A mortgages began to default, exposing large amounts of CDOs as junk. The result is what we have been witnessing.

The major indexes have now fallen substantially below their August 2007 lows. Never in the 80-year history of the S&P 500 has the index fallen 5% in the first week of the year – until now. Not in the past 60 years has the unemployment rate reversed by this amount without the economy being very near, or already in recession. The drop-off in new and existing home sales rivals the plunge of the late 1970s. Consumer confidence has fallen 24 points in just 4 months, with recent polls showing 70% of the public believes the economy is in or will soon enter recession. Retailers failed to meet already lowered sales projections, making 2007 the weakest holiday season since 2002.

Fed Intervention Delayed the Inevitable

The DJIA closed on Dec 31st at 13,264.82, no higher than its May 4th close. The S&P closed on Dec 31st at 1,468.36, no higher than its February 21st close. And the Nasdaq closed on Dec 31st at 2,652.28, no higher than its July 5th close. For the entire second half of the year, the major indexes made no real progress – and in the case of the S&P 500, for the last 10 months of the year! Although the indexes soared to multi-year highs in October, they did so on the mistaken belief that Federal Reserve and Treasury interventions would stave off recession. Recall that on August 16th the Nasdaq had fallen all the way to 2,386.69 (-12% from its mid-year high). The next morning the Fed announced an emergency ½ point cut in the Discount rate, and followed that with another ½ point cut in both the Fed Funds rate and the Discount rate on September 18th.

In what will go down as our best decision of 2007, we firmly resolved to “Fight the Fed” – a decision that was met with more than a little frustration. History was certainly against us: only two other times have the markets dropped more than 10% in the six months after a 3rd Fed rate cut – once in 1930, during the Great Depression, and again in 2001, when the dot-com bubble burst. In both cases, the rate cuts failed to cushion the economy from a recession that was already underway. The outcome for many investors will be the “dark-side” of Federal Reserve intervention: a severe whipsaw that saw them chase artificial gains through October, only to see the collapse begin in November once the fundamental rifts in our economy began to take hold. Having already experienced short-lived declines in February and August, selling early into the November decline would defy human nature. This is how markets work so deliberately to separate investors from their money.

The Strategy Going Forward

The closing highs achieved by the DJIA, S&P 500 and Nasdaq in October 2007 most likely formed a long-term market top. If historical precedents hold, we will not regain those highs for 12-18 months. Consequently, the decline that began in early November 2007 is the beginning of a relatively severe bear market that, at the very least, should return the indexes to their 2006 lows: 10,700 for the DJIA, 1,230 for the S&P 500, and 2,020 for the Nasdaq. Despite the gloom, there are good reasons for encouragement. We are once again fully in sync with the markets, and we will remain in sync (much has been learned over the last 12 months). We are never hesitant to call significant turning points: the market top in this report, and the October 2002 market bottom (way back in January 2003), when most investors were still heading for the exits. BCN Advantage clients are now positioned to take advantage of the coming capitulation and washout – because we have patiently and steadfastly maintained our cash reserves.

As always, we look forward with great optimism. We appreciate your faith and confidence. And we are eager to apply the lessons learned for your benefit.