RESPONSIVE FINANCIAL GROUP, INC.
A Registered Investment Advisory Firm

October 2, 2007

Greetings:

We are going to jump right into the investment discussion this quarter. It was a crazy quarter and I know you want to know that everything is going okay.

From an investments standpoint, the last three months have been ridiculous. If you had looked at your June 30th statement and then took a nap until your September 30th statement arrived, you would think that the quarter had been really boring. Our Risk-Adjusted Portfolio returns ranged from an average of just under 1% for the Capital Preservation Portfolio to little more than 3% for the All Equity Portfolio. On a risk-adjusted basis, all of the portfolios remain above the benchmark return established for them for the year. This is the benchmark that adds the U.S. Treasury bill Index return as the risk-free element.

Any of you who didn't sleep through the last three months are well aware that the investment markets have been anything but boring. During the last three months the S&P 500 was down more than 6% and up more than 3%. Nearly a 10% swing from high to low during the quarter. It finished up just more than 2%. While our portfolios finished very near their benchmark returns by the end of the quarter, the path to that result was lumpy. What a quarter to have begun monthly reporting!

We will shortly eliminate *Schwab Hedged Equity* and *Hotchkis & Wiley Core Value* and *Large Cap Value* funds from the portfolios. We will be reallocating those assets to increasing our exposure to the *Wintergreen Fund* and to adding two new holdings, the *Ivy Asset Strategy Fund* (to all portfolios) and the *Schwab Total Market Index* (to all but the Capital Preservation and Conservative Portfolios). For those of you for whom these changes will result in any significant tax liability, we will be contacting you individually to insure that we have reviewed the impact prior to executing trades in your account. The remainder of this letter will be dedicated to a *very interesting* discussion of why we are eliminating these two funds and replacing them in our portfolios. Proceed at your own risk!

As you may recall from my previous letters, we don't mind one bit when our returns are different from that of the S&P 500 index. In fact, one of our objectives in constructing our portfolios is to insure that our returns don't simply mimic the index. This, in our view, is an important risk management consideration. Our use of the S&P 500 and US Treasury Bill indexes to produce benchmark returns for you is simply to compare how your portfolio is doing relative to overall US markets. Our job as investment managers for you is to ensure that your capital is employed in a manner that most efficiently and effectively utilizes capital markets to achieve your objectives. Our risk-adjusted portfolios are our method of streamlining the process of getting from a category of objectives and constraints down to a specific portfolio. In this way, we are able to focus our investment management activities very intensely on our very best ideas across just a few portfolios. We then can utilize a series of daily monitoring activities of the securities in our portfolios, and of the performance of our portfolio models in order to maintain an intimate awareness of the securities' and portfolios' behaviors in relation to capital markets. We could not do this if we had custom portfolios for all 420 accounts currently in our Risk-Adjusted Portfolios.

We found through these monitoring activities this quarter that the *Schwab Hedged Equity Fund* behaved (for just a few trading days) very poorly, and in a manner not in keeping with its history. During the subsequent week or two the majority of the loss that the fund had incurred was recovered. On a conference call during this period we learned from the managers of the fund that this behavior was not a complete surprise to them based upon previous back testing of their strategy. However, they had not previously discussed the possibility of this kind of behavior with investors in the fund. While I am comfortable with their management of the fund and its strategy, I am disappointed that a disclosure of those possible outlier (unusual and very infrequent but possible) returns was not made. This is also an example of the sometimes negative consequences of using derivatives (financial products whose return is derived from the behavior of a real asset), particularly when the derivatives purpose is to avoid risk or volatility. I am referring to the "hedged" element of the Schwab fund. It is extremely difficult to exactly hedge a risk, and the result in extreme circumstances can be that the hedge breaks down completely. In this case the extreme circumstance was simply the huge number of quantitative managers using strategies which were very similar, and one extremely large participant using that strategy began suddenly to sell out of it. As a consequence, the highly rated stocks that these managers all owned had to be sold in very large volumes in order to produce the cash necessary to buy the very low rated stocks that the same managers owed or "sold short." The net effect was that the value of the things these managers *owned* went down at the same time that the value of the things these managers *owed* went up, this is called a "short strangle." The effects of this particular strangle began the last week in July and continued through mid-August.

What does this mean for us? It means that while I do still believe that the *Schwab Hedged Equity Fund* is one of the better funds in its category, and is effective in meeting its objectives, I do not wish to maintain a position in it. We will be selling it from our Risk-Adjusted Portfolios very shortly. Why? I believe now that these types of hedges, while effective during periods of normal volatility, are less so in extreme periods and may break down when that volatility is accompanied by substantial deleveraging.

Those of you who have heard me speak about our equity markets in the past are aware that I have felt for a few years that this bull market would end in an unwinding of leverage. That the "liquidity" driven market we were in was being driven by a false liquidity, borrowed money. Debt driven liquidity disappears just at the moment when real liquidity is the most important. I have also known for some time that hedging a portfolio is a form of leverage, in that if the securities that you are short must be delivered, you must buy them then and you do not have a choice of either the time of purchase or the price available. I will be exceptionally careful about introducing another such dedicated hedged exposure to our portfolios in the future. We have managers in the portfolios that may use hedging techniques as they see fit. I believe it is necessary to maintain a very short horizon on derivative and short positions and so I expect at this time to leave those techniques to managers such as Leuthold Capital and a few others in our portfolios.

We have also decided to eliminate *Hotchkis and Wiley Core Value* and *Large Cap Value* funds from our portfolios. While we had a good run with them they seem to have crossed from "sticking to their guns" to stubborn regarding some of their opinions on sectors of the securities markets. While we prefer to stay with managers as long as possible to allow for the full expression of their talents over appropriate time frames,

occasionally good managers have periods during which their stubbornness keeps them from acknowledging or appropriately reacting to facts. The performance of these funds was in keeping with other funds of their ilk, until the end of July. While it appeared that some of their under performance was possibly due to holdings in housing related stocks, we concluded that that was not the only problem. During our daily monitoring we noted that they continued to underperform, even on recent days when housing stocks were strong.

These changes will serve to increase the adaptability of any one of our portfolios to changing market conditions by increasing the percentage of assets we have allocated to "flexible" managers. While we are pleased with the durability of our portfolios as this market changed substantially over the last year or so, we do believe that these changes will improve that characteristic even more.

Thanks for your patience! You will hear from us a time or two more between now and the end of the year, particularly if you are on our digital delivery platform. (You are if you received this by email!)

I hope that the fall season is a great one for you.

Sincerely,

Benjamin G Baldwin III CFP® CHFC
President