



HEYDON TRAUB
Traub Capital Management, LLC
97 Chapel Street
Needham, MA 02492

(781) 453-3929
Cell: 781-405-4410

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TRAUB CAPITAL MANAGEMENT 2nd QUARTER 2007 MARKET REPORT

June finally stalled the market's torrid pace in the second quarter as the S&P 500 fell 1.7% for the month. But that only minimally impacted the quarter's strong gains with a return of 6.3%. All of the broad-based indices performed well for the quarter although the small-cap indices lagged behind with a gain of "only" about 4%.

The bad news that led to the market sell-off in June was that bond yields rose and lending standards tightened causing a rise in interest rates. This led to worries that the cheap debt financing supporting the buyout boom would become more expensive. And if the buyout boom ends, it seems likely the market would fall as much of the recent market rise seems to have been fueled by the heavy volume of takeover deals. But there was a whole lot of good news prior to June with earnings coming in much stronger than expected in the first quarter and record numbers of buyout deals. In addition, company share buybacks continued as well with Wal-Mart leading the way with a new \$15 billion buyback plan.

Market Outlook

Our market outlook continues to be moderately optimistic. Our best guess is that the market will continue to move up in line with earnings. So with earnings expected to grow in the high single digits over the next year we think that is a likely gain for the stock market over that time. Interestingly, even though the market rallied over 6% last quarter, the valuations didn't change much as earnings came in better than expected and the earnings outlook has improved as well. Consensus estimates of earnings growth for 2007 are now up to 8%, while 2008 is expected to bring 12% growth. So the market continues to trade at 16 times 2007 estimated earnings.

One thing which has changed to the negative is that interest rates have moved up significantly over the last few months. So with bond yields higher now and above 5%, bonds offer a more interesting alternative to stocks than at the start of the year. However, rates are still low, especially corporate bond yields making it still attractive for buyouts and share buybacks, which should continue to support the market for now.

As noted in previous letters, it is hard to envision a scenario of significant declines in stocks given what some refer to as the "private equity put" that seems to exist. In recent years there has been a surge in takeover activity helped by a

flood of money into private equity. Since private equity uses substantial leverage, the amount of capital they have to do deals with has grown significantly. Thus, companies that have had earnings disappointments or operating problems leading to stock price declines often become attractive to private equity. This occurs where the private equity firms feel they can bring some improvements to the operation, and leveraging with high debt loads often forces changes that might not otherwise occur.

All that said we have seen for the first time in many years problems in the last month for some companies looking to place their debt to finance these deals. These deals are still likely to go through as the investment banks arranging the loans have made commitments. However, as they are forced to hold more of these loans on their own books, their capacity to facilitate future deals is reduced. So although it is likely premature to call the end of the buyout mania, we think it is likely that the deal flow will slow down significantly by next year as investors become more discerning about which "buyout" bonds they will buy.

Regards,

Heydon