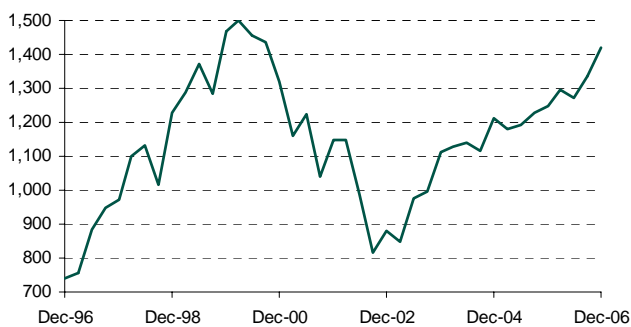




Financial Review

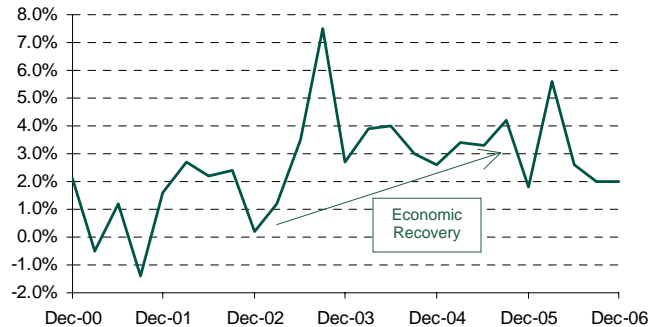
Equities finished 2006 strong, with broader indices recording impressive gains for the Fourth Quarter. Large-cap stocks, as represented by the S&P 500 Index, increased 6.7% for the quarter, while the benchmark index for small-cap stocks, the Russell 2000 Index, advanced 8.9%. International stocks continued their out-performance, with the benchmark EAFE Index up 10.4% for the quarter. For the full year, the S&P 500 was up 15.8%, while the Russell 2000 and EAFE Index logged gains of 18.4% and 26.3%, respectively.

S&P 500 Index



Since the bear market low set in September 2002, the S&P 500 has returned over 85%, leaving the index within 10% of its all time high. The strength of the domestic market over the past four years is largely attributable to a rebound in economic activity.

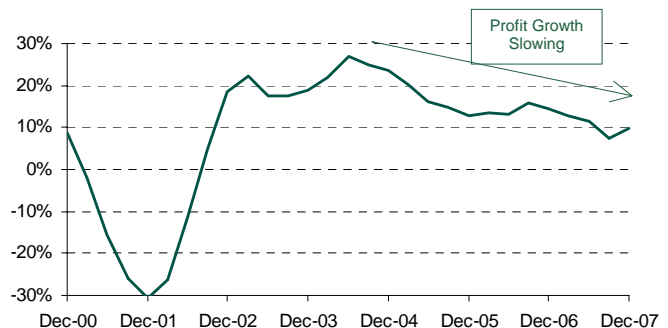
US GDP (Annualized)



After bottoming out in 2001, the domestic economy recovered smartly – as low interest rates and high employment levels fueled a consumer driven surge in economic activity. This provided the backdrop for resurgent corporate profit growth – earning’s growth for companies in the S&P 500 has remained above 10% for each of the last four years.

The economy, however, slowed noticeably in 2006, in large part due to weakness in housing related activity. Many economists forecast anemic growth for 2007, which likely will result in slowing corporate profit growth. S&P 500 profit growth is expected to decelerate to the lowest levels since 2002.

S&P 500 Index
Operating Earnings Growth
Trailing 12 months



What do we expect for equity markets in 2007?

Despite the continued deceleration in corporate earnings growth, there are several factors that lead us to believe 2007 will shape up as a decent year for investors. First, liquidity is abundant, as cash-rich corporations and private equity funds have the resources to pursue sizable transactions. Second, despite persistent worries regarding the housing slump, the economy should avoid a recession, primarily thanks to high domestic employment levels as well as continuing economic strength abroad. Finally, although we do not view valuations as “cheap”, we believe the market is not excessively valued either. Although the performance of equity markets in 2006 will be a difficult act to follow, we look forward to additional gains in the year ahead.

Core Equity Portfolio

During the quarter we initiated a new position in EOG Resources, and eliminated our holdings in Schering-Plough and Time Warner.

EOG is an independent oil and gas company with reserves primarily in the United States, Canada, and Trinidad. Unlike many other energy companies, EOG has pursued organic growth rather than large-scale acquisitions and mergers, with impressive results. Total production increased 16% in 2005 and is targeted to approach 10% annually through the end of the decade. Competitively, the company has the lowest finding costs in the industry, leading to superior margins compared with EOG’s peers. Additionally, the company is in the strongest financial condition within the independent energy

companies, providing substantial flexibility in pursuing shareholder friendly strategies. We believe the management team will continue to deliver strong results for shareholders, and see the company as an attractive complement to our existing energy holdings.

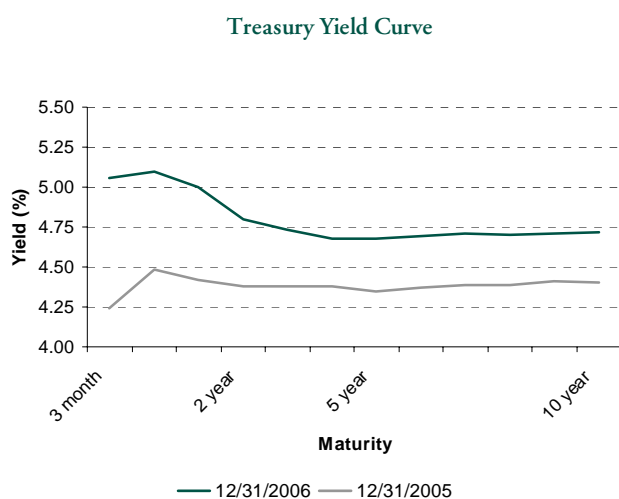
We sold our positions in Schering-Plough and Time Warner as each company met our respective valuation targets.

We originally purchased Schering-Plough in 2004, subsequent to the company suffering through the loss of exclusivity to their allergy drug (Claritin), which resulted in the stock declining over 60% from its all time high. We believed the company was undervalued based upon decent prospects in its product pipeline. In 2005, the company began to benefit from sales of Vytorin, a drug collaboratively produced by Schering-Plough and Merck. The stock has recovered to a valuation of 25 times 2007 earnings, a level that fully reflects the economic prospects of the company.

To say that Time Warner was out of favor in 2002 would be a gross understatement. The company, then AOL Time Warner, was the target of ridicule for a poorly conceived merger, as well as being subject to an SEC probe regarding questionable accounting practices. After suffering a decline of more than 80%, we initiated our position believing the stock did not appropriately reflect the value of the old Time Warner entertainment assets. As the cloud of the infamous merger dissipated, and the company resolved its accounting issues, the market began to value the company as a diversified media conglomerate with attractive assets. At current levels, we believe the stock is fairly valued, leading us to exit the position for better long-term opportunities elsewhere.

Fixed Income Markets

Interest rates edged slightly higher in the Fourth Quarter, as strong employment reports stoked fears of inflation - making it less likely that the Federal Reserve will cut interest rates soon. For 2006, rates on intermediate and long-term treasury securities climbed about 30 basis points.



Although the Fed has left short-term rates unchanged for the last six months, many Fed members have made public statements expressing continued concern over inflationary pressures. This has disappointed market observers, who have viewed rate cuts as necessary to prevent the economy from stalling. We believe these observers will be disappointed, as our view is the Fed will avoid rate cuts this year unless the stock market begins a protracted decline – an event we deem unlikely.

In client portfolios, we are maintaining duration at near benchmark maturities. Agency bonds continue to offer attractive yields relative to corporate and treasury securities.

Alternative Investments

After yielding single digit returns in 2004 and 2005, absolute return strategies enjoyed stronger returns this year, having benefited to varying degrees from a liquid, debtor friendly credit market.

The most obvious beneficiaries of the easy credit environment were **Merger Arbitrage** managers. Record-breaking merger and acquisition activity in both Europe and the U.S. was made possible by the enormous pools of money willing to purchase the debt of these leveraged transactions.

An active merger environment would normally hurt the results of **Convertible Arbitrage** funds, as these bonds become more junior in the capital structure when a company takes on leverage. Convertibles performed well this year, however, assisted by new issuances and slightly higher interest rates.

Distressed Securities provided another year of strong returns, but new opportunities remain hard to find. Results have been driven by gains on formerly troubled companies such as Enron, Adelphia and United Airlines. A decent economy coupled with easily available credit has resulted in low levels of corporate defaults. Consequently, we expect this category to decline in importance until the economy demonstrates signs of further weakness.

The easy credit market benefited **Equity Long/Short** managers directly and indirectly. Managers enjoyed more of their holdings purchased at a premium by both strategic and financial buyers. Activist managers were also successful in pressuring corporate management teams to make strategic changes

December 31, 2006

or face the possibility of being acquired. Indirectly performance was also aided as proceeds from buyouts were often reinvested back in the market.

Specialty Finance continues to provide consistent returns with minimal impact from changing interest rates (or equity markets). With public markets or banks still unable to meet the financing needs of small and middle market businesses, many companies continue to rely on private lenders as their primary capital source. Spreads for new transactions remain at attractive levels, as the strategies have not seen the mass inflows of liquidity that have inundated larger lenders.

New Investments

Private Equity

We expanded our fund-of-funds portfolio by establishing our second private equity fund. The fund has committed to investing in the following areas: emerging markets, buyouts, distressed situations, growth equity, and energy. We have selected partnerships that have niche strategies and those with proprietary deal flow, tax efficient investments, and top tier investment teams whose interests are aligned with investors. Funds will be called down over a four-year period.

Real Estate

Qualified clients invested in two separate real estate partnerships in the quarter.

A triple net lease investment purchases and leases-back commercial properties, creating a bond-like investment as rent collections are distributed to investors. Risk is managed through disciplined property valuation analysis, strict protocols on the credit

worthiness of the tenant, and acquiring mission critical properties.

The second investment makes equity investments in under-managed and under-capitalized B and C class apartment buildings. The focus is on high traffic sites near strong retail corridors in communities where there is a wide “affordability gap” between the cost of owning versus renting. The fund’s strategy may incorporate opportunistic property renovations, allowing rents and property value to increase.

One Year Economic Overview

		Dec 2006	Dec 2005
Stock Market			
S&P 500 Index	▲	1,418.30	1,248.29
Russell 2000 Index	▲	787.66	673.22
Fixed Income Yields			
3-Month Treasuries	▲	5.06%	4.24%
5-Year Treasuries	▲	4.68	4.35
10-Year Treasuries	▲	4.72	4.40
30-Year Treasuries	▲	4.80	4.50
Inflation Monitor			
CPI-Trailing 12-Month Growth	▼	2.0%	3.5%
CPI-(Excluding Food/Energy)	▲	2.6	2.1
Market Expectations*		2.3	2.3
Commodities			
Gold (per ounce)	▲	\$636.70	\$523.40
Crude Oil (per barrel)	▲	61.05	61.04

*Comparison of yields for 10-Year Treasury and 10-Year TIPS

Final Note

This letter as well as other significant communications can be emailed to you instead of sent through regular mail. Please send your email address to info@cedhill.com to be added to our email distribution list.