The Economy and the Markets

The economy enjoyed a rebound in growth in the second quarter, challenging assumptions that 2007 would see a slow down. Retail spending remained strong, employment was solid, and the housing market's problems didn't appear to significantly damage the larger economy.

This positive performance brought about an attitude adjustment in the bond market. The market had assumed the Federal Reserve would have to cut rates at some point in 2007 to spur growth. It was a perspective we did not share, and the increases in bond yields reflected the end of that train of thought.

The Federal Reserve's commitment to containing inflation appears to have new credibility, another factor contributing to the change in thinking. The Fed has consistently reiterated that inflation ranks as its primary concern, and the core inflation rate continues to push at the limits of the Fed's comfort range.

Equities

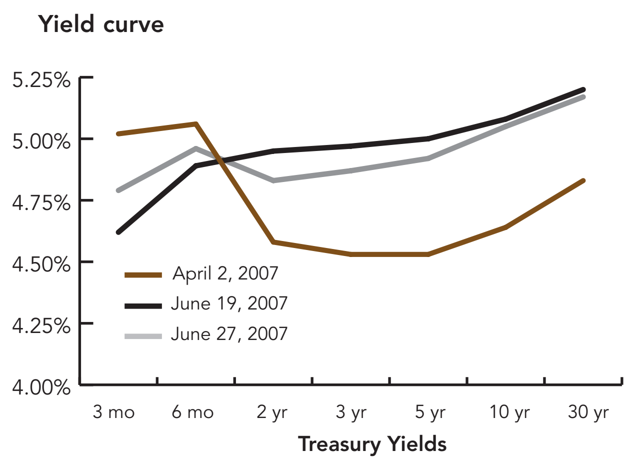
Stocks experienced some volatility during the quarter but generally remained resilient. Corporate profit increases for the quarter were expected to be in the four to six percent range. Wages continued to grow, a trend that could eventually act as a drag on earnings. That hasn't happened yet, and the Standard & Poor's 500 Index finished up 6.28 percent for the quarter and is now up 6.96 percent year-to-date through June 30.

Fixed Income

A sharp sell-off in the bond market drove 10-year Treasury yields up 75 basis points and brought an end to the year-long inverted yield curve. Two-year Treasuries stood at 4.95 percent as the quarter ended, and 10-year Treasuries reached 5.10 percent.

It was generally a difficult quarter for fixed income investors. While we don't rule out further sell-offs, we don't think it is likely that the next quarter will be as volatile. The good news is that bonds are now priced more fairly and are more competitive with stocks.

Riskier fixed income assets continue to be the best performers. The Lehman Intermediate High Yield Index returned 0.28 percent over the quarter, and is up 3.02 percent year-to-date through June 30. The run-up in high yield could mean that these assets don't have much more room to go.



Treasury yields rose in June after the economy's positive performance, ending the year-long inverted yield curve.

Real Estate

The residential housing market continued to struggle, with sales falling and inventories increasing. It may be awhile before housing pulls itself out of its funk. Mortgage loan underwriting terms have tightened up, taking some borrowers out of the market. Mortgage loan rates are also up.

Continued

During the housing boom, investors accounted for as much as 40 percent of sales in some states. They've now left the market and aren't likely to return. Many of the buyers who remain are biding their time waiting for further price decreases.

Fundamentals in the commercial real estate market remain strong across all major sectors. In a positive development for investors, Moody's rating agency recently tightened its commercial real estate debt ratings. More restrictive underwriting standards have been put in place, bringing discipline to the market.

REITs experienced weakness during the quarter. REITs compete with fixed income instruments and were dinged by the increase in bond yields. Investors who were using REITs to get on the bandwagon of the real estate sector's momentum are now moving out. This opens the field to asset managers who focus on fundamentals and use in-depth analysis to identify opportunities in individual companies.

Outlook

With the economy continuing to grow, and inflation not yet problematic, the Federal Reserve could for some time be in a holding pattern on rates. The Federal Reserve in the past has had a history of overreacting to short-term trends, and Chairman Benjamin Bernanke appears to want to change that.

The rise in gas prices and the burst of the housing bubble may have helped make the Fed's task easier, slowing growth and self-correcting the economy from overheating. We believe the economy continues to be close to equilibrium between growth and inflation, a recipe for a relatively stable investment environment over the second half of the year.

The S&P 500 dividend-adjusted Index is market-value weighted based on 500 common stocks, which are traded on the NYSE, AMEX and NASDAQ. The weightings make each company's influence on the performance of this index directly proportional to that company's market value.

The Economy and the Markets has been prepared for informational purposes only and is the opinion of Advantus Capital Management, Inc, a Registered Investment Advisor.

The Lehman Brothers High Yield Index covers the universe of fixed rate, non-investment grade debt. Pay-in-kind (PIK) bonds, Eurobonds, and debt issues from countries designated as emerging markets (e.g., Argentina, Brazil, Venezuela, etc.) are excluded, but Canadian and global bonds (SEC registered) of issuers in non-EMG countries are included. Original issue zeroes, step-up coupon structures, and 144-As are also included.

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