

McGladrey & Pullen
Certified Public Accountants

Sentinel Management Group, Inc.

Statement of Financial Condition

December 31, 2006

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McGladrey & Pullen

Certified Public Accountants

Independent Auditors' Report

Board of Directors of
Sentinel Management Group, Inc.

We have audited the accompanying statement of financial condition of Sentinel Management Group, Inc. as of December 31, 2006. This financial statement is the responsibility of the Company's management. Our responsibility is to express an opinion on this financial statement based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statement is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statement. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the statement of financial condition referred to above presents fairly, in all material respects, the financial position of Sentinel Management Group, Inc. as of December 31, 2006 in conformity with accounting principles generally accepted in the United States of America.

McGladrey & Pullen, LLP

Chicago, Illinois
March 30, 2007

Sentinel Management Group, Inc.
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Assets

| | | |
|-------------------------------------|-----------|---------------------------|
| Cash | \$ | 986,822 |
| Cash in segregation | | 2,159,184 |
| Securities, pledged | | 233,268,260 |
| Income taxes receivable from Parent | | 121,084 |
| Other assets | | <u>271,390</u> |
| Total assets | \$ | <u>236,806,740</u> |

Liabilities and Stockholder's Equity

| | | |
|---|-----------|---------------------------|
| Liabilities | | |
| Short-term bank loan payable | \$ | 230,628,000 |
| Loan interest payable | | 1,369,379 |
| Management fee payable to Parent | | 350,000 |
| Accounts payable and accrued expenses | | <u>1,201,009</u> |
| Total liabilities | | 233,548,388 |
| Stockholder's equity | | <u>3,258,352</u> |
| Total liabilities and stockholder's equity | \$ | <u>236,806,740</u> |

Sentinel Management Group, Inc.
Notes to the Statement of Financial Condition
December 31, 2006

Note 1 Nature of Operations and Significant Accounting Policies

Nature of Operations—Sentinel Management Group, Inc. (the "Company"), an Illinois corporation, is a special purpose registered futures commission merchant and registered investment advisor that earns fees for providing investment services. The Company specializes in providing custom cash management services primarily to participants in the futures industry, including futures commission merchants, and public and private trading funds. The Company is a wholly owned subsidiary of Sentinel Investment Group, Inc. (the "Parent"), an Illinois corporation.

Use of Estimates—The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Securities—Securities transactions are recorded on trade date. The Company purchases securities for customers and for its own account that are generally held in trust until maturity. As described in the Company's Form ADV, net investment gains from customers' securities sold before maturity are held in trust for the benefit of customers. Net investment gains from proprietary securities are included in revenue. Securities held in trust and proprietary securities are carried at cost plus accrued interest, net of related unamortized discounts or premiums.

Revenue Recognition—Service fees are recognized when earned and are based upon a percentage of assets under management. Interest income includes interest from investments in securities and amounts charged to customer accounts.

Income Taxes—The Company's taxable income is included in the consolidated tax return of the Parent. The Company computes a provision or benefit for current income taxes, and the resulting payable to or receivable from the Parent, as though the Company files a separate return. Deferred income taxes are recorded to reflect the effects of differences in the recognition of income and expenses for financial reporting and tax reporting purposes, primarily investment gains from customers' securities sold before maturity.

Translation of Foreign Currencies—Assets and liabilities denominated in foreign currencies are translated at year end exchange rates.

Stock-Based Compensation—The Company accounts for employee stock-based compensation (phantom stock awards) in accordance with the provision of SFAS No. 123 Revised, *Share Based Payment* ("SFAS 123R") which requires entities to measure the cost of employee services received in exchange for an award of equity based instruments based on the grant date fair value of the award, with limited exceptions.

Recently Issued Accounting Pronouncements—On July 13, 2006, the Financial Accounting Standards Board ("FASB") issued FASB Interpretation No. 48 *Accounting for Uncertainty in Income Taxes* ("FIN 48"). FIN 48 provides guidance for how uncertain tax positions should be recognized, measured, presented and disclosed in the financial statements. FIN 48 requires the evaluation of tax positions taken or expected to be taken in the course of preparing the Company's tax returns to determine whether the tax positions are "more-likely-than-not" of being sustained by the applicable tax authority. Tax positions not deemed to meet the more-likely-than-not threshold would be recorded as a tax benefit or expense in the current year. Adoption of FIN 48 is required for fiscal years beginning after December 15, 2006 and is to be applied to all open tax years as of the effective date.

Sentinel Management Group, Inc.
Notes to the Statement of Financial Condition
December 31, 2006

Note 1 Nature of Operations and Significant Accounting Policies, Continued

In September 2006, the FASB issued Statement of Financial Accounting Standard No. 157, *Fair Value Measurements* ("SFAS 157"). SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years.

At this time, management is evaluating the implications of FIN 48 and SFAS 157 and their impact of financial statements issued in subsequent periods.

Also in September 2006, the FASB issued Statement of Financial Accounting Standard No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans – an amendment of FASB Statements No. 87, 88, 106 and 132(R)* ("SFAS 158"). SFAS 158 requires an employer to recognize the overfunded or underfunded status of defined benefit pension and other postretirement plans, measured solely as the difference between the fair value of plan assets and the benefit obligation, as an asset or liability on the statement of financial condition. As a result of recognizing the funded status in the statement of financial condition, employers are required to recognize as a component of other comprehensive income, net of tax, the actuarial gains and losses and the prior service costs and credits that arise during the period and any remaining transition asset or obligation. Further, SFAS 158 requires that employers measure plan assets and obligations as of the balance sheet date.

Management is evaluating the implications of SFAS 158 and its impact on the Company's financial statements upon adoption during the year ending December 31, 2007, but is confident the Company will remain well capitalized following the reduction to stockholders' equity for this change.

Note 2 Customers' Cash and Securities Segregated and Held in Trust

At December 31, 2006, customers' cash and securities segregated and held in trust at a bank are as follows:

| | <u>Stated Value</u> | <u>Market Value</u> |
|--|-------------------------|-------------------------|
| Cash | \$ 189,638,000 | \$ 189,638,000 |
| Securities purchased under agreement to resell | 240,000,000 | 241,076,477 |
| Corporate notes | 914,781,844 | 917,687,590 |
| U.S. Government obligations | 4,936,878 | 4,959,672 |
| Mortgage-backed securities | 5,000,000 | 5,003,007 |
| Preferred stock | <u>49,597,950</u> | <u>49,032,500</u> |
| Total assets | <u>\$ 1,403,954,672</u> | <u>\$ 1,407,397,246</u> |

Total assets above include customers' cash and securities that are not reflected in the statement of financial condition, and securities pledged of \$207,608,000 for the short-term bank loan. Also, total assets above are net of \$2,070,873,121 of securities sold under agreements to repurchase.

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Notes to the Statement of Financial Condition
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Note 2 Customers' Cash and Securities Segregated and Held in Trust, Continued

At December 31, 2006, the aggregate fair value of collateral pledged under repurchase agreements is substantially equal to the aggregate carrying value.

The Company does not guarantee the rate of return to its customers. Additions and redemptions are based on amortized cost rather than market value.

Note 3 Short-Term Bank Loan

The Company has a loan agreement with a bank to meet short-term liquidity needs that bears a floating daily interest rate based upon the bank's stated short-term lending rate plus 3/4 percent (6.0625 percent at December 31, 2006). At December 31, 2006, the bank loan of \$230,628,000 was secured by securities pledged.

Note 4 Pension Plan

In 2004, the Company adopted a defined benefit pension plan (the "Plan") covering all eligible employees. The benefits are based on 8.25 percent of a participant's average monthly compensation and the total number of years of service prior to 2004 (up to a maximum of five years) and 1 percent of such participant's average monthly compensation and total number of years of service subsequent to 2003. Contributions from participants are not required under the Plan.

| | |
|---|---------------------|
| Fair value of plan assets at December 31 | \$ 459,187 |
| Benefit obligation at December 31 | <u>1,009,760</u> |
| Funded status | <u>\$ (550,573)</u> |
| Accrued benefit cost recognized in the statement of financial condition | <u>\$ 170,196</u> |

The accumulated benefit obligation for the defined benefit pension plan was \$202,456 at December 31, 2006.

| | |
|---|-------|
| Weighted-average assumptions used to determine benefit obligation at December 31, 2006 | |
| Discount rate | 6.0 % |
| Rate of compensation increase | 0.0 |
| Weighted-average assumptions used to determine net periodic benefit cost for year ended December 31, 2006 | |
| Discount rate | 6.0 % |
| Expected return on plan assets | 6.0 |
| Rate of compensation increase | 0.0 |

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Note 4 Pension Plan, Continued

The Company's pension plan weighted-average asset allocations at December 31, 2006 by asset category are as follows:

| | |
|---------------------------|--------------|
| Equity securities | 55 % |
| Mutual funds | 5 |
| Cash and cash equivalents | <u>40</u> |
| Total | <u>100 %</u> |

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

| | |
|-------|-------------------|
| 2007 | \$ 2,696 |
| 2008 | 3,655 |
| 2009 | <u>732,736</u> |
| Total | <u>\$ 739,087</u> |

The expected long-term rate of return on assets was selected from within the reasonable range of rates determined by projections of inflation over the long-term period during which benefits are payable to plan participants.

Funding of contributions is based on amounts allowed under the Employee Retirement Income Security Act of 1974 ("ERISA") as actuarially determined.

Note 5 Stock Based Compensation

On January 2, 2005, the Company established a phantom stock plan and awarded deferred compensation in the form of phantom stock rights. These rights are non-voting and vest over five years. They will be exercised and payable on the first to occur of death, disability, change of control, or retirement. The rights are expensed at the time of issue and are marked to the current value of the stock for each subsequent period. The fair value of the stock rights awarded during the year ended December 31, 2006 was \$5,504 per share and there are 12 shares of phantom stock rights outstanding as of December 31, 2006. Compensation payable at December 31, 2006 for the vested rights was approximately \$13,400.

Note 6 Commitments

The Company has entered into an operating lease agreement for office space expiring on December 31, 2008. The minimum rental commitments for office space at December 31, 2006, exclusive of additional payments that may be required for certain increases in taxes and operating costs, are as follows:

| | |
|-------|-------------------|
| 2007 | \$ 49,418 |
| 2008 | <u>50,974</u> |
| Total | <u>\$ 100,392</u> |

Sentinel Management Group, Inc.
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Note 7 Related-Party Transactions

The Company has a management fee agreement with the Parent to provide economic research, forecasting, and analysis in support of the Company's operations.

Note 8 Indemnification

In the normal course of business, the Company enters into contracts that contain a variety of representations and warranties that provide indemnifications under certain circumstances. The Company's maximum exposure under these arrangements is unknown, as this would involve future claims that may be made against the Company that have not yet occurred. Management of the Company expects this risk of loss to be remote.

Note 9 Concentration of Credit Risk

The Company enters into various transactions with financial institutions. In the event these counterparties do not fulfill their obligations, the Company may be exposed to risk. The risk of default depends on the creditworthiness of these counterparties. It is the Company's policy to monitor the creditworthiness of each counterparty with which it conducts business.

Note 10 Net Capital Requirements

The Company is required to maintain "adjusted net capital" of \$500,000 pursuant to "no-action" letters received from the Commodity Futures Trading Commission and the National Futures Association. Adjusted net capital changes from day to day, but at December 31, 2006, the Company had adjusted net capital of approximately \$2,724,000. The net capital requirements may effectively restrict, among other things, the payment of cash dividends, the making of unsecured loans and the purchase by the Company of its own stock.