Market Review and Outlook—September 12, 2006

No one knows. Are stocks overvalued? Will inflation rise further? Will the Fed continue to raise rates? Will the Republican Party lose the majority of one or both of the Houses of Congress? Is Iraq falling into a civil war? Will the market rise further by year-end? No one knows ... and that could be a good thing. When everyone thinks that they know what is going to happen, the unthinkable invariably happens. Healthy markets require both buyers and sellers, and buyers require optimism while sellers require pessimism. A balance of opinions is required for a stable market. By this definition, the current market is exceptionally stable, for no one knows where things are going!

In the past three months, during June, July, and August, the markets generally rose due to generally good news. The Israeli military action in Lebanon cooled down, and inflation fears also cooled down. While the housing market appears to be about to enter a free-fall, markets see a silver lining here, as a housing meltdown could lead to the end of increased Fed rate hikes—wouldn't that be nice!

During the past three months, bonds recovered, and income-linked stocks also did well (utility funds rose almost 9% and real estate surged more than 11%). This helped value funds leapfrog growth funds, +1.2% to –2.6%. Diversified portfolios strongly benefited from strong overseas results, as foreign stock funds rose more than 3%. Oil prices have begun to come back to earth, as have natural resource mutual funds, which actually fell in the past three months (by 2.4%).

The perennial question is what to do now. Our perennial answer is to rebalance your portfolio. In this 'No one knows' environment, we like for clients to stick to their long-term targets. We don't try to second-guess uncertain markets. If you have more stocks than your target, sell some and direct them to bonds/cash. If you have more in overseas stocks than your target, shift some to US stocks. We expect that investments which have done the best deserve a break, and we favor taking some profits and directing them into weaker sectors. This means that this year we have favored moving profits from smaller US stocks to larger US stocks.

We expect portfolio returns to be only moderate for several years; we don't expect home runs. We feel that the best long-term approach at this time is to spread your eggs in many baskets: cash, bond, and stocks—large, small, US and foreign. It is a fine time to sound like a broken record.

Category	3 Months	Past Year	3-Yr Avg	5-Yr Avg	10-Yr Avg
Money Market—Taxable	+1.11%	+3.76%	+2.00%	+1.73%	+3.39%
Intermediate Term Bond	+2.78%	+1.35%	+3.70%	+4.31%	+5.77%
Intermediate Muni Bond	+1.91%	+2.25%	+3.59%	+3.75%	+4.84%
Large-Cap Core Stock	+1.94%	+7.87%	+10.34%	+4.20%	+7.91%
Mid-Cap Core	-0.53%	+7.42%	+13.40%	+9.05%	+10.97%
Small-Cap Core	-1.90%	+7.33%	+14.68%	+10.54%	+10.93%
International Stock	+3.11%	+22.53%	+21.49%	+10.17%	+6.98%
Real Estate	+11.43%	+23.33%	+25.82%	+20.40%	+15.51%
Natural Resources	-2.42%	+12.47%	+30.66%	+20.13%	+13.96%
Science/Technology	-1.11%	+4.06%	+5.73%	+0.13%	+7.27%
Multi-Cap Growth	-2.59%	+4.03%	+9.14%	+4.07%	+7.14%
Multi-Cap Value	+1.18%	+8.73%	+14.76%	+9.84%	+10.90%
Balanced	+2.24%	+6.04%	+8.29%	+4.84%	+7.17%