Market Review and Outlook—December 11, 2006

No complaints here. **2006 is turning out to be a wonderful year for investors**, with gains in every major asset class. That is not to say that it has been boring—we have had the retirement of Alan Greenspan, sharply higher energy prices, a few months of slumping stock prices, a sharp decline in the booming housing market, two wars which are going poorly for the US, and a very contentious election which changed which political party is in charge of Congress.

Only two asset classes have lost money so far this year—Japan stock funds are down 4% and bear-market funds, those that bet that stocks will fall, are down 10%. In contrast, **several classes are up 20% or more, including most foreign stock sectors** including emerging markets and Europe, precious metals, (commercial) real estate, and utilities.

These strong results are due to mediocre economic backdrop, some sectors of the US economy are weak while others are strong. The lack of a strong direction means that the Fed can stand still—much of the market's strength is attributed to the end of the Fed's seemingly-endless quarter-point interest rate increases. Even the **'inverted yield curve'** can be read two ways. Traditionally it foretells a recession. However given that long-term US treasury interest rates are kept low by purchases by foreigners, there is an argument that the inversion is purely a timing anomaly, reflecting the likely reduction next year by the Fed of short-term interest rates, unrelated to any upcoming recession.

I like economic uncertainty, and mixed signals. I worry when all indicators point to a single direction, for I worry about the impact when so many people are surprised when that foregone conclusion does not come to pass. That is a recipe for a very painful market. In this environment, I turn down the volume on market seers, and hit the books.

US and foreign companies seem fairly priced at this time (with exception in the stronger areas including emerging markets) . I generally favor sticking to targets at this time. Some of the excessive prices from smaller companies were wrung out in this summer's market decline. I continue to favor large companies, largely due to their reasonable prices, more stable dividends, and greater access to global markets (which are more attractive with a weaker US dollar). For bonds, I am comfortable both with short– and intermediate-term bonds. **I expect 2007 to provide middle-of-the-road results**, 4 to 6% for bonds, 6 to 8% for stocks. While it may appear fairly boring, results like this can build very solid long-term returns.

The following data, reflecting results through 11/30/2006, comes from Morningstar's Principia Pro.

Category	3 Months	Past Year	3-Yr Avg	5-Yr Avg	10-Yr Avg
Money Market—Taxable	+1.18%	+4.21%	+2.35%	+1.83%	+3.39%
Intermediate Term Bond	+2.60%	+5.48%	+3.86%	+4.58%	+5.45%
Intermediate Muni Bond	+1.68%	+4.80%	+3.16%	+4.18%	+4.64%
Large-Cap Core Stock	+7.72%	+13.28%	+11.28%	+5.94%	+7.52%
Mid-Cap Core	+8.64%	+14.11%	+13.83%	+11.38%	+10.92%
Small-Cap Core	+8.99%	+14.68%	+14.35%	+12.95%	+11.20%
International Stock	+7.06%	+27.17%	+20.32%	+12.76%	+7.04%
Real Estate	+12.60%	+36.22%	+27.10%	+23.89%	+15.82%
Natural Resources	+5.50%	+18.43%	+31.29%	+23.19%	+13.40%
Science/Technology	+10.32%	+8.36%	+6.15%	+1.47%	+6.48%
Multi-Cap Growth	+8.52%	+8.09%	+9.05%	+4.56%	+6.51%
Multi-Cap Value	+7.77%	+16.35%	+14.25%	+10.08%	+9.51%
Balanced	+5.56%	+10.82%	+8.68%	+5.90%	+6.69%