Market Review and Outlook—June 12, 2007

OMG (or Oh My Gosh to those over 25 years of age), what a run! In the past three months stocks of all stripes gained 8-10%. I consider 8% a wonderful return for twelve months—your portfolio has earned a nine-month vacation!

Why did it happen? I can offer my best guesses. The housing decline has not yet led to consumers closing their wallets. Neither have oil's price hikes and gasoline hitting record levels caused consumers to stay home. Corporations have continued to grow their earnings, and their strong balance sheets make them less susceptible to a little economic weakness. Mergers and acquisitions and stock buybacks have cut the supply of stocks, and investors chasing hot sectors have increased demand for stocks. Together, this creates a strong market, where you can earn a quick return.

Where are we heading? Last week the market finally fell back, after a fairly steady three-month march upward. This was partially due to the Fed explaining that it is more worried about inflation than a recession, and therefore interest rates will likely rise rather than fall in the coming months. Higher interest rates hurt stocks in two ways: they increase the companies' cost to borrow money, and they increase the attraction of investing in bonds (and selling stocks in order to buy these higher-yielding bonds). I think that investors were looking for a reason to take some of their 'winnings' off the table, to take profits that they had not expected so soon this year. There is still a likelihood that stocks will rise further by year-end, however this likelihood is much smaller than it was three months ago.

What should you do? My answer is unchanged: examine your portfolio and rebalance, cutting back areas where the strong 2007 returns have resulted in you drifting off course. This naturally harvests gains from your stronger areas and adds to areas that are at better prices.

I will be returning to a neutral stand on large versus smaller US companies. I am relieved that real estate funds (finally) fell back, but would like to see further declines before I return there. International stocks have enjoyed a tremendous year; I favor rebalancing, but not yet under-weighting these. Growth may finally be asserting itself. An all-weather strategy continues to feel right—balance in all things, regular rebalancing of your portfolio when it gets out of line. This approach side-steps both the highest highs and lowest lows, while delivering fairly steady results.

The following data, reflecting results through 5/31/2007, comes from Morningstar's Advisor Workstation product.

Category	3 Months	Past Year	3-Yr Avg	5-Yr Avg	10-Yr Avg
Money Market—Taxable	+1.18%	+4.71%	+3.12%	+2.14%	+3.28%
Intermediate Term Bond	-0.32%	+6.21%	+3.96%	+4.43%	+5.48%
Intermediate Muni Bond	-0.37%	+3.70%	+3.45%	+3.74%	+4.52%
Large-Cap Blend Stock	+8.94%	+21.15%	+12.92%	+8.97%	+7.49%
Mid-Cap Blend	+9.32%	+22.03%	+16.30%	+12.94%	+11.30%
Small-Cap Blend	+8.38%	+18.36%	+16.27%	+13.07%	+11.52%
International Stock	+9.53%	+25.66%	+22.32%	+14.91%	+7.61%
Real Estate	-0.83%	+29.78%	+25.58%	+21.57%	+14.93%
Natural Resources	+16.27%	+16.58%	+29.41%	+22.22%	+13.43%
Technology	+8.27%	+18.08%	+9.25%	+8.60%	+6.57%
Lipper Multi-Cap Growth	+9.56%	+19.21%	+12.35%	+9.41%	+7.55%
Lipper Multi-Cap Value	+9.13%	+22.89%	+15.53%	+11.10%	+9.55%
Conservative Allocation	+3.11%	+11.08%	+7.14%	+6.43%	+5.78%