

## May 2006 Market Observations

Given our 21 years in business as an investment advisory firm, it doesn't surprise us that many in the media and elsewhere get anxious when markets violently decline as they have in the past few weeks. All markets are volatile at times, but it is only when they are volatile on the down side that people really take notice. Today's market environment seems to qualify.

Optimists may characterize the recent decline as a "correction"; in fact, we haven't experienced a 10% correction since the market began recovering in 2003. Pessimists may believe the decline is the beginning of another cyclical bear market, a decline of 20% or more. Time will tell, and economic signals are mixed.

What is certain is that interest rates have been rising since June of 2004, but what hasn't received a lot of coverage is that they were abnormally low for an extended period of time. Low interest rates were necessary to fend off serious crises in an unbalanced world economy that flirted with deflation in 2003. However, low interest rates foster speculation and investment bubbles. Speculative money moves from stocks to bonds to real estate to commodities and currencies as "investors" reach for yield. People take on additional risk without really understanding they are doing so. Hedge funds pile-on and bubbles get extended, then either dissipate (correct) or burst (cyclical decline). Put simply, low interest rates morph some investors into speculators as they chase yield.

The reality is that markets, by nature, are volatile. Risk comes in many forms, and risk aversion is one of our primary concerns. That is why we take a balanced approach. Even though the market tide "will lower or raise all ships" a balanced approach can "cut-through" a lot of the downside and conversely, capture most of the upside.

At the end of the day, we have years of experience working in "difficult" market environments of all stripes and we will continue to focus on your objectives and our fiduciary responsibility to you, our valued clients.

Sincerely,

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