



2ND QTR 2006

A client recently asked when his bond portfolio will stop bleeding. Even though the bond bear market began seventeen interest rate hikes ago, this has not been your father's bloody bear market; at least not like 1994. The carnage has mostly been within the short maturity range; intermediate and long term bond yields have barely budged. The streak of rising interest rates is the Federal Reserve's longest since the 1970's.

Corporate bonds lost -1.3% on average this year – hardly a bloodbath, never-the-less, the worst total return since 1998 according to Merrill Lynch. It's no wonder that with rising inflation and additional rate increases, the bond market had no where to go but down in value.

The sector winner was municipal bonds. Stodgy, dull, munis ended up in the winners circle so far this year. The reasons are most logical; property tax and sales tax revenues have increased which is credit supportive. Demand is brisk and wealthy investors appear to be satisfied by avoiding event risk occurring with corporate bonds.

Meanwhile, it's important to remember rising interest rates are not a U.S. phenomenon; at least sixteen central banks have recently raised rates. This global occurrence conveys the strength of the global economies.

When you think about the Fed's position which is to maintain economic growth, avoid a hard landing and contain inflation, they've done a pretty good job. Most investors and pundits have negative things to say about the Fed, being optimistic appears to be the contrarian position; which is where I stand.

We, in the real world, see signs of slower growth in housing and consumer spending. Employment growth is ebbing and the Index

of Leading Economic Indicators has declined three out of the past four months.

Index of Leading Economic Indicators

A monthly measure of the future state of the economy, issued by the Conference Board. The index is a compilation of such items as unemployment, new business formation and factory orders. Officially named the Composite Index of 12 Leading Indicators, this index has a good record of providing accurate forecasts.



Our last Investment Outlook speculated that the Federal Reserve is closer to the end of its tightening cycle than the middle. They don't want to overshoot thereby putting the economy into a recession. It's a fine line between the two but they can walk it.

My words of wisdom are to enjoy the rest of your summer. The worst is over for this interest rate cycle.

All the best,

Marilyn