

**Perspectives**  
**Second Quarter – 2006**  
June 30, 2006

*Market Snapshot*

	Close on 6/30/06	Quarterly Performance	Year to Date
Dow Jones Industrial Average	11150.22	+0.94%	+5.22%
S&P 500 Index	1,271.92	-1.44%	+2.71%
NASDAQ Index	2,172.09	-7.01%	-1.08%
Lehman Bros. Aggregate Bond		-.08%	- .72%
Crude Oil (WTI)	\$73.93	+6.90%	+12.70%
3 Month T-Bill Rate	5.04%		

*Market Summary and Opinion*

The heady growth rate of the S&P 500 Index in the first quarter of '06 did not continue into the second quarter as it fell -1.44%. Fears of inflation, partly due to higher energy prices, uncertainty regarding the sustainability of corporate profits, a softening of the housing market, and troubling behavior by North Korea and Iran held the market in check.

The top performing market sectors included utilities, media and energy. The worst performing sectors included hardware, software and consumer services. Large cap value stocks grew only 0.59%, and outperformed all other major asset classes. The bond market continued to slide, reacting to the latest rise in interest rates.

Federal Reserve actions continued to be a top story. In June, the Fed raised interest rates to 5.25%, its 17<sup>th</sup> consecutive increase since June 2004, with no clear indication when it will stop. The question ahead is when this long streak of interest rate increases will end. Fed Chairman Bernanke's June 5<sup>th</sup> speech gave the markets some hope when he stated: "the anticipated moderation of economic growth seems now to be underway." The Fed's recent comments softened the outlook a bit, but an August 8<sup>th</sup> hike to 5.5% is priced in to the market with a two-thirds probability.

The Fed's goal has been to find the level of interest rates that will slow the economy's growth rate just enough to restrain inflation, but not enough to harm the economy. Economists call this maneuver a "soft landing". History tells us that the Fed generally errs on the side of inflation control.

Many investors worry the surge in energy prices, coupled with the ongoing softening in housing prices and Fed tightening could increase the chances of an economic recession. Also, they fear the return the "stagflation" of the 1970s brought about by simultaneous rising prices and an economic slowdown, which is bad for both stocks and bonds. A 20% jump in gas prices from the first quarter to the second quarter required consumers to shell out an additional \$60 billion at the pumps for the same amount of gas.

Not all the news is bad, though. The US dollar is bouncing back, thanks in large part to the Fed's anti-inflationary stance. The Fed shifted global financial market perceptions and many now expect interest rates to keep rising. If the US rates rise faster than those in Europe and Japan, the dollar is likely to keep strengthening and keep import prices in check.

Also, for the past three years, US companies have been making a great deal of money which has supported the stock market. The second quarter earnings reports will likely bring more of the same, with companies in the S&P 500 index forecast to generate earnings growth of 12.3% according to Thompson Financial. That would be the 12<sup>th</sup> consecutive quarter of double-digit profit gains – a run that has only been bettered once since 1950. Finally, despite the recent slowdown in job growth, labor markets remain tight, with the jobless rate at a low 4.6%, implying the economy remains strong.

Our team will continue to work diligently to position your portfolio to maximize your return and limit your risk. We are available to answer any questions you may have. Thank you for your business and the trust you have placed in our management of your assets.

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