

# Perspectives

September 30, 2006



## Perspective on the 3rd Quarter

The S&P 500 Index regained some of its momentum from the spring with an overall gain of 5.67% for the third quarter. Lower oil prices reduced production costs and became a positive factor for many companies. At the sector level, strong gains were seen in technology, utilities, and financial services stocks. Weakness was observed in the energy sector as the price for crude oil fell from its mid-July peak of \$79 per barrel to \$62.91 by quarter end.

When oil prices were in the seventies, the Federal Reserve's concern was that high energy costs could fuel inflation as businesses passed through price increases on their goods. Lower oil prices have helped ease inflationary pressure on the market. In response, the Fed left the Fed Funds rate at 5.25% at its September 20th meeting. The outlook for inflation is mixed as consumer spending remains strong amid ongoing weakness in housing prices.

The bond yield curve plots Treasury securities, showing the range of yields from the 3 month Treasury bill to the 30 year bond (see diagram). The Fed's moves on interest rates directly affect the bond yield curve. The September 29th 6-month Treasury bill yielded 4.82%. The 30 year bond had a lower yield to maturity of 4.76%. We feel that the market is not compensating investors for the additional risks of long term bonds. Our clients' portfolios include mostly shorter-term bonds for this reason.

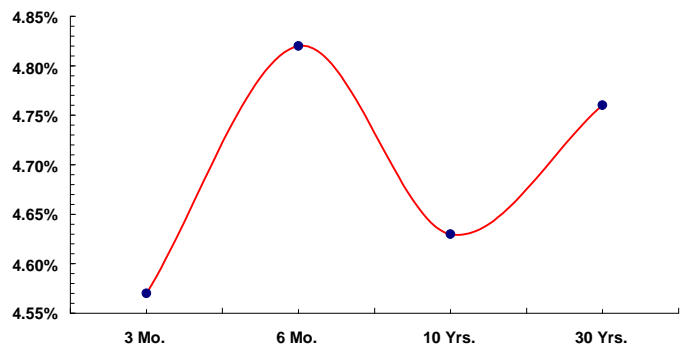
Thank you for the trust you continue to place with us in our management of your portfolio. Please feel free to call us if you have any questions or concerns.

**Buddie Ballard, CFA    Michael Turner, CFA    Richard Archer, CFA**

Index Returns		
	3rd Quarter	Year To Date
S&P 500 Index	5.67%	8.53%
Dow Jones Industrial Avg.	4.74%	8.97%
Morningstar Mid Core	2.34%	5.95%
Morningstar Small Core	1.17%	11.50%
Lehman Bros. Agg. Bond	3.81%	3.06%
MSCI EAFE Int'l Index	3.93%	6.63%

Economic Data		
	3rd Quarter	2nd Quarter
Fed Funds Rate	5.25%	5.00%
Oil Price Per Barrel	\$62.91	\$75.81
6 Month Treasury Bill	4.82%	5.03%
10 Year Treasury Note	4.63%	5.14%

U.S. Bond Yield Curve



## Perspective on our Equity Portfolio Management Styles

For our equity portfolio management, Alpha Capital Management is guided by our proprietary quantitative model which is based on our application of a Constant Proportion Portfolio Insurance (CPPI) discipline. We place a heavy emphasis on quality of earnings, current cash flows, history of growth, strong businesses with reasonable or no debt, and good future sales prospects.

Our quantitative model performs fundamental and technical screens on each member of the S&P 500 Index. Companies that meet our criteria are then ranked, sorted, and assessed for applicability to specific portfolios. Individual efficient portfolios are constructed based upon Markowitz diversification methodologies in an effort to limit systemic risk. A rigorous sell discipline is enacted upon violation of our model criteria.

Alpha Capital Management's All Cap Core and Equity Income portfolios are each comprised of 20-30 companies. The All Cap Core portfolio focuses on growing companies with less regard for dividends while the Equity Income portfolio is built with high-quality, dividend-paying stocks that provide a growing level of cash flow with the potential for price appreciation. Equity Income portfolio companies have generally displayed a history of raising their dividends 5% - 10% annually.

For both portfolios, at the time of purchase we will not invest more than 5% of a portfolio's market value, specifically the funds committed to common stocks, to the common stock of a single corporation. The portfolios are diversified among the nine industry groups of the S&P 500 Index based on our outlook for the market. Additionally, no more than 20% of a portfolio, at market value, may be committed to a single industry at the time of purchase.

It has been our observation that at varying points of a given market cycle, our performance may outperform or underperform depending on market conditions. Periods of underperformance typically occur when the market seems to favor lower quality companies. This condition seems to have occurred during the summer months of 2006. We are staying with our discipline of focusing on higher quality companies. By doing so, we have found we increase our clients' probability of outperforming the market over the long term.