

Investment Matters

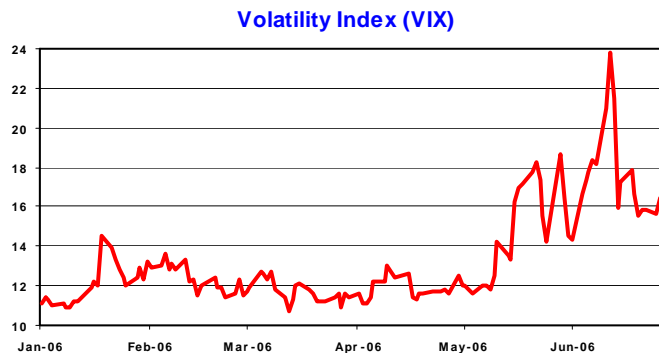
For the quarter ended June 30, 2006

Less Appetite for Risk

Foreign, energy and commodity stocks, the hot performers of 2004 and 2005, fell sharply in May and June. At the same time, bonds and other conservative investments, which have had lackluster returns for the past few years, held their value or even moved up. Market risk, as measured by the Volatility Index, rose sharply.

This "flight to quality" by investors was brought on by concerns about rising short term interest rates and their potential to slow economic growth. In the U.S., the new Chairman of the Federal Reserve, Ben Bernanke, is wrestling with the question of whether to raise rates further in order to stem inflation or to pause long enough to determine if the two year series of rate increases from 1% to 5.25% was enough to do the job. The fact that Mr. Bernanke is new on the job and has given some conflicting indications of his concerns added to the uncertainty.

Inflation is a secondary concern. While inflation measures have ticked up recently there is little



A "FLIGHT TO QUALITY" TOOK PLACE AS MARKET VOLATILITY INCREASED IN MAY AND JUNE

indication of real wage pressure, and businesses are not having much success raising prices. As long as the worldwide supply of labor continues to grow strongly, inflation will have a hard time taking hold.

"other central banks around the world have joined the Fed in raising interest rates."

Alan Greenspan faced the issue of when to stop raising rates three times in his eighteen year career as Fed Chairman. Each time he stopped, inflation indicators continued to rise for months after, but eventually subsided. The

Fed is well aware that it takes six months or more for its actions to work their way into the economy.

Less well known but equally important to financial markets is the fact that other central banks around the world have now joined the Fed in raising interest rates. This raises the risk that what has been a synchronized global economic expansion could turn into a synchronized slowdown. As traded goods and services have become a bigger part of the world economy, world financial markets have become increasingly interdependent.

Freedom & Prosperity

The Pacific Research Institute, a free market think tank, recently released a state-by-state study showing a strong correlation between economic freedom and prosperity.

The study looked at 143 variables such as tax rates, state spending, number of state agencies, occupational licensing, tort reform, wage laws, etc. It then ranked each state by its level of imposition on economic activity. Texas, Colorado and Arizona were well ranked while California and New York finished last.

The study also looked at income per capita. After adjusting for education and age levels, the study found that more economic freedom was associated with higher income per capita. They estimated that a 10% improvement in a state's economic freedom score yields about a 0.5% increase in annual income.

Other similar studies of economic policies and prosperity, done on a country-by-country basis, have reached the same conclusion.

Oil Realities

"Presidential" Cycle Promising

Since World War II, the Dow has been up 46% on average from the low in the second year of a presidential term to its high in the fourth year.

21st Century China

In 1996 the Chinese owned seven million cell phones. By 2005 they had 360 million.

The U.S. annually consumes about 7 billion barrels of oil (BBO) and 11 BBO equivalents (BBOE) of coal, natural gas, uranium and hydroelectric power. Over 80% of this comes from North America. The U.S., Canada and Mexico also produce 60% of the oil we consume. Less than 1 BBO of the oil we use is produced by Persian Gulf states. While this is nearly 15% of our total oil use, it's only about 5% of our annual energy consumption.

The major rationale for oil use is that liquid hydrocarbons are relatively cheap, efficient and easy to transport. This is especially important for vehicle power. Passenger cars alone burn about 3 BBO per year.

Finding better ways to power our vehicles would greatly help reduce our dependence on foreign oil. Most of the progress on this goal is likely

to come from shifting to existing energy sources which are already available and relatively cheap.

Fleet vehicles (trucks and busses) can be economically powered by natural gas, much of which is currently used to produce electricity. By switching electricity production to new clean burning coal technologies and nuclear power, more gas can be made available for transportation. Additional electricity production from coal and nuclear power could also be used to power electric cars, at least in urban areas.

Tar sands in Alberta, Canada are also a promising source of oil. They are estimated to contain over 1,000 BBO, much of which is already accessible with current technology.

Though ethanol substitution is relatively new, we already use over 10% of the entire

U.S. corn crop to produce only 0.05 BBOE of ethanol for vehicle use. Additionally, U.S. taxpayers provide subsidies for farmers to grow the corn and a \$.51 per gallon subsidy for ethanol production. Without these subsidies, ethanol would not be able to compete at the pump.

Fuel cells, which use hydrogen and produce only water as a by-product, are often touted as the ultimate answer for powering electric cars of the future. Fuel cell technology is many years away from being able to compete with gasoline engines on a cost basis. Additionally, the U.S. only produces about 0.1 BBOE of hydrogen per year, and that at a cost which is far above the energy equivalent cost of oil. Hydrogen is also difficult to transport and store.

Based on an article by Peter Huber. WSJ, 2/3/06

The Bottom Line

Market Indicator	Current Value	One Year Change
Large company stocks (S&P 500 Index)	1270	+8.6%
Small company stocks (S&P Small Cap Index)	363	+13.9%
Short term interest rates (3 Month T-Bill Yield)	4.9%	Up from 3.0%
Long term interest rates (10 Year T-Bond Yield)	5.1%	Up from 4.0%
Inflation (Consumer Price Index)	201.9	+4.1%
Energy (West Texas Intermediate Crude Oil)	\$73.77/bbl.	+31%
The economy (Inflation adjusted GDP)	\$12.5 trillion	+3.6%

QUOTABLE

"In the short run the market is a voting machine. In the long run it's a weighing machine."

Warren Buffett

Robshaw & Julian Associates, Inc.
6255 Sheridan Drive, Suite 400
Williamsville, New York 14221
Tele: (716) 633-6555
E-mail: info@robshawjulian.com
Website: www.robshawjulian.com