

# 3<sup>rd</sup> QUARTER 2006

## **DOW AND S&P 500 POST BEST QUARTERLY GAINS IN OVER A DECADE !**

*A huge 3<sup>rd</sup> Quarter stock rally propelled the Dow Jones Industrial Average to near an all-time high and produced the best 3<sup>rd</sup> quarter gains for the Dow and the broader S&P 500 indices in more than a decade. Largely ignored by the media, this rally was prompted by tumbling oil prices (down \$10 per barrel), continued strong corporate earnings, continued low inflation, strong consumer spending and bargain basement stock prices.*

*We expect that this rally will continue into the 4<sup>th</sup> quarter, and at the risk of sounding like a broken DVD (notice the update to this cliché), our forecast for 10% stock market gains this year remains unchanged. You will be pleased with your September Schwab statements.*

### **INVESTMENT REPORT**

Stocks surged in August and September in a near repeat of the 3<sup>rd</sup> quarter of 2005. Major stock indices around the world produced large gains, as seen in our normal benchmark indices below. The leader so far this year is the EAFE index which measures stock performance in the major, developed countries in Europe and the Far East: up 12.2% YTD. While the Nasdaq underperformed other indices this quarter and year-to-date, it is still up an astounding 95% since the lows of 2002. With the interest rate decline during the quarter, U.S. bond indices gained ground, approaching bank CD rates of return YTD.

	<u>3<sup>rd</sup> Qtr. 2006</u>	<u>YTD 2006</u>
<b>Dow 30</b>	<b>5.4%</b>	<b>10.9%</b>
<b>S&amp;P 500</b>	<b>5.7%</b>	<b>8.6%</b>
<b>Nasdaq</b>	<b>4.0%</b>	<b>2.4%</b>
<b>Russell 2000</b>	<b>1.9%</b>	<b>8.7%</b>
<b>EAFE (Foreign Stocks)</b>	<b>3.4%</b>	<b>12.2%</b>
<b>Lehman Aggregate (Bonds)</b>	<b>3.8%</b>	<b>3.0%</b>

### **SAM OUTLOOK**

After the June gloom and doom, almost no major market mavens forecast the tremendous 3<sup>rd</sup> quarter rally. So why were we so optimistic and why do we remain positive for the near-term? Stocks still look cheap! And, there is still around \$2 trillion in brokerage account money market funds. Real estate and other investment alternatives look very expensive. While slowing from an unsustainable pace, the

economy is still very strong. In fact, it's not just our economy that is strong, but most of the world's major economies as well.

We believe we are now in the second half of a huge bull market cycle. It is during the second half of bull markets that the major money moves into the market, propelling stock prices to record highs. Of course, at some point it will be necessary to reduce our stock exposure and become more conservative. We're not there yet! The 4<sup>th</sup> quarter of each year is usually the best quarter for the year. During mid-term election years, market gains are even better. We believe that this quarter will produce at least normal rates of return, easily allowing us to meet our double-digit stock forecast.

As for interest rates and the bond arena, the picture is cloudy at best. About half of the normal indicators call for rising rates, and the other half call for falling rates. In this situation, we are still not inclined to invest in bonds. (SEE SAM STRATEGY BELOW)

### **SAM STRATEGY**

We remain near the maximum allowable allocation for stock in each of our investment strategies. We will remain broadly diversified for investment safety, but we expect to increase our allocation to the large companies represented by the S&P 500, and to the international sectors. We are watching the energy sector for significant declines and a possible entry point.

Our avoidance of bonds has proven correct so far this year. In our *Balanced Stock & Bond* and *Conservative* strategies, CD's and institutional money market funds have produced greater rates of return than bonds. There is little incentive to take much risk in bonds, when risk-free investments are producing higher rates of return.

### **PORTFOLIO REBALANCING**

During the 4<sup>th</sup> quarter, we rebalance client portfolios in order to bring them back into alignment with our strategies, and to implement strategic changes to our models. You will see more trading activity during this period. **With this year's stock gains, we anticipate that taxable gains will be higher than normal. For taxable accounts, we try to minimize tax impacts. If you need taxable gains to off-set accumulated capital losses, please let us know as soon as possible.**

**IMPORTANT NOTE: If you are planning to make a large withdrawal from your account at any time during the year, please let us know as soon as possible for investment planning purposes.**

### **YEAR END PLANNING**

*It's Less Than 90 Days To Year-End! Time to start thinking about...*

- **Tax planning:** Schedule an appointment with your CPA or tax preparer
- **IRA and retirement plan contributions:** Be sure to fund by the deadlines
- **RMD's (Required Minimum Distributions):** Charles Schwab will notify clients who are 70½ or older in 2007 of the Required Minimum Distribution (RMD) from all types of IRA accounts. The RMD must be taken this year in order to avoid severe penalties, and can be taken in periodic payments or in a lump sum. If you have any taxable account with us, we can arrange to have the RMD amount (either in cash or securities) directly transferred from your IRA to your personal account- no hassle! Just call our office at 658-5193, toll-free 1-877-658-5193.

## **GIFTING**

Don't give your favorite charity another dime! That is, don't give cash! There are major advantages in donating appreciated securities instead of cash. When you donate an appreciated security, you don't have to pay capital gains tax on the gain, and generally, you get a tax deduction for the full value of the security on the day it is donated. Giving appreciated securities instead of cash can save you hundreds or even thousands of dollars, versus a cash gift. See your CPA or tax preparer to see if you should take advantage of this unique way of giving.

Stock or mutual fund gifts to a charity's brokerage account can take from several days up to several weeks. If you are planning on making a securities gift in 2006, please let us know before November 28<sup>th</sup> to insure that your gift will be made prior to year-end.

***“A generous man will prosper; he who refreshes others will himself be refreshed.”***  
**Book of Proverbs 11:25**

**HOLIDAYS:** 'Twill soon be the time of many holidays. We will be closed for Thanksgiving on Thursday & Friday, November 23<sup>rd</sup> & 24<sup>th</sup>, for Christmas on Monday, December 26<sup>th</sup> and for New Years on Monday, January 1st.

***Sierra Asset Management ended the 3<sup>rd</sup> quarter with a record \$71 million in client assets under management. We sincerely appreciate your business and the many wonderful referrals this year. If you would like us to send a SAM company brochure to give to someone who you think could benefit from our service, please give us a call toll-free at 877-658-5193.***