

UP 4 YEARS IN A ROW!

DOW, Russell 2000 Hit All-Time Highs!

It was a really tough year for doomers & gloomers as the Dow Jones Industrial Average and the Russell 2000 small company index hit new all-time highs, while the S&P 500 was just shy of a new record. Will stocks go even higher in 2007? We believe we are now in the second half of a long bull market run, so there is still a lot of money to be made. However, some strategic stock adjustments will be necessary (See SAM OUTLOOK and SAM STRATEGY below).

INVESTMENT REPORT

A huge rally that began in July boosted stocks around the world to record highs in 2006, with nearly all major global stock indices up double digits for the year. Despite Wall Street forecasts for only 3.5% stock gains in 2006, this was not the year to be out of the stock market. Including dividends, the Dow Jones Industrial Average was up 19.0%, the Russell 2000 small company index was up 18.4%, the broad-based S&P 500 climbed 15.8%, and the Nasdaq was up 9.5%. The Lehman Aggregate Bond index gained 4.3%. Notice that every number for the last four years is a positive number:

	<u>2006</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>
Dow 30	+ 19.0%	+ 1.6%	+ 5.3%	+ 28.3%
S&P 500	+ 15.8%	+ 4.8%	+10.8%	+ 28.7%
Nasdaq	+ 9.5%	+ 1.4%	+ 8.6%	+ 50.0%
Russell 2000	+ 18.4%	+ 4.5%	+18.3%	+ 47.3%
Lehman Aggregate (Bonds)	+ 4.3%	+ 2.4%	+ 4.3%	+ 4.1%

The yield on long-term bonds, 1-year CD's, and institutional money market funds were all about the same! Around 5%. This is called a flat yield curve. The flat yield curve and lower than expected inflation produced modest bond returns for the year. The housing bubble didn't burst, but real estate prices did drop 10% to 20% last year (depending on location), after doubling or tripling over the prior five years. Some of the real estate investment money clearly moved into stocks.

Have you visited our website? In addition to 24/7 access your Schwab account (once you sign up for that free service), there are many helpful resource links: www.SierraAM.com

SAM OUTLOOK

The economy and history are great long-term predictors of stock and bond performance. Here are our key predictions that we feel will influence investments for 2007 and beyond:

- A slowing economy will keep inflation in the 2% range in 2007
- With stable interest rates, the economy will experience a “soft landing” (no recession); then as the economy heats up, expect a rate increase late in the year
- For the third year in a row, bonds will not out-perform CD’s or money market rates
- Housing prices will decline another 5% to 10%
- Continued good news on wages, jobs, and consumer spending
- Low prices relative to earnings and fewer stocks available (due to merger & acquisition activity and corporate buy-backs) will cause stocks to rise in 2007
- Larger, dividend-paying, consumer staple stocks will outperform small company stocks
- Technology weakness will continue because there are few “block-buster” breakthroughs on the horizon, and competition is fierce
- The globalization of companies will virtually eliminate the concept of “foreign companies” over the next 10 years
- Developing Asian economies will continue to grow
- The dollar will continue to weaken against the Euro and most Asian currencies, boosting U.S. exports to record levels
- Growing debt and deficit spending will eventually dampen economic growth

As we enter the second half of a long bull market cycle, the economy is clearly slowing. With a backdrop of low inflation and low unemployment, corporate earnings will continue to grow, but not at the torrid pace of the last three years. Stocks are still a bargain, and earnings growth will continue to propel stock prices higher in 2007 and higher still in 2008.

OUR 2007 FORECAST (not guaranteed!): *U.S. and international stocks will post a fifth year of gains for 2007. For the first time in four years, our forecast is in line with the Wall Street consensus: +9.5%. Short and long term interest rates may decline slightly in the spring, and start rising during the fourth quarter, with bond returns up 4% or less for the year.*

SAM STRATEGY

In light of the above forecast, these are some of the major changes in our strategy that have been, or will be made, for 2007 in your account. Your December statement may show an abnormal amount of cash in the high-yield money market fund, as we are waiting until January to finish our rebalancing. **In general, we are moving toward a more conservative position:**

- Eliminate Nasdaq holdings- We do not have one buy rating on any of the top 10 Nasdaq holdings, reflecting our continued concern for the tech sector
- Reduce our smaller company holdings
- Increase our holdings in larger, dividend paying stocks
- Increase our holdings in international stocks, both in Europe and in Asia

- Reduce our stock holding in our *Aggressive Stock & Bond* strategy from 95% to 75%
- Reduce our stock holding in our *Balanced Stock & Bond* strategy from 70% to 60%
- Continue our very successful strategy of using CD's and high-yield money market funds as "bond substitutes" in our stock & bond portfolios
- However, buy rising rates bond funds during any significant interest rate decline

EXPECT LARGE 2006 CAPITAL GAINS

Taxable accounts will experience significant gains for 2006- the highest since 2003. Unlike 2003 (where accumulated losses from 2000 – 2002 offset gains), there will be few if any losses to offset this year's gains. If you would like an estimate of 2006 realized gains emailed or faxed to you please call or email our office.

2006 TAX REPORTS TO BE MAILED BY SCHWAB

In February, Charles Schwab will mail **2006 Form 1099** interest/dividend reports for taxable accounts. For individual stock and bond sales, you will receive a *GAINS/LOSS REPORT* and for mutual fund sales, a *MUTUAL FUND AVERAGE COST BASIS REPORT*. Partnership or private placement information will be forwarded to you as soon as Schwab receives it-- usually in early March. **Please look for these reports in the mail and give them to your tax preparer.**

REQUIRED DISCLOSURES

Sierra Asset Management's *Privacy Notice* and *Proxy Voting Policy Summary* are enclosed with this bulletin. If you have any questions, please contact us. During the 1st quarter of 2007, we will update our *U.S. Securities & Exchange Commission Form ADV*. While we anticipate only minor updates to this registration, you may request a copy by calling or sending an email.

PAPER? OR, NO PAPER?

Charles Schwab is now offering all clients the choice of receiving statements and trade confirmations via the Internet only. For our more computer savvy clients, this may be a good option: Your individual stocks trade costs are lower, you have a 10 year archive of statement and tax information, and earlier delivery of account trades and statements. If you already are on-line with Schwab, go to www.schwab.com/sa_edocuments and click the delivery preferences tab to go paperless. If you do not have online access to your accounts and want this feature, call our office for instructions.

THANK YOU FOR HELPING US GROW! *We start this year with a record \$75 million under management, up 23% in 2006. We really appreciate your business and the trust and confidence that you have placed in us. We also appreciate your referrals. Please think of us when you talk to your friends, relatives and business associates.*

