



# Park Piedmont Advisors LLC

Registered Investment Advisor

VICTOR LEVINSON

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## JULY 2006 COMMENTS

### **CHECKING ACCOUNT and CREDIT CARD FACILITIES:**

You can have both a checking account and credit card from National Financial Services (NFS), the custodian of the securities in your accounts managed by Park Piedmont Advisors (PPA). NFS is 100% owned by Fidelity Investments. For further information, contact either Lynette, Victor, or Nick

### **REFERRALS of ACCOUNTANTS as POTENTIAL INVESTMENT ADVISORS:**

PPA is looking to expand its business by associating with currently practicing accountants who also have an interest in providing investment advice to their clients using the PPA methodology of setting an appropriate asset allocation and implementing with indexed investments. If you know of an accountant who might be interested, please let us know.

### **IMPORTANT INSIGHT**

On the use of historical data in trying to estimate future risk and return: ...”the overwhelming historical data do not guarantee accuracy in estimating these risk-reward parameters... As Nobel laureate Paul Samuelson is fond of saying, ‘We have but one sample of history.’”

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*Any recommendation contained in these Comments may not be suitable for all investors. Moreover, although the information contained herein has been obtained from sources believed to be reliable, its accuracy and completeness cannot be guaranteed.*

**COMMENTS: INDEX RESULTS for period ending JULY, 2006**

<u>STOCKS</u>	<u>YEAR</u> <u>1999</u>	<u>YEAR</u> <u>2000</u>	<u>YEAR</u> <u>2001</u>	<u>YEAR</u> <u>2002</u>	<u>YEAR</u> <u>2003</u>	<u>YEAR</u> <u>2004</u>	<u>YEAR</u> <u>2005</u>	<u>YTD</u> <u>2006</u>	<u>CURR.</u> <u>MONTH</u>
Vanguard Total Stock Market Index Fund (1)	23.8%	(10.6%)	(11.0%)	(21.0%)	28.4%	12.5%	6.0%	3.1%	(0.2)%
Standard & Poors 500 Index (2)	19.6%	(10.1%)	(13.0%)	(23.4%)	26.4%	9.0%	3.0%	2.3%	0.5%
Vanguard S&P 500 Growth Index Fund (1)	28.8%	(22.2%)	(13.0%)	(23.7%)	25.9%	7.2%	5.1%	(2.8)%	(2.0)%
Vanguard S&P 500 Value Index Fund (1)	12.6%	6.1%	(12.0%)	(20.9%)	32.2%	15.3%	7.1%	9.1%	2.9%
Dow Jones Industrial Average Index (2)	25.2%	(6.2%)	(7.1%)	(16.8%)	25.3%	3.2%	(0.6)%	4.4%	0.4%
NASDAQ Composite Index (2)	85.6%	(39.3%)	(21.0%)	(31.5%)	50.0%	8.6%	1.4%	(5.2)%	(3.7)%
Vanguard Midcap US Index Fund (1)	25.0%	2.6%	(4.8%)	(16.3%)	34.1%	20.4%	13.9%	2.0%	(2.4)%
Vanguard Smallcap US Index Fund (1)	19.6%	(4.2%)	1.0%	(21.6%)	45.6%	19.9%	7.4%	3.3%	(3.6)%
Vanguard International Index Fund (EAFE) (1)	25.3%	(15.2%)	(22.6%)	(17.5%)	40.3%	20.8%	15.6%	10.8%	1.3%
Vanguard Emerging Markets Index Fund (1)	61.6%	(21.6%)	(2.9%)	(7.4%)	57.7%	26.1%	32.1%	7.4%	1.3%
Vanguard Real Estate Invest. Trust Fund (1)	(0.4%)	26.4%	12.4%	3.8%	35.7%	30.8%	11.9%	17.2%	4.0%
<b><u>BONDS</u></b>									
Vanguard Total Bond Market Index (1)	(0.8%)	11.3%	8.3%	8.2%	4.0%	4.2%	2.4%	0.4%	1.3%
Vanguard Interm. Tax-Exempt Index Fund (1)	(2.9%)	9.2%	5.0%	7.9%	4.4%	3.2%	2.4%	1.2%	1.1%
Vanguard Short-term Bond Index (1)	2.1%	8.9%	8.9%	6.1%	3.4%	1.7%	1.3%	1.5%	1.0%
Vanguard Short Tax-Exempt Index Fund (1)	2.6%	4.9%	4.8%	3.5%	1.6%	1.1%	1.8%	1.6%	0.4%
Vanguard High-Yield Bond Fund (1)	NA	NA	NA	1.7%	17.2%	8.5%	2.8%	1.8%	0.8%
Vanguard Inflation-Protected Bond Fund (1)	NA	NA	7.6%	16.6%	8.0%	8.3%	2.6%	(0.1)%	1.6%

1) Results for Vanguard funds include dividends and fund expenses but do not reflect PPA's advisory fee.  
 2) Results for S&P 500, Dow Jones, and NASDAQ indexes do not reflect dividends or PPA's advisory fee.

%	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q			
		<u>1999</u>					<u>2000</u>					<u>2001</u>			
<b>S&amp;P 500</b>	4.1	7.6	(7.7)	15.6	2.0	(3.0)	(1.3)	(7.8)	(12.1)	4.8	(13.8)	8.1			
<b>NASDAQ</b>	14.6	10.0	0.0	61.0	12.4	(14.8)	(7.2)	(29.6)	(25.5)	12.9	(26.7)	18.3			
<b>BONDS</b>	0.0	(0.5)	0.4	(0.7)	2.4	1.5	3.1	4.3	3.2	0.8	4.3	0.0			
Interm. Tax.															
		<u>2002</u>					<u>2003</u>					<u>2004</u>			
<b>S&amp;P 500</b>	0.0	(13.8)	(14.1)	4.5	(1.8)	12.8	2.2	13.2	1.3	1.3	(2.4)	8.8			
<b>NASDAQ</b>	(5.5)	(19.5)	(13.5)	7.0	2.5	19.2	12.1	16.2	(0.5)	2.7	(7.5)	13.9			
<b>BONDS</b>	0.0	2.8	3.6	1.8	0.9	2.7	0.2	0.2	2.7	(2.6)	3.1	1.0			
Interm. Tax.															
		<u>2005</u>					<u>2006</u>					<u>2007</u>			
<b>S&amp;P 500</b>	(2.6)	0.9	3.1	1.6	3.7	(1.9)									
<b>NASDAQ</b>	(8.1)	2.6	4.4	2.5	6.1	(7.6)									
<b>BONDS</b>	(0.5)	3.0	(0.7)	0.6	(0.7)	(0.2)									
Interm. Tax.															

### JULY 2006 COMMENTS

**STOCK** index prices for various segments of the market showed substantial divergence during July, a month also marked by continuing volatility (see the discussion starting on page 7 on the Impact of World Events on Market Prices). While the S&P 500 and the Dow Industrials showed fractional gains, the NASDAQ declined (3.7)%, and the Total Stock Market (TSM), which includes Midcap and Smallcap stocks, declined fractionally. Both Midcap and Smallcap declined, at (2.4)% and (3.6)% respectively, while both International and Emerging Market indexes gained 1.3%, and the REIT index continued its remarkable outperformance, up 4.0%. Largecap Value also continued its substantial outperformance compared to Largecap Growth. See page 2 for figures for the month, YTD, and since 1999.

**BOND** returns (price change plus interest) had their first strong gains in many months. The benchmark 10-year US Treasury yield closed at 5.0%, well below the previous month's close of 5.14%, and a full quarter point below the current 5.25% overnight rate set by the Federal Reserve. The chance that the Fed might pause in its rate increases was the apparent impetus for the decline in rates, and resulting rise in bond prices. YTD bond returns are now all positive for both short and intermediate maturities, but continue to lag the returns from money markets, which benefit most directly from increases in short-term interest rates. Further, it should be remembered that **rising interest rates, while they adversely affect bond results over the short term, eventually provide higher returns in the form of higher interest rates.** See page 2 for results for the month, YTD, and since 1999.

The stock market rally that began decisively in March 2003 has raised the S&P 500 approximately 64% from its October 2002 low, but is still 250 points from its all-time high of 1,527 (this is 16% from the all-time high, and 32% from the 2002 low). This result occurs because after a 50% price decline, prices must increase by 100% to reach their previous high levels. By contrast, the Dow Jones Industrials are a mere 5% below their all-time high, while the NASDAQ remains a stunning 58% below its all-time high. Although the longer-term results of these three averages are quite similar (see next paragraph and chart below), the differences in the magnitude of both the gains and declines since 1994 are strikingly large.

In order to keep the current recovery in perspective, we continue to show the chart below, which sets out the extent of the declines measured from the highs of Q1 2000. The chart also puts these declines in the context of results since the end of 1994 (also see the figures on page 10). Note that the three indexes have positive average annual returns ranging from 9.2% to 9.7% for the 11.58 year period from the end of 1994 through July 2006, very much in line with long-term stock returns going back to 1926. Further, as these returns converge more and more, the idea of “regression to the mean,” described by Swensen as “one of the most powerful influences in the world of finance” (pg. 154), comes clearly into focus.

**The long-term investor therefore has a very different view of the stock market's returns than those measuring returns from the highest levels.**

	<u>S&amp;P 500 (1)</u>		<u>DOW (1)</u>		<u>NASDAQ (1)</u>	
1st Qtr 2000 High	1,527		11,723		5,048	
Year End 2000	1,320	(13)%	10,785	(8)%	2,470	(51)%
September 21, 2001 Low	965	(37)%	8,235	(30)%	1,425	(72)%
Year End 2001	1,148	(25)%	10,020	(17)%	1,950	(61)%
October 9, 2002 Low	777	(49)%	7,286	(38)%	1,114	(78)%
Year End 2002	880	(42)%	8,342	(29)%	1,336	(73)%
Year End 2003	1,112	(27)%	10,454	(11)%	2,003	(60)%
Year End 2004	1,212	(21)%	10,783	(8)%	2,175	(57)%
Year End 2005	1,248	(18)%	10,718	(9)%	2,205	(56)%
Year 2006 thru July 31, 2006	1,277	(16)%	11,185	(5)%	2,091	(58)%

**Context: Prior Five-Year Gains in Bull Market of 1995 - 1999**

	<u>S&amp;P 500 (1)</u>	<u>DOW (1)</u>	<u>NASDAQ (1)</u>
End 1994	459	3,834	752
End 1999	<u>1,470</u>	<u>11,500</u>	<u>4,070</u>
Gain	1,011	7,666	3,318
Avg. Ann. % Gain: '95-'99; 5 years	26.2%	24.6%	40.2%
July 2006	1,277	11,185	2,091
Gain	818	7,351	1,339
Avg. Ann. % Gain: '95-7/06; 11.58 yrs	9.2 %	9.7 %	9.2 %

1) Results for S&P 500, Dow Jones, and NASDAQ indexes do not reflect dividends or PPA's advisory fee.

## I. UPDATE OF KEY ECONOMIC INDICATORS

The strength of the overall US and world economies is one of a number of factors likely to influence the future direction of both stock and bond prices. We, along with many market observers and academics who write about the markets, believe stock and bond prices already reflect consensus expectations of economic growth. Further, we believe that even if you could accurately predict any number of actual economic figures, the market's reaction to those figures is essentially unpredictable. In any event, an understanding of the direction of current economic trends may at times be useful as a context to help understand market conditions. This section of the Comments provides an update of key economic indicators.

- (1) Gross Domestic Product (GDP) is the broadest measure of goods and services produced in the US economy (GDP figures are inflation-adjusted, annualized growth rates). The initial estimate of GDP for Q2 2006 was 2.5%, "less than half the 5.6% expansion in the first three months of the year, ... as the housing market cooled and consumer spending pulled back, slowing the economy to a more sustainable rate of expansion" (NY Times [NYT], front page, 7/29/06).
- (2) Employment growth for July continued "at a slow pace for the fourth consecutive month... offering the strongest evidence yet of a weakening economy... and persuading most Wall Street analysts that the Federal Reserve will not raise interest rates when it meets next Tuesday.... The July report showed a gain of 113,000 jobs, in line with the average for April through June, and well below the first quarter pace of 176,000 a month" (NYT, 8/5/06, C1).
- (3) Interest Rates on longer-term bonds declined in July, with the benchmark 10-year US Treasury interest rate, which is set by buyers and sellers in the bond market, closing at 5.0%, below the rates of the last three months. The apparent catalyst for this change in direction was Fed Chairman Bernanke's testimony to the Senate Banking Committee, which "predicted an unfolding economic slowdown would reverse a worrisome rise in inflation" (Wall Street Journal [WSJ], front page, 7/20/06). Interestingly, in the same July 20<sup>th</sup> edition (A12), a WSJ editorial argued that "slower economic growth did not necessarily mean lower inflation," and that the Fed should not discontinue its campaign to raise rates to fight off inflation. The July rate decline occurred even after the Federal Reserve, on June 29<sup>th</sup>, raised the short-term rate it controls for the seventeenth consecutive time, to 5.25%, up from 1% two years ago.
- (4) Inflation, as measured by the Consumer Price Index (CPI) "core" rate, which excludes the volatile food and energy sectors, increased 0.3% in June, and is up 2.6% from a year earlier, "the largest increase since December 2001." With food and energy included, the monthly rate was up 0.2%, "its smallest gain in four months, and the most recent twelve-month increase was 4.3% (Vanguard Economic Week in Review [VEWR], 7/17-21/06). The Producer Price Index (PPI) core rate was up 0.2%, with the twelve month increase at 1.9%. With food and energy included, the monthly increase was 0.5%, and the yearly increase 4.9% (WSJ, 7/19/06, A2). (Note: The CPI measures prices of goods and services; the PPI, only goods). The close relationship between inflation rates and interest rates has been discussed at length in a number of recent Monthly Comments.

(5) Sector Economic Activity Continued Mixed

- (a) Durable goods orders (industrial and consumer) rose 0.4% in June after factoring out the highly volatile aircraft and defense segments, “sharply lower than May’s 1.3% rise” (WSJ, 7/28/06, A2).
  - (b) Industrial production “surged in June...The growth was wide-ranging....Overall production was up 4.5% from the year-ago level, and capacity utilization rose to 82.4%, which was 1.4% above its 1972-2005 average and marked the highest rate since June 2000” (VEWR, 7/17-21/06).
  - (c) Retail Sales declined 0.1% in June, but, excluding autos, were up 0.3%, and were 20.4% higher than in June 2005 (VEWR, 7/10-14/06). (Retail sales are not adjusted for inflation, and include disparate categories such as gasoline sales, auto sales, and non-store retailers such as the Internet.)
  - (d) Housing sales for existing homes declined by 1.3% in June, “and inventories swelled to the highest levels since 1997, the latest sign that the housing market continues to cool” (WSJ, 7/26/06, A2). Further new home sales fell 3% in June, and sales for May were revised “sharply lower” (WSJ, 7/28/06, A2).
  - (e) Personal Income increased 0.6% in June, while personal spending grew 0.2%. The personal savings rate, which excludes gains in stock prices and housing, declined again, but slightly less than in May (WSJ, 8/2/06, A2).
- (6) Consumer Confidence, as measured by the Conference Board’s Index, rose 1.1 to 106.5 for July, but was “below levels seen earlier this year” (VEWR, 7/24-28/06).
- (7) Corporate Profits for the first quarter of 2006 “climbed at an annual rate of 13.8%, to \$1.2 trillion” (WSJ, 6/30/06, A5), and came to 12.1% of GDP, “the highest level in 40 years” (WSJ, 7/31/06). Since stock prices have been relatively flat, the S&P 500 index has a Price/Earnings ratio of 16 times the past year’s earnings, “the lowest point in more than 10 years” (WSJ, 7/31/06). Estimates for Q2 earnings growth are at 9.4% (WSJ, 7/12/06, C1). Whether this means stocks are cheap, or that the quality of earnings is suspect, or that earnings growth is about to slow, remains to be seen.

Overall, the economic news reported during July was mixed. A much slower growth rate for GDP, continued slower-than-expected employment growth, and weakness in housing and retail sales, seemed to outweigh continued strength in the industrial sector. While stock prices showed little change, bond prices increased, based on a decline in market interest rates that accompanied the perceived economic slowdown. How this combination of potentially slower growth, caused at least in part by higher interest rates, higher oil prices, and increasing rates of inflation plays out in the markets going forward, remains to be seen.. Considerable day-to-day volatility remained in the markets in July, in part because of some serious new world events, apart from the ebb and flow of economic data. The impact of significant world events on market prices is the subject of our in-depth discussion for this month, which follows on page 7.

## II. INVESTMENT RISK: The Impact of WORLD EVENTS on MARKET PRICES

We are postponing our discussion of Investment Risk and Annuities for this month, to focus instead on the more current issue of the impact of world events on market prices. This month's major event was the renewed fighting in the Middle East, this time between Israel and the Syria/Iran-backed Hezbollah. These Comments will review the market price reactions associated with significant world events of the past five years, and then discuss how the current crisis, on its own and by its influence on a variety of other factors, has impacted current market prices. As to the future, it should be clear more than ever that future market prices, and the events that affect these prices, are indeed unpredictable.

Recent Significant World Events, and the Impact on Market Prices:

Event	Start Date	Stock Prices = S&P 500			Bonds = 10-yr US Treasuries		
		Day Before	90 Days Later	One Year Later	Day Before	90 Days Later	One Year Later
9/11	9/11/01	1,093	1,137	909	4.84%	5.08%	4.06%
Afghan War	10/7/01	1,071	1,165	785	4.50%	5.06%	3.63%
Iraq War	3/19/03	866	995	1,110	3.96%	3.90%	3.34%
Madrid Bomb.	3/11/04	1,124	1,136	1,200	3.73%	4.79%	4.53%
London Bomb.	7/7/05	1,195	1,223	1,265	4.07%	4.36%	5.13%
Hurricanes:							
Katrina	8/29/05	1,205	1,257		4.19%	4.48%	
Rita	9/24/05	1,215	1,269		4.25%	4.38%	
India Bomb	7/11/06	1,267			5.13%		
Israel-Hezb	7/11/06	1,267			5.13%		
<b>July 31 Figures:</b>		<b>1,277</b>			<b>5.00%</b>		

### NOTES:

1) We have not included such human catastrophes as the Tsunami in Indonesia (12/04), because the event did not have a major economic impact in the US. Also, this list is not presented as the only significant events during this period, but rather what we believe is a representative sampling of significant world events.

2) The chart uses the level of the S&P 500 index as representative of stock prices, and the percentage yield on the 10-year US Treasury as representative of bond prices. The three time periods for measuring prices for each event are: (1) the day before the event; (2) 90 days after the event; and (3) one calendar year after the event.

In examining the results, the question is what conclusions, if any, can be drawn.

First, as to Stock Prices:

- 1) In every instance, stock prices were higher three months after the event than they were the day before the event. This is powerful evidence that while each of these events had major significance at the time of its occurrence, these negative events have had LITTLE (IF ANY) IMPACT on stock prices three months later. As for the July 2006 events, the pattern continued, at least as of the end of the month in which the events occurred. It would appear that OTHER INTERVENING FACTORS occurred to change what would intuitively be considered a negative for stock prices, even over as short a time period as three months.
- 2) If the ninety-day results showed no direct negative impact on stock prices, then it stands to reason that the one-year results, whether better (starting with 2003) or worse (the events of 2001), have been impacted by INTERVENING EVENTS and economic developments. The world event cannot be said to have been the cause of any significant stock market decline.
- 3) Therefore, the message for the long-term investor is to hold your course, assuming your allocation to stocks is appropriate at the time the event occurs. For the short-term market timer/trader, the message would seem to be to buy shortly after the decline that typically occurs immediately after the event, relying on the recovery that appears to occur as early as ninety days after the event. However, since PPA does not engage in or encourage market timing activities, we make this point only because it seems to flow from the data.

Second, as to Bond Prices (Note: to understand bond price changes from the 10-year US Treasury yield, the key point is that the higher the yield, the lower the bond price, and the lower the yield, the higher the bond price):

- 1) In all but one of the three-month periods (the exception being the Iraq War), yields were higher (and bond prices lower) three months later. This result is just the opposite of the stock price changes.
- 2) The one-year yields are lower for the events that occurred between 2001 and 2003, but higher starting with the March 2004 event. However, the July 31, 2006 yield was lower than the yield the day before the July 11<sup>th</sup> events.
- 3) In our view, there is no causal relationship between any of these events and bond prices, either three month or one year later. Rather, these bond price changes were primarily influenced by the Federal Reserve's actions in (a) reducing the short-term interest rates it controls, all the way down to 1% by mid-2004; and then (b) raising the short-term rates it controls from June 2004 to the present.

The Federal Reserve's actions on interest rates are based primarily on its view of domestic inflation and economic growth. While certain of these world events may have some impact on these pivotal economic factors, it would be hard to conclude that any of these events caused the Fed to act in a particular way. Just after 9/11, it was the conventional wisdom that there would be a major slowdown in economic activity (and accompanying decline in interest rates), and yet yields were higher 90 days after the event. The hurricanes of 2005 also gave rise to talk of a major economic slowdown, but interest rates continued to rise during the ninety-day period, and most likely will over the one-year period. And currently, the July 31<sup>st</sup> yield is lower than the yield on July 10<sup>th</sup>, a fact that is much more likely attributable to the view that the US economy is slowing down, thereby allowing the Federal Reserve to stop increasing the short term rates it controls, than it is to the events in the Middle East.

These observations lead us to the first of our more general points on this subject:

1) Causation is a difficult concept under any circumstance, but particularly difficult when a major world event occurs. As Nick Taleb writes in his excellent book, *Foiled By Randomness, The Hidden Role of Chance in the Markets and in Life*, "causality can be very complex. It is very difficult to isolate a single cause when there are plenty around... For instance, if the stock market can react to US domestic interest rates, the dollar against various international currencies and stock markets, US inflation, and another dozen prime factors, then the journalist needs to look at all these factors, look at their historical effect both in isolation and jointly, look at the stability of such influence, then after consulting the test statistic isolate the factor if it is possible to do so" (pg. 165-6).

The daily explanation of the ups and downs in stock prices provides a perfect example of the difficulties inherent in establishing causation. How often do we read that stock prices declined because of higher oil prices or some adverse economic report, only to experience another day when stock prices rise, and the market is said to have ignored or shook off the effect of those same higher oil prices or that same adverse economic report. We believe, along with Taleb, that it is quite rare to be able to isolate and identify a single cause to even significant market price moves. Even though we agree that the 7% stock price decline on the day the stock market opened following 9/11 was certainly directly related to that event, as we have seen from the data in the chart, three months after 9/11 stock prices were higher than they had been the day before the event.

2) The media, which needs to fill its available space every day, has a real institutional need to amplify events and their likely consequences. Whether predicting recession after 9/11, or major oil shortages after the start of the Iraq war or the hurricanes of 2005, the media finds that dire predictions make headlines, add to public interest and attention, and frighten people. Taleb's book cited above has a number of observations (mostly negative) regarding the media, an example of which is that "a journalist is trained in methods to express himself rather than to plumb the depths of things – the selection process favors the most communicative, not necessarily the most knowledgeable" (pg. 162).

3) Similarly, the Wall Street community benefits economically from sharp short-term price swings, because increased trading activity enhances revenues. In a recent front page article on hedge funds and their use of potentially “inside” information (WSJ, 7/27/06), the authors state that hedge funds “control so much cash – some \$1.2 trillion – and trade so heavily that they account for up to half of the daily volume on the New York and London stock exchanges.” Since the primary objective of many hedge funds is to outperform the various market indexes so as to justify their high fees and fulfill the expectations of their investors, they tend to be short-term traders, reacting to every event, hoping to realize some short-term gain that enhances their reported investment results. If they are correct, their record improves, and more money flows to their management. If they are wrong, their returns suffer and the money under management declines. There is great incentive to make the bets that move the markets short-term. But just as likely, a week or a month thereafter, some other event, perhaps a world event, perhaps an economic reading or Federal Reserve pronouncement, causes them to reverse their positions and go elsewhere for the next perceived short-term advantage. Given their impact on day-to-day price changes (“up to half the daily volume of the New York and London stock exchanges”), it is no surprise that time, the great leveler, produces results that minimize the impact of the short-term price movements that follow many world events.

Since the current fighting between Israel and Hezbollah continues as of the date of this writing, and has the potential to become a broader, regional conflict involving countries such as Syria and Iran, with the additional complication of a potential disruption in the supply of oil from the region, some additional historical perspective may prove helpful. In an article dated July 17<sup>th</sup>, 2006 (C1), the WSJ states that “Almost never has Middle East fighting done long-term damage to the US stock market. Short-term stock pullbacks typically have been opportunities to buy at a reduced price. Only when economic fundamentals have been seriously damaged, usually in the form of a disruption in oil supplies, has Middle East fighting led to serious market troubles... The problem, of course, is that there never is a guarantee that the economic fundamentals will be fine. Stocks weathered the 1967 Six Day War well, and they also did well following the two US invasions of Iraq (1990 and 2003). But they ran into trouble after the 1973 October war... probably because a few days after that war began, Arab oil exporters declared an embargo on oil shipments to countries that had supported Israel, and quadrupled export prices. Stocks also fell in the wake of Iran-Iraq fighting in 1980, but that decline probably had more to do with the recession that hit the US around that time, and very high interest rates needed to rein in the inflation that had been caused, in part, by soaring oil prices. A few years later, U.S. stocks entered a prolonged bull market (August, 1982).” The article then goes on to discuss the major fear of investors in the current crisis, a disruption in oil supplies at a time when prices are already very high and supplies tight.

We think this article confirms our views that: (a) significant world events often have little impact on stock prices over even relatively short time frames (three months to one year); (b) intervening events quickly become the focus for the next market price movements; and (c) attributing causation to market price movements is difficult. Overall, our advice to our clients is to follow the course of these events, but not to use them as a reason to change an otherwise appropriately developed asset allocation. As a short-term trader (seller or buyer), individual investors are competing with the hedge fund world and other professionals, all dedicated to trying to gain from short-term price swings. By essentially ignoring these short-term price swings, investors are able to place their investment returns in the hands of the longer-term trends in the markets, and the long-term growth of the economy. Of course, the one major caveat to this advice is that if you come to a conclusion that all the events of the past are just prelude to some future event that can destroy the world as we know it, then that worldview could lead you to make significant changes to your investment portfolios. But if that conclusion proves incorrect, the maintenance of a more broadly diversified portfolio, consistent with an allocation appropriate to your goals and risk tolerance, is likely to provide you with a better long-term result.

S&P 500 (1)                      DOW JONES (1)                      NASDAQ (1)

1) Results for S&P 500, Dow Jones, and NASDAQ indexes do not reflect dividends or PPA's advisory fee.

**I. Figures From Period Starting 2000 (% Figures Are Cumulative Declines From 1/01/00)**

Start of 2000	1,470		11,500		4,070	
End of 2000	1,320	(10.1)%	10,785	(6.2)%	2,470	(39.3)%
Sept. 21, 2001 <u>Low</u>	965	(34.3)%	8,235	(28.4)%	1,425	(65.0)%
End of 2001	1,148	(21.9)%	10,020	(12.9)%	1,950	(52.0)%
Oct. 9, 2002 <u>Low</u>	777	(47.1)%	7,286	(36.6)%	1,114	(72.6)%
End of 2002	880	(40.1)%	8,342	(27.5)%	1,336	(67.2)%
End of 2003	1,112	(24.3)%	10,454	(9.1)%	2,003	(50.8)%
End of 2004	1,212	(17.5)%	10,783	(6.2)%	2,175	(46.5)%
End of 2005	1,248	(15.1)%	10,718	(6.8)%	2,205	(45.8)%
Through July 31, 2006	1,277	(13.1)%	11,186	(2.7)%	2,091	(48.6)%

**II. Figures From Period Starting 1995 (% Figures Are Gains From 1/01/95)**

Start of 1995	459		3,834		752	
End of 1999	<u>1,470</u>		<u>11,500</u>		<u>4,070</u>	
5 Year Gain; Annualized %	1,011	26.1%	7,666	24.6%	3,318	40.2%
End of 2001	<u>1,148</u>		<u>10,020</u>		<u>1,950</u>	
7 Year Gain; Annualized %	689	14.0%	6,186	14.7%	1,198	14.6%
End of 2002	<u>880</u>		<u>8,342</u>		<u>1,336</u>	
8 Year Gain; Annualized %	421	8.5%	4,508	10.2%	584	7.5%
End of 2003	<u>1,112</u>		<u>10,454</u>		<u>2,003</u>	
9 Year Gain; Annualized %	653	10.3%	6,620	11.8%	1,251	11.5%
End of 2004	<u>1,212</u>		<u>10,783</u>		<u>2,175</u>	
10 Year Gain; Annualized %	753	10.2%	6,949	10.9%	1,423	11.2%
End of 2005	<u>1,248</u>		<u>10,718</u>		<u>2,205</u>	
11 Yr Gain; Annualized %	789	9.5%	6,884	9.8%	1,453	10.3%
Through July 31, 2006	<u>1,277</u>		<u>11,186</u>		<u>2,091</u>	
11.58 Yr Gain; Annualized %	818	9.2%	7,352	9.7%	1,339	9.2%



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