Views From The Heartland

Investment Perspective of Buena Vista Investment Management

Volume 4 Issue 4
December 2006

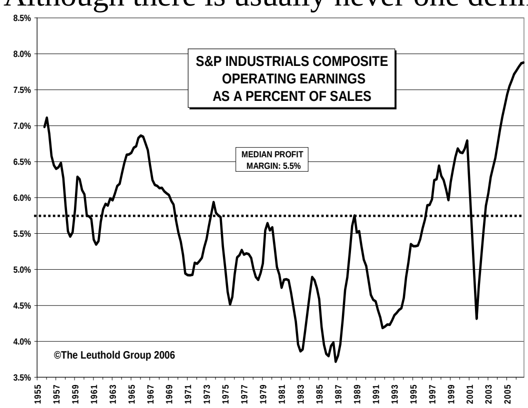
RECORD PROFITS LIFT STOCK PRICES IN 2006

After Five Years of Soaring Profits, Can Corporate America Make It Six?

By John Moffat and Joel Sullivan, Partners

2006 proved to be a very good year for equity investors, with some major market indices breaking out to record highs in the 4th quarter. **The S&P 500 stock index finished 2006 at 1418, a 13.62% gain for the year** and slightly above the upper range of our 2006 target of 1400. All in all, it was a very good year for equity investments and the fourth year in a row of solid gains for the US markets.

Although there is usually never one definitive reason to explain the movements in capital markets, one of the main reasons for the climb in stock prices over the last four years is the incredible rise in corporate profits. The numbers are very impressive to say the least. **2006 will be the 5th year in a row of double digit earnings increases.** On top of that, as our chart indicates, profits as a percentage of sales have soared to their highest level in 50 years.



What this means for investors is that the price/earnings ratio (a fundamental tool for valuing stocks) has declined, even as stock prices have risen over the last four years. Consider this; since the markets bottomed in 2003 the stock market has risen approximately 80% while at the same time **the P/E on the S&P 500 stock index has declined from 18 at the end of 2004 to a projected 16 as we finish 2006.**

Therein lies the problem for us as stock investors. On a valuation basis stocks look cheap and corporate America seems to be a big beneficiary of the trend toward globalization. On the other hand, we have seen five years of double digit earnings growth and wonder how long can that continue? **We are now almost four years without a 10% correction**, a fact that we spoke about during 2006. With this backdrop, the economy seems to be slowing, as evidenced by the decline in the Index of Leading Economic Indicators and the contraction in the housing industry. Also, the ISM index, which has been a very reliable indicator of economic activity, has been slumping recently. Then there is the bond market, which has pushed interest rates on the long-end of the curve lower, which normally means the economy will slow.

So what does this all mean for our portfolios in 2007? We are anticipating that the stock market will show increasing volatility as it deals with all of the economic cross currents discussed above. **The good news is that stocks are cheap by historical standards.** The global nature of our economy should help minimize any downturn in the US economy, as the emerging economies of the world continue to grow. We still are of the opinion that a 10% correction is on the horizon. We were looking for that correction in 2006, but we only saw an 8% decline in prices during the summer.

So as we begin 2007, we want to remind our readers that our main responsibility is to protect the principal of our clients. We will finish this newsletter exactly as we finished our December 2005 newsletter….. **our investment disciplines allow us to feel confident that we can add significant value to portfolios even in difficult market environments.**

BUENA VISTA INVESTMENT MANAGEMENT LLC

LONG-TERM MARKET INDICATORS

Buena Vista Conservative Buy/Sell Discipline:	Buy (solidly bullish)
Leuthold Major Trend Index:	Buy (issued a buy signal in August 2006)
Coppock Guide:	Buy (a good buy signal but less reliable on the sell side)
S&P 500 Stock Index:	1,418.30 (+13.62 thru 12-31-06)
Wilshire 5000:	14,257(+13.90 thru 12-31-06)

Buena Vista Current Investment Strategy – 2007 is shaping up to be a very interesting year for stock investors. We are anticipating that market volatility will increase in the upcoming year, as the equity markets react to a slowing US economy and the potential for smaller rate of growth in corporate profits. **We start the year fully invested but anticipate that we will be making mid course adjustments in our asset allocations as the year progresses and market conditions warrant**.

DIVERSIFIED MUTUAL FUND PROGRAM

Absolute Return Strategy – The Absolute Return Strategy met its short-term portfolio objective for the fourth year in a row, as it generated a positive return in 2006. As we begin a new calendar year, the strategy has only 50% invested in long equities and the balance in fixed income and money market funds.
Performance for the Absolute Return strategy in 2006 was 12.75%

Conservative Equity Strategy – We are pleased to report that the portfolio strategy once again performed well in 2006. Although we slightly lagged our benchmark in 2006, we are still ahead of it on a 3 year basis. It is also important to remember that this portfolio is about 30% less volatile than the market overall. Changing economic and market conditions caused us to make a lot of changes this past year. We felt they were necessary to make sure your principal was protected. We will be making one other change in January. Cambiar Opportunity Fund (CAMOX) will replace Chase Growth Fund. Cambiar has been much more consistent in both up and down markets over the past 10 years.
Performance for the Conservative Equity strategy in 2006 was 12.19%.

Income and Growth Strategy – This portfolio strategy had another good year, beating its benchmark for the fourth year in a row. During 2006 the strategy maintained our normal balanced allocation of 65% stocks and 35% fixed income during the course of the year and it is our intention to begin 2007 with the same allocation. In January, we will be replacing Payden Bond Fund with Loomis Sayles Bond Fund (LBFAX). This change is being made due to underperformance by the Payden Fund and because the Loomis Sayles fund takes a more global approach to security selection. This fund has been run by Dan Fuss for the past 20+ years and given Dan's impressive long term track record, we feel this change will serve the strategy well. **Performance for the Income & Growth strategy in 2006 was 10.11%.**

Total Return Strategy **–** No major changes are planned for the Total Return Strategy as we begin 2007. During 2006 we made strategic asset allocation adjustments which resulted in performance in excess of the S&P 500 index. We will continue to look for opportunities to add to our international and emerging market exposure. It remains our opinion that investments outside of the US will help performance of this strategy.
Performance for the Total Return strategy in 2006 was 16.48%.

BUENA VISTA INVESTMENT MANAGEMENT LLC
320 WEST GRAND AVENUE WISCONSIN RAPIDS, WI 54495
715-422-0700 buenavista@charterinternet.net