



Views From The Heartland

Investment Perspective of Buena Vista Investment Management

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MARKET SHOWING UPSIDE MOMENTUM

Is It Time To Increase Equity Exposure?

By Joel Sullivan and John Moffat

The last six months have provided equity investors with a fair amount of volatility. April and May generated positive returns, June and July were negative, and then August and September were again positive. The S&P 500 stock index reached a high of 1325 on May 5th and declined to a low of approximately 1224 in both June and July, a modest decline of 7.5%. Not quite the 10% to 15% correction we were looking for when we increased our cash position in 2006. *As of this writing, both the S&P and Dow Jones Industrial indices are back to where they were last May, while the NASDAQ is still 5% below its May high.*

In our opinion, the recent volatility in the US equity markets is due to the fact that traders and market participants are trying to decide **if higher inflation and higher global interest rates will cause the U.S. and global economies to transition from a period of strong growth to a period of modest or declining growth.** This up and down movement in the major averages over the last few months is the markets way of grappling with the daily flow of economic information that does not definitively point to either continued growth or a period of slower growth.

The potential for rising inflation and slower economic growth were the economic conditions which led us to take a cautious portfolio stance over the last 6 months and to increase money market positions to 20% for most portfolios. **The question for us now, from a strategic standpoint, is whether or not the 7.5% correction in the US equity market is all we are going to get for now?**

Before we answer that question, let's look at the current worldwide economic picture. World gross domestic product (GDP) is on track to grow more than 4.5% in 2006. **This is the fourth consecutive year of growth above 4%, making this the strongest four years of global expansion in more than 3 decades.** We would take the position that this kind of global growth will be hard to sustain if the US economy moved into a period of slower economic growth.

Even with the recent pullback in energy and commodity prices, it is our position that inflationary pressures have begun to develop around the world. The emergence of industrialized growth in China, India, and others has dramatically increased the demand for natural resources, a long-term trend we have spoken about in recent issues of this newsletter. The response to increasing commodity prices and strong economic growth by more than 20 central banks around the world has been to increase interest rates. **At last count, there have been more than 60 separate rate hikes around the globe so far in 2006.** Of course, the sole purpose of these hikes is to slow down economic growth and reduce inflationary pressures. Another consequence of rising interest rates is to take away the "easy money", which helped fuel a significant part of the economic and stock market gains of the last four years

If global economic activity begins to slow where does that leave us as equity investors?

MARKET SHOWING UPSIDE MOMENTUM -Is It Time To Increase Equity Exposure? (contd.)

It is also important to note **the current bull market already is now the second longest on record without a 10% correction in the S&P 500 stock index.** This fact alone should cause investors concern but we can't act on individual facts alone. The big picture requires us to consider other more positive factors;

- * Corporate America is in the best operating and financial condition in decades
- * Profit margins stand at their highest level in post-war history
- * Companies are buying-back record amounts of their own stock - \$500 billion in last 4 quarters
- * The S&P 500 price-to-earnings ratio is below its long term average

So where does all this lead us as we try to answer our earlier question? Does the 7% decline in the S&P 500 index last summer mark a bottom or is there more downside we, as investors, should prepare for?

In the short term, (3 to 6 months), we feel that there is the potential for a tradable year-end rally of 5-10%. November through February has historically proven itself to be the best time of the year for equity investors. **This time period has provided investors with positive returns in 17 out of the last 20 years.** Additionally, **the Leuthold Major Trend Index has recently given a "bullish" signal.** With that said, we still are of the opinion that global economic activity will slow and that the 10% correction we have been waiting for is now likely to occur after the first of the year rather than before.

How does this forecast impact your portfolios? Barring some unforeseen negative development in the near future, we would anticipate moving 10 –15% from the money market position back into equities in the near future to take advantage of this potential market rally and then again reversing these positions in 2007.

DIVERSIFIED MUTUAL FUND PROGRAM PORTFOLIO CHANGES

In September, we replaced MFS International New Opportunities (MIDAX) in the Conservative Equity and Income and Growth portfolios with Oakmark International (OAKIX). This change was made for two specific reasons. First, MFS International was closed to any new money, which made it impossible to add to existing positions. Second, we felt this was a good opportunity to reduce our exposure to small and mid sized international companies and increase our exposure to large international companies. The small and mid cap segment has had a very good run over the last 4 years and we felt it a good time to realize those gains. In Oakmark International we are investing in a fund that uses a value approach in its stock selection, has a lower than average standard deviation, a management team which has been in place for over 10 years and has outperformed its benchmark for the last 3, 5 and 10 years.

BUENA VISTA INVESTMENT MANAGEMENT LLC

LONG-TERM MARKET INDICATORS

Buena Vista Conservative Buy/Sell Discipline:	Positive
Leuthold Major Trend Index:	Bullish (moved back to bullish on September 26th, 2006)
Coppock Guide:	Buy (a good buy signal but less reliable on the sell side)
S&P 500 Stock Index:	1,335.85 (+7.01% thru 9-30-06)
Wilshire 5000:	13,345.97 (+6.62% thru 9-30-06)

Important Disclosure – The performance numbers contained on this page are provided for informational purposes only. Returns may vary depending on personal objectives and timing of invested dollars. The performance numbers contained on this page are based on investments that have been in place since 1-1-04. Contact Buena Vista Investment Management LLC for more specific information concerning performance and market data. Do not rely on this information to make investments.

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