**Robshaw & Julian Associates, Inc.**
*Helping Investors Reach Their Financial Goals Since 1979*

# Investment Matters

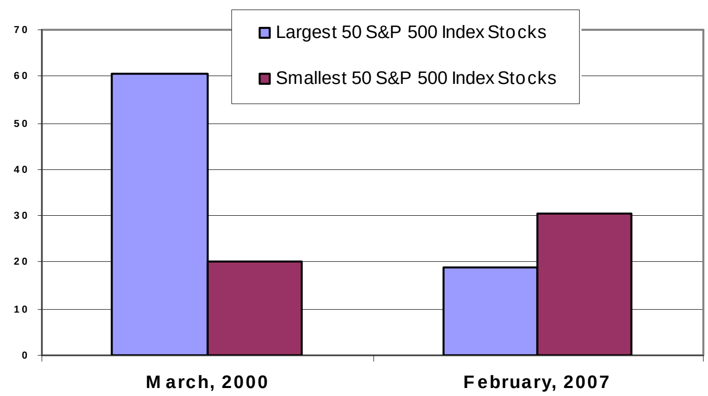
**For the quarter ended March 31, 2007**

## Large and Small: Then and Now

At the top of the stock market in March of 2000 the S&P 500 Index was selling at 31 times operating earnings, a very high level by historical standards. Today the price earnings ratio of the market is about 17, fairly typical for a low inflation environment.

But averages do not tell the whole story. In the five years prior to the March, 2000 market top, large company stocks dramatically out-performed the rest of the Index. Small company stocks also went up during this period, but at a much slower pace. By March of 2000 the largest 50 stocks in the S&P 500 were priced at 61 times earnings while the smallest 50 stocks were selling at only 20 times earnings.

At the time this seemed less an anomaly than it does today. For one thing the price earnings ratios of large company stocks had been higher than small company stocks for years. Large companies were not only experiencing better growth but they were generally regarded as less risky. Analysts made the argument that large companies should always trade at a premium price.




VALUATION DISPARITIES HAVE REVERSED SINCE 2000

Today, after years of stronger returns from small company stocks, the situation is largely reversed. Small company stocks are valued considerably higher than their larger brethren. Currently the price earnings ratio for the 50 smallest stocks in the S&P 500 is 31 while the largest 50 have a PE of 19.

> *"Small company stocks are valued considerably higher than their larger brethren"*

For investors attempting to reach long term financial goals, significant valuation disparities, such as exist today between large and small capitalization stocks, should not be ignored. As Warren Buffett has famously proclaimed, "In the short run the market is a voting machine. In the long run it's a weighing machine." There is no way to know when market participants may decide to switch their 'votes' to large capitalization stocks but the valuation advantage of owning large company stocks suggest the switch is coming.

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## Free Credit Report

There are at least two good reasons why you might want to check your credit report periodically. The first is to see if your credit file includes any information about you which is incorrect. Incorrect information could result in your being denied credit or even being turned down for a job. The second reason, and in today's world probably the more important, is to determine if your identity is being used by someone else for fraudulent purposes.

Identity theft has become all too common. Thieves, using your name, social security number and other easily obtained personal information, can open bogus accounts and steal thousands of dollars. Resolving these problems can take months or even years. While safeguarding your personal information is the best first line of defense, an occasional review of your credit report is recommended.

Each of the three major credit reporting agencies must now provide you with one free copy of your credit report each year, but only if you ask. You can do this on the internet, by mail or by phone.

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### *Free Credit Report continued*

Online access is available at www.annualcreditreport.com. By way of caution, don't go to the much advertised freecreditreport.com. This is actually a "free trial membership" which will cost you $12.95 per month after the first report. It is very misleading.

Phone access is at (877) 322-8228. The mailing address is Annual Credit Report Request Service, P.O. Box 105281, Atlanta, GA 30348-5281. The website has a request form which you can download and print.

If you want to check more than once per year you can request a report from one agency now, the second in four months and the third after eight months.

*Private Equity Boom*

*In 2006, for the first time, more equity was raised in private transactions than was raised in initial public offerings on all U.S. stock exchanges.*

# Trade Deficit or Capital Surplus?

The trade deficit is defined as the difference between the total dollar value of goods and services which the United States buys from other countries and the value which we sell. Currently the U.S. trade deficit is about $700 billion, based on $2.2 trillion in imports and $1.5 trillion in exports. Imports represent about 17% of our total economy and exports 11%. The trade deficit is therefore about 6% of our total economy.

One way to view the trade deficit is that, as a nation, we are consuming more than we produce and borrowing to finance the production shortfall. This view leads to ominous predictions of economic decline and soaring interest rates if we don't begin to reverse the trend right now. Common solutions advanced to eliminate the trade deficit include higher import duties, reduced consumption and greater incentives to save rather than consume.

But there is another view of the trade deficit which leads to very different conclusions.

When foreigners receive extra dollars which they do not need to purchase U.S. goods, they don't just hide their dolars in a mattress. Ultimately, either directly or indirectly, they use all their excess dollars to buy U.S. assets - stocks, bonds and investment property. These investments exactly balance the trade deficit and are referred to as our capital surplus.

When viewed as a capital surplus, the trade deficit doesn't seem so problematic. The image of foreign money lined up at our borders trying to get in is a positive one for the U.S. A capital surplus is the result of the U.S. economy creating investment opportunities which are attractive to people in the rest of the world.

Taken by itself, a trade deficit is neither good nor bad. What matters is how we are using the foreign investment dollars. If we are using them to finance future growth, a trade deficit can continue indefinitely. If instead, we are using them to finance wasteful spending, the oft-predicted ruin will surely follow.

Absent restraint, capital moves to where it is most welcome. Based on our rule of law and our capital friendly policies, the U.S. has been a magnet for capital for a long time. Recently, as barriers to capital movement have come down, particularly in the developing world, the external pressure of foreign money trying to get in has created a capital surplus. The correct response is not to restrain ourselves but to continue the policies which allow our economy to absorb capital and to provide better growth opportunities than other developed countries.

## The Bottom Line: 3/31/2007

| Market Indicator | Current Value | One Year Change |
|---|---|---|
| **Large company stocks** *(S&P 500 Index)* | 1421 | +12.0% |
| **Small company stocks** *(S&P Small Cap Index)* | 412 | +8.6% |
| **Short term interest rates** *(3 Month T-Bill Yield)* | 4.9% | Up from 4.5% |
| **Long term interest rates** *(10 Year T-Bond Yield)* | 4.7% | Down from 4.9% |
| **Inflation** *(Consumer Price Index)* | 203.9 | +2.4% |
| **Energy** *(West Texas Intermediate Crude Oil)* | $65.87/bbl. | +1.1% |
| **The economy** *(Inflation adjusted GDP)* | $13.5 trillion | +2.5% |

QUOTABLE

"If the business does well the stock eventually follows."

Warren Buffett

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