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

Investment Matters

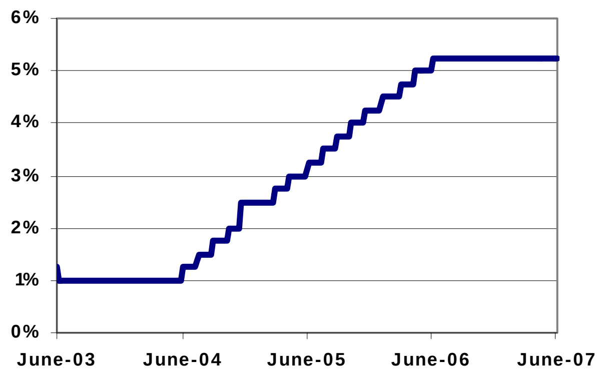
For the quarter ended June 30, 2007

Is the Fed's Next Move Up or Down?

Monetary policy, as illustrated by the actions of the Federal Reserve, is arguably the most important factor in moving markets. Excessively tight money in the late 1920's and early 1930's was surely a major cause of the Great Depression. However, appropriately tight money in the early 1980's broke the back of runaway inflation and set the stage for a long bull market.

As the chart nearby illustrates, the Fed raised short term interest rates from 1.00% to 5.25% in 16 steps from July, 2004 until June, 2006. Because a change in short rates has a lagged effect, the economy continued to grow at an accelerating rate until the third quarter of 2006, when it moderated some.

The Fed's objective is to provide appropriate conditions for sustained non-inflationary growth. By raising rates they hoped to rein in the expanding economy just enough to prevent inflation from catching fire, but not enough to bring on a recession. In June of last year they stopped increasing rates and adopted a 'wait and see' approach.



THE FED FUNDS RATE IS AT A PLATEAU

> *"The Fed's objective...to provide sustained non-inflationary growth"*

While the rise in rates had a profound negative effect on the housing boom, it has had little apparent effect on inflation. The core PCE deflator, the Fed's preferred inflation measure, has stubbornly stayed above the 2% high end of their target range. Furthermore, the weakening dollar has been signaling that Fed policy has been too loose, at least in comparison with other economies around the world. The recent halt in the dollar's decline coincides with tougher inflation talk by the Fed and a shift away from what was a broad consensus that the next Fed move would be down.

If the housing market firms up and core inflation stays high the Fed may feel that the economy can absorb one or two more inflation fighting rate increases. If housing remains a problem however, the Fed may be forced to ease again even if inflation has not yet come down. Although the Fed has been on hold for almost a year, the tipping point is getting close.

Contrarian Indicator Proven Valid

The cover of the August 13, 1979 issue of Business Week famously proclaimed "The Death of Equities", at a time when the Dow Jones Industrial Average was languishing at 875. Over the next ten years the Dow more than tripled in price to 2800.

Anecdotal evidence that the popular press is a good contrarian indicator is abundant, but until recently the premise had not been rigorously tested. A recent study published in the Financial Analysts Journal provides fairly conclusive evidence that there is valuable investment information content on the covers of popular business magazines.

The study examined headlines from 593 cover stories in Business Week, Forbes and Fortune over a 20 year period. Both positive and negative stories about featured companies were compared with the stock subsequent stock performance of those companies over the next 24 months. Superior and inferior stock performance was determined using

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Food or Fuel?

One fifth of the U.S. corn crop is now used to make ethanol.

Contrarian Indicator: continued

comparable companies or appropriate indexes.

The results, which are statistically relevant, indicate that positive stories about public companies generally indicate the end of a period of superior performance while negative stories usually mark the end of inferior performance. It appears that using popular magazine covers as contrary indicators is not just cynicism, but may produce better investment decisions.

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Cheap Labor Plentiful

86% of the people in the world live in developing economies.

Wealth Without Savings

Most everyone has heard that Americans spend more than they make. But it is also true that household net worth as a percentage of income is hitting new highs. How is it possible that we are getting richer even as we save less?

The Commerce Department defines the 'savings rate' as after-tax income minus consumption spending, divided by income. If you make $100 and spend $101, your savings rate is negative by 1%. Income in the calculation includes wages, dividends, interest and capital gains. Consumption spending includes goods, services and interest charges on loans. Mortgage principal payments are not counted as consumption spending and hence qualify as savings.

There are three important items which are not included in the official savings rate. First, if you buy a car or a computer, invest in a college education or remodel your kitchen, these items are treated as consumption rather than savings. This is true even though they may last for many years and may even grow in value with time. Compare durable goods such as these with disposable items like groceries, a haircut or a movie ticket and the difference is clear.

Second, if the value of your house or your stock portfolio rises, but you do not sell, nothing is credited to your savings. Only realized capital gains count as income in the savings equation. This creates the counter-intuitive conclusion that retired people who liquidate their stocks for living expenses are better savers than their middle aged children who are allowing their stock portfolio to grow.

The third item requires more explanation. The value of savings to our economy is the capital it provides for investment in productive assets. Banks loan money for business expansion. Corporations issue stocks and bonds in exchange for money to build new plants. Without a source of capital, economic growth will eventually stop.

One way to obtain investment capital is to get it from someone else. By providing attractive investment opportunities, America is able to attract foreign money to invest in our productive capacity. So long as America remains a magnet for foreign capital, foreign money can be used to supplement our savings. As the Wall St. Journal put it, "Foreigners are not buying up America's stock of wealth, they are investing in ways that add to it."

The low official savings rate is actually a sign of strength for our country. As long as America provides good opportunities for growth and investment, the need to sacrifice consumption to provide savings for the future will remain subdued.

The Bottom Line: 6/30/2007

Market Indicator	Current Value	One Year Change
Large company stocks *(S&P 500 Index)*	1503	+20.6%
Small company stocks *(S&P Small Cap Index)*	432	+16.0%
Short term interest rates *(3 Month T-Bill Yield)*	4.7%	From 4.9%
Long term interest rates *(10 Year T-Bond Yield)*	5.0%	From 5.1%
Inflation *(Consumer Price Index)*	207.4	+2.7%
Energy *(West Texas Intermediate Crude Oil)*	$70.68bbl.	-4.2%
The economy *(Inflation adjusted GDP)*	$13.6 trillion	+2.7%

QUOTABLE

"If you want to redistribute wealth, make it easy to become wealthy."

Arthur Laffer

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