

Financial Focus



Pegasus Asset Management

April 2006
2nd Quarter

1st Quarter 2006 Wrap-Up

Bond investors could be forgiven for thinking they saw light at the end of the tunnel at the beginning of this year. Coming out of 2005, market expectations were for the economy to show visible signs of slowing. Those expectations, many thought, would make the Federal Reserve pause its campaign of short-term interest-rate increases, and bond prices would rise.

Instead, healthy employment expansion and other economic data released in February and March suggest the economy is strong. That raises the specter of inflation and further interest-rate increases by the Federal Reserve, which would keep pressure on bond prices. The result was a rise in the benchmark 10 year Treasury yield to levels last seen in June 2004, when the Fed began its current campaign to raise rates. From 4.393% at the end of 2005, the yield rose to 4.857% at the end of March. (Bond yields move inversely to prices.)

After falling 0.6% in all of 2005, the Dow Jones Industrial Average rebounded 391.82 points or 3.22% to 11109.32 in this year's first quarter, breaking a three year streak of first quarter declines. It has moved within sight of a six year high, just 613.66 points off the record 11722.98 hit six years ago, in January 2000.

The broad Standard & Poor's 500 stock index did slightly better than the Dow industrials in the latest quarter, up 3.73%, to 1294.83. It rose 3% all of last year. The NASDAQ Composite Index, whose volatile technology stocks have continued to endure sharp ups and downs, rose 6.1% to 2339.79 in the first quarter, its best first quarter start since 2000. Last year it rose 1.4% for the full year. These two indexes, which were weighted down more than the Dow Jones Industrials in the 2000 to 2002 bear market by sagging technology stocks, remain far from their record highs, which date from March 2000. The S&P would have to rise 18% to return to its record, while the NASDAQ Composite would have to more than double.

Many analysts continue to warn that investors should brace for sharp ups and downs this year, as the outlook for interest rates and corporate profits becomes less clear.

Treasury – bond yields and benchmark short-term interest rates were at 45 year lows in 2003, which fueled that year's stock gains, as cheap money poured into the

financial markets. Companies and individuals found it easy to borrow and spend. At the end of 2004 to stave off inflation, the fed began to slowly raise rates. Last month's quarter-point increase marked the 15th consecutive rise, leaving the Fed's target rate for over-night lending at 4.75%.

Early this year the Fed signaled rates were nearing a neutral level, where they would be neither too low, creating the risk of inflation, nor too high, touching off the threat of recession. Federal officials indicated they would decide when to stop raising rates based on such inflation indicators as price data and employment levels.

The problem for investors is that the new Fed Chairman, Ben Bernanke, isn't proving to be the stock booster they were hoping he would be. After he presided over his first Fed interest rate meeting last month, he sent a signal that he intends to be as determined an inflation fighter as were his predecessors Alan Greenspan and Paul Volcker.

Investors took that signal to mean the Fed would definitely push its benchmark rate to 5% at this next meeting, in May, and might send it higher in June.

Some analysts and investors worry that the uncertainty about the Fed's plans, could help create more stock volatility this year than investors have already seen.

Retirement Corner... Did you know?

That Company Sponsored Retirement Plans such as 401(k)'s account for the sole savings of more than 50% of plan participants? With such an important part of the nest egg, what are your employees doing to ensure it is being managed properly? We can help. For more information contact John Sebastiano at 845-369-9422 or jms@pegasusassetmgt.com

Introducing ROTH 401(k)'s

Beginning in 2006, 401K plans will be permitted to allow employees to designate their contributions as Roth contributions. These Roth contributions will be subject to the same rules as Roth IRAs. This will allow employees to contribute money that has been taxed into a Roth where contributions and earnings will grow tax free until the participant retires.

COMPUTER BYTES

As small and convenient as a laptop or a notebook computer is, it still takes up considerable space and weighs a fair amount. Enter what the computer industry is now formally calling UMPC's (Ultra-Mobil Personal Computers), into the world of miniature PC's. Based on a design by Microsoft called Origami, these new hand held PC's, are about the size of a paperback book, 9 inches by 5 inches by 1 inch thick and weigh only 1.7 pounds with a viewing screen that is 7 inches diagonally. The device runs Microsoft's XP operating system and features additional software that allows the user to control the PC with a touch of a finger. Microsoft considers the device to be a fully functional PC with wireless and strong video support.

One manufacturer, Samsung Electronics Co., expects its model, the Q1, to be available in the summer of 2006 and will sell for between \$600 and \$1,200. The Samsung device comes with a 40 gigabyte hard drive and built in Wi-Fi and Bluetooth capabilities.

In addition to Samsung, Asustek Computer Inc. and Founder Group also plan on rolling out UMPC models this year.

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With more and more of our personal data being stored on portable devices (laptops, notebooks and UMPC's) security continues to be a major concern.

The first issue of security is the log-in procedure and passwords. Biometric technology hopes to replace the long list of passwords and better secure the entry into a device. Currently, two laptops come equipped with built in fingerprint recognition that replaces log-in passwords; the Portege R200 by Toshiba and the ThinkPad Z60t by Lenova Group. Additionally, Microsoft sells a fingerprint reader which attaches to any USB computer port running Windows XP.

The second security issue is the compromising of important data on a lost or stolen device. Palm Inc., the maker of the Treo devices recently announced that its newest smart phone will come with the ability to allow the administrator to wirelessly wipe out all information on the device. Wasn't that used in Mission Impossible back in the 70's?

Technology marches on...

NUMBERS TALK

Amount in billions of dollars, of originated sub-prime mortgages in the U.S. in 1996...97

Amount in billions of dollars, of originated sub-prime mortgages in the U.S in 2005...628

Negative savings rate percentage in 1933, the last year for a negative rate until 2005...1.5

Negative savings rate percentage in 2005...0.5

Percentage of U.S labor force that will reach the traditional retirement age by 2010...40

Percentage increase in monthly Social Security payments for 1991...5.4

Percentage increase in monthly Social Security payments for 2006, the largest since 1991...4.1

Percentage of senior citizens who plan on remaining in their homes as they age...81

Number of years, until 2005, that the U.S. Treasury Bond yield curve was inverted...24

Percentage increase of art prices in New York for the period January 2001 thru July 2005...47

Percentage increase of art prices in London for the period January 2001 thru July 2005...92

Percentage increase of crude oil in 2005...40

Number of times in 2005 that the Federal Reserve raised interest rates...8

In billions of dollars, the estimated savings in credit card finance charges if every card user raised their credit score an average of 30 points...16

In billions of dollars, amount Wal-Mart Stores says it has saved consumers over the past 19 years...263

Number of changes to the U.S. tax law since the tax reform act of 1986...15,000

If you would like to discuss any of the topics contained in this issue of "FINANCIAL FOCUS," contact either Rodd Berro or John M. Sebastiano, at 845-369-9422 or rberro or jms@pegasusassetmgt.com.

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