

Financial Focus



PEGASUS
ASSET MANAGEMENT

July 2006 • 2nd Quarter

2nd Quarter 2006 Wrap-Up

After a strong first quarter, stocks gave investors a wild ride in the second quarter, leaving many market experts pondering how much more volatility could be in the future.

The Dow Jones Industrial Average was up more than 8% for the year on May 10, less than 100 points away from the record. Then the Dow began gyrating putting in 100 point declines and advances in rapid succession, as investors debated the market's outlook. The Dow Industrials would give up half of the year's gain by the end of the second quarter. The Dow ended the quarter at 11150.22, or 0.37% for the quarter and up 4% for 2006. That left it 572.76 points short of the record 11722.98, which dates back from January 2000.

In more than seven years, since mid-1999, blue chip stocks as a group haven't done more than move sideways – and most technology stocks, which suffered most of the long bear market, are languishing well below their records.

Behind the market's uncertainty is Federal Reserve Chairman Ben Bernanke, who took office on February 1, 2006, and began issuing statements that took some investors by surprise. After initially indicating he was looking for a way to pause in the Fed's two year campaign of interest rate increases, Mr. Bernanke changed his tune in May. He began warning that he was seeing signs of inflationary pressures that could keep the rate increases coming. Then, after the Fed's latest policy meeting in June, he changed again. The Fed issued a statement hinting that it's looking for a way to break from further rate increases.

Stock investors have been fixated on interest-rate news because, historically, rising rates often have been what has derailed bull markets. Higher rates are bad for stocks because they raise business costs and squeeze profits. They make alternate investments, such as money-market funds, more attractive.

Even if the Federal Reserve breaks from further rate increases, indications from Europe and Asia are continuing rate increases, as well as increase reserve requirements for banks. The worldwide tightening of monetary policy has made investors more cautious. Throughout the world, they had used cheap money to buy stocks and other financial investments. Now, feeling the pinch of tighter money, investors have pulled back from some riskier investments.

The Nasdaq Composite Index, dominated by technology stocks, had been up more than 7% for the year at its high on April 19. It gave up all of its gains and finished the

second quarter at 2172.20 down 7.17% for the quarter and down 1.5% for the year. The Standard & Poor's 500- stock index finished June at 1270.20, down 1.9% for the quarter but still up 1.8% for 2006.

Small U.S. stocks suffered, too. The Russell 2000 small stock index, which had more than doubled from its 2002 low, was trading at a record in May, up 16% for the year. Since then, it has fallen 7.3%, despite a late-June rebound. It finished Friday at 724.67 down 5.3% for the quarter but still up 7.6% for the year.

Worrisome to stock investors has been the run-up in bond yields. Treasury yields, especially on the 10-year note, are benchmarks for a wide variety of other market interest rates, notably those of fixed-rate mortgages. For more than a year, bond yields had remained persistently low despite the Fed's steady increase in short term rates.

Starting this year, bond yields followed short-term rates higher, crimping economic growth, consumer spending and corporate profits. The 10-year note's yield was a 95 low as 4.3% in January. It pushed above 5% in April and kept rising, finishing the quarter at 5.145%.

Many investors believe stocks are fundamentally sound; however there is a higher degree of risk aversion with rising interest rates, energy prices and stock market volatility.

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

The growing number of chronic illness cases coupled with continuing nursing shortages, has the health-care industry turning to new technology for home based, patient operated, solutions. These communication gadgets allow patients to transmit to their health-care providers' weight, blood sugar, oxygen levels and other vital health data. Although the systems themselves can be costly to obtain, the long term costs can be less and the potential for heading off more serious illnesses should lead to reduced expenditures.

Equipment such as American Telecare's CareTone Telephonic Stethoscope, monitors heart, lung and bowel sounds then transmits them over normal phone lines using the company's two way video stations allowing patients to remain at home, monitor their progress without the need of professional health-care aides. Other equipment currently available includes Honeywell HornMed's Genesis which can monitor oxygen saturation, weight, along with glucose levels and Matria Healthcare's Home Uterine Activity Monitor, which can watch contractions that may signal preterm labor. More devices are coming to market quickly and with the growing ease of use of wireless communication so should their effectiveness and portability grow.

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How about a digital video camera which can be held in the palm of your hand, shoots 30 minutes of video, is easy to use, and costs less than \$130? The Point & Shoot Video Camcorder by Pure Digital Technologies is just such a device. Running on only 2 AA batteries, with a built in USB plug and operating software for instant viewing and sharing with your PC, this gadget should be a consumer hit. Although the current initial model has only a basic and limited lens along with a limited microphone, Pure Digital has been smart enough to license out their design to some of the more prominent electronic brands, including RCA, who will no doubt tweak the camera with greater memory, better lenses and a superior microphone. Camera shy people beware!

Technology marches on...

NUMBERS TALK

Percentage of trades currently executed on U.S. stock exchanges attributed to hedge funds...30

Number of years the NY Stock Exchange was a non-profit entity before its IPO in March of 2006...213

Percentage of United States citizens, who after paying for essential bills and discretionary spending, have no money left at the end of the month...22

United States ranking out of 42 countries for the highest percentage of citizens left with no money after essential and discretionary spending at the end of the month...1

Percentage of U.S. gross domestic product consumed by health care costs in 1997...13.6

Percentage of U.S. GDP currently consumed by health care costs...16

Percentage of businesses with fewer than 100 employees that offer a retirement plan...44

In millions, the number of American senior citizens who are financially mistreated through investment scams...5

In millions of dollars, the amount that NFL players have been bilked out of by investment scams since 1999...42

Number of months that past before 33 percent of newly retired individuals (average age of 61) return to the work force...18

Percentage increase from 1991 to 2001 for individuals, age 55 to 64, who filed for personal bankruptcy in the United States ...85

Percentage increase from 1991 to 2001 for individuals, age 65 and above, who filed for personal bankruptcy in the United States ...244

Percentage increase of housing prices in the United States for 2005...13

Total amount in billions of dollars that Americans gave to charity in 2005...260

Percentage increase for Americans in charitable giving from 2004 to 2005...6

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 e-mail us at rberro or jms@pegasusassetmgt.com.

Remember, past performance may not be indicative of future results. Different types of investments involve varying degrees of risk, and there can be no assurance that the future performance of any specific investment, investment strategy, or product made reference to directly in this newsletter, will be profitable, equal any corresponding indicated historical performance levels, or be suitable for your portfolio. Moreover, you should not assume that any discussion or information contained in this newsletter serves as the receipt of, or as a substitute for, personalized investment advice from Pegasus Asset Management