



October 2006 • 3rd Quarter

3rd Quarter 2006 Wrap-Up

Literally and figuratively, Wall Street has been transformed in the past five years. Investors are now taking new paths with commodities such as oil and gold, while large companies reorient themselves, aggressively investing in post-9/11 necessities such as security, defense, and even water.

Defense and security companies understandably have received much more investment attention now than they did in the past. Still, the larger interest is in commodities such as oil and gold. On September 10, 2001, crude oil closed at \$ 27.83 a barrel and gold finished the day at \$273 an ounce. Earlier this year, oil hit a high near \$80, a 189% gain in five years, and gold topped \$725, a 166% rise.

Surging demand from China and India has been the primary driver, but the fact that these commodities are derived from hostile or politically unstable regions has further accelerated this drive. The turnaround: crude-oil hit a six-month low on September 25, 2006, below \$ 60 a barrel, as natural gas also fell to its weakest price in nearly three years; this as a result of easing tensions with Iran. As a result of their performance and the overall desire among large pension funds and others to diversify their portfolios, commodities continue to be a major institutional asset class.

Also notable, the housing market has been on top of the Federal Reserve's list of concerns. Ben Bernanke's decision to hold the federal-funds rate target at 5 ¼% has reinforced what has become increasingly obvious: the "cooling" of the housing market. Although sales of existing homes in August didn't fall as sharply as expected, median sales fell for the first time in 11 years.

The economy's slowdown is ongoing; a downshift from the strong pace displayed at the beginning of the year. When the housing market spiraled in previous cycles, it was due to tight credit. Credit isn't the issue this time around; home prices simply got out of sight.

When asked about the growth of inflation and its risk potential facing the economy, former Federal Reserve chairman Alan Greenspan declined to comment. What he did say was that much of the run-up in housing prices has apparently been due to speculators and investors, not homeowners, and that low interest rates worldwide have played an important role in underpinning housing.

On the blue-chips: analysts seemed unsure about whether the downturn by stocks will be severe, looking back to May when stocks tumbled after the blue-chip average last

neared its record, or if it would simply be a pause that will refresh before another push higher. In late September, a surge in the blue chips to within a half percent of their record was due to a rebound in the Conference Board's consumer confidence index, which seemed to mirror the drop in retail gasoline prices.

The Dow flirted with its record closing high of 11,722.98, set on January 14, 2000. Adding 170 points, or 1.5%, the Dow finished at 11,679, ahead by 9% year-to-date. The S&P closed the final week of the quarter adding 1.6%, ending the quarter at 1335.85, ahead by 7% year-to-date. The NASDAQ composite closed at 2,258.43, adding 1.8%, ahead by 2.5% year-to-date. Bonds, meanwhile, gave back a bit of their recent impressive gains, with the benchmark 10-year Treasury note's yield edging up to 4.58% from 4.54%.

Small-cap funds on average lost 0.7% in the period, while midcap portfolios turned out a 0.6% gain. Weakness in small-cap growth stocks shaved 2.5% from related funds, and midcap growth funds fell 1.1% on average.

The concern forthcoming is the strength of the economy and corporate profits. The earnings season is crucial, not so much for quarter's results, but for the months to follow.

Sources: *Barron's*, September 2006; *MarketWatch*, September 2006; *The Wall Street Journal*, 2006

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**

If you watch science fiction movies, one of the questions often asked is “where do they come up with those ideas?” Well more often than not, they are derived from fact and not fiction.

In 2002, the Tom Cruise film “Minority Report” featured technology that enabled individuals to manipulate computer images on a screen by the wave of their hands. For more than five years, Microsoft’s research department for unusual human-computer interfaces has been working on TouchLight technology; a system designed to do just that. Despite, however, the five years of work and a successful prototype, no product has come to market.

That could be about to change. A small company called Eon Reality Inc., which currently makes 3D computer models for businesses such as Boeing, recently licensed TouchLight from Microsoft. Using three cameras behind a semitransparent screen, Touchlight allows you to rotate, turn and grab images on the screen by picking up the hand movements as perceived by the human eye and translating them to motion of the item viewed.

Initial uses being contemplated are as a marketing tool and interactive advertising. Keep your eyes open.

Technology marches on...

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 **NUMBERS TALK**

Including all share classes, number of mutual funds with over \$1 billion in assets...1,123

In billions of dollars, amount of assets held by the largest mutual fund including all share classes...137

Number of millionaires in California, out of the nation’s 3.5 million...572,000

Total number of individual bankruptcy filings in the United States in the first quarter of 2006...102,949

Total number of individual bankruptcy filings in the United States in the second quarter of 2006...142,815

In millions, number of senior citizens (over 65) residing in the United States in 2004...36.3

In millions, estimated number of senior citizens residing in the United States in 2030...70

The percentage of senior citizens residing in the United States living below the poverty line in 1959...35

The percentage of senior citizens residing in the United States living below the poverty line in 2005...10

In dollars, average annual premium for a 55 year old to purchase three-year long term care insurance...772

In dollars, average annual premium for a 65 year old to purchase three-year long term care insurance...1,456

Percentage of grandparents who contribute money to their grandchildren’s college education...55

Percentage of grandparents who contribute \$5,000 or more a year to their grandchildren’s college education...15

Number of pages for General Electric’s e-filed tax return in 2005...24,000

Percentage of tax payers who successfully appeal the IRS and receive some amount of relief...41

In millions, number of additional tax payers in 2006 who would have faced the minimum alternative tax had congress not passed legislation...18

In 2005, the percentage of residential real estate transactions that were second home purchases...39.9

Average time in minutes a commuter traveled, one-way, per day, in 2005...25.1

Average number of people in a U.S household in 2005...2.55

Average number of television sets in a U.S. household in 2005...2.73

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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.

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