

# The Advantage Advisor

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## Market Commentary:

The stock markets have provided truly remarkable return for two months in a row now. Right at the end of May, the S&P-500 Stock Index finally pushed above it's prior record high close, set back in March, 2000. Thinking back to those days, there were very few who would have believed that an investment at that time would have provided no positive returns for more than seven years!

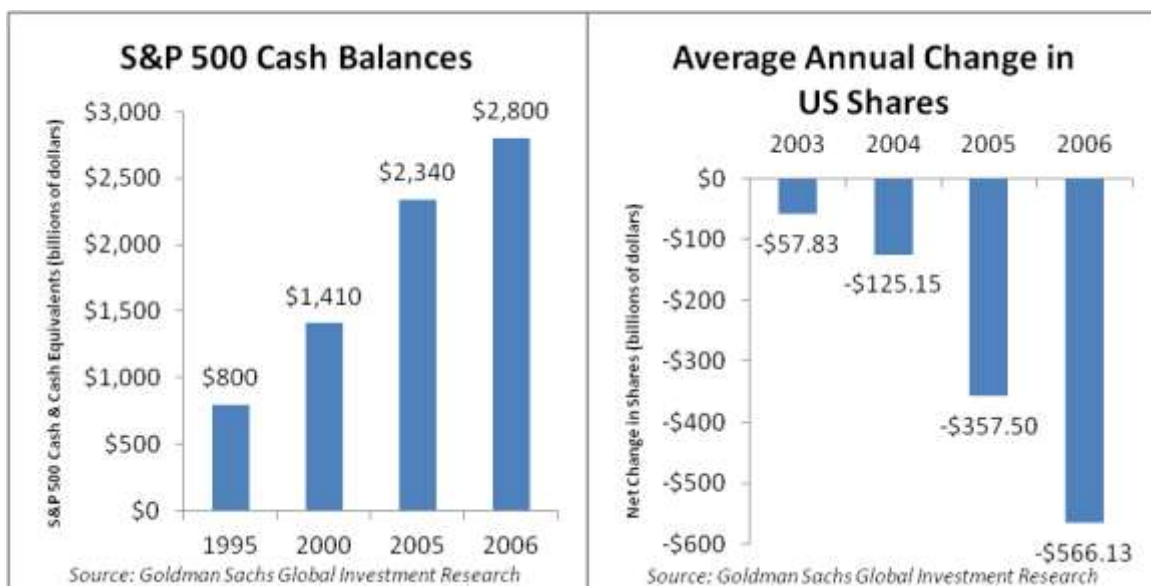
Of course, once again I must bring up the fact that this kind of advance cannot sustain itself for the long term. I'm not trying to call an end to things, just to be realistic. As I pointed out last month, the S&P-500 is running about at the long term 9.5% annual trend, so we are not overheating as yet. As I also pointed out last month, the market is being supported by record high corporate cash balances and record breaking reduction in shares outstanding.

The two charts below detail how that trend has increased over the past several years. In addition, from 1999 through 2006, earnings per share for the S&P-500 grew by 70.7% while the price actually fell by 3.5%. In other words, even though the S&P-500 is

Market Index	Closing Price	% Change
Dow Jones Industrial Average	13,628	4.32%
S&P-500 Stock Index	1,531	3.25%
Russell 2000 Stock Index	847	4.00%
Shearson Treasury Bond Index	13,821	-1.92%
Dow Jones World Stock Index	305	2.80%
Nasdaq Composite Index	2,605	3.15%

now at new highs, companies are trading at far more reasonable levels.

There is yet one market that does cause me concern over it's value - that is China. The Chinese market has provided incredible returns over the past several years, and now even the Chinese government is stepping in to slow the rate of foreign investment. While the Chinese economy continues to expand at a record rate of more than 10% per year, the stock market has far surpassed that rate, and is definitely in "bubble" territory. Because of this, I am already reducing our direct exposure there in favor of other international markets that are much more fairly valued.



# The Economic Picture

This has been a very active month in terms of economic reports and changes in outlooks by major economists. In fact, all of the data has caused a dramatic change in the outlook for the Fed to lower interest rates during 2007. Thanks to stronger than expected readings in the job market and persistently high energy prices, the financial markets are now pricing in virtually no chance of a rate cut this year.

While high energy prices have been a consistent problem, inflation is still well contained. The core PCE deflator is now running at 2.0% year over year. That effectively puts it inside the Fed's non-official inflation comfort zone. If that trend continues, the headline rates should moderate by year-end as well, giving us all some additional breathing room.

As we move along in the economic cycle, we may soon see a shift into a stage four economy. As you can see in the charts below, we are looking at a potential top in bonds, which corresponds to a low in interest rates. That is not to say that we expect rates to start rising anytime soon. It is more likely that interest rates will move along in a sideways range between 4.8% and 5.2% in terms of the benchmark Ten Year Treasury Note.

In a stage four economic environment, earnings driven companies will outperform other asset classes

Current Economic Position:  
Stage 3—Growth

## Economic Indicators

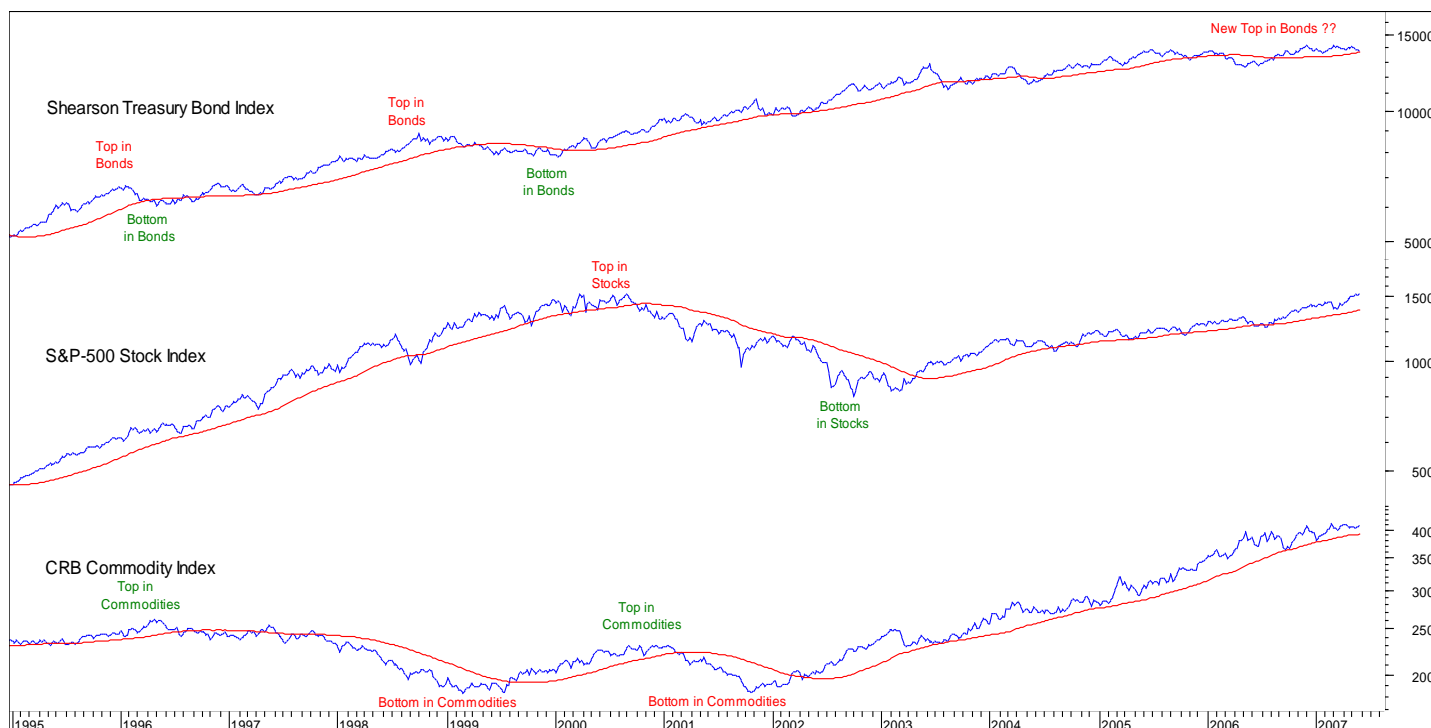
	Latest	Prior
<b>Growth</b>		
<b>GDP</b>	+0.7%↓	+2.5%
<b>Productivity</b>	+1.7%	+2.1%
<b>Employment Cost Index</b>	+0.8%	+0.9%
<b>Capacity Utilization</b>	81.6%	81.2%↓
<b>Inflation</b>		
<b>Consumer Price Index</b>	+0.4%	+0.6%
<b>Core PCE Deflator</b>	+0.1%	+0.0%
<b>Implicit Price Deflator (GDP)</b>	+4.0%	+1.6%
<b>Sentiment</b>		
<b>Consumer Confidence Index</b>	108	106.3↑
<b>Unemployment Rate</b>	+4.5%	+4.5%
<b>Personal Income</b>	-0.1%	+0.8%

↑=revised up, ↓=revised down

Source: Moody's Economy.com

(growth stocks over value stocks), and interest sensitive stocks will see their peak. We would normally have already seen a top in commodities prices, but global demand has kept those elevated, and so we may not see that turn until the global economy begins to slow.

Housing is still the greatest potential weakness for our economy. There are signs though that the bottom is forming. For example, while the S&P/Case-Schiller Home Price Index nationwide dropped by 1.4% year over year, several individual metropolitan areas reported strong gains. We will continue to keep a close eye on this situation.



Source for Data: Investor's Fast Track

## How's Your Investment Mileage?

Fuel efficiency is a hot topic these days. As the cost of fuel rises, it becomes all the more important to have a vehicle that gets the most out of every gallon of gas. When it comes to your investments, there is another measure of efficiency that is often ignored, but shouldn't be. That is how much return you are getting for the amount of risk are you taking. In other words, what is the mileage of your investment portfolio?

Investment risk is a bit of a nebulous term, and there have been many ideas about how it should be measured. The most widely accepted measure of risk is the volatility of returns. This is generally measured by looking at the standard deviation of investment returns over a specific time period. For those unfamiliar with the term, the standard deviation is a measure of the average difference of the various returns for the period from the median or central return. The more volatile (or risky) an investment is, the higher the standard deviation.

Advantage Investing strives to provide our clients with the maximum return for the minimum amount of risk. To see if we are doing our job properly, we can look at two different statistics based on the standard deviation. The first is called the Standard Return, and it is simply the total annualized return divided by the standard deviation. This is a pure measure of just how much return you get for

each unit of risk. For this measure, the higher the number, the more efficient the return.

The other risk measure is known as the Sharpe Ratio. This is very similar to the standard return except that it strives to measure only the return generated by an investment that is in excess of the "risk free rate". The risk free rate is simply the return any investor could achieve by putting their money into US T-Bills and receiving a return that is essentially free of risk because it is guaranteed by the US Government. Once again, a higher number shows a more efficient investment. Also of note, if the Sharpe Ratio is negative, then the investment did not even keep pace with a risk free investment, so it was very *inefficient*.

The table below shows these risk measures for each of our investment strategies, for three major market benchmarks, and for a group of well known individual blue-chip stocks. As you can see, each of our investment strategies have been doing a great job at maximizing return while minimizing risk. In particular, both the Bond and Strategic Allocation strategies took top honors in both of the efficiency measurement categories, as well as handily outperforming the market benchmarks for total return. For clients of Advantage Investing, it is almost like getting the mileage of a Toyota Prius Hybrid with the performance of a Dodge Viper! That is a combination that is pretty tough to find.

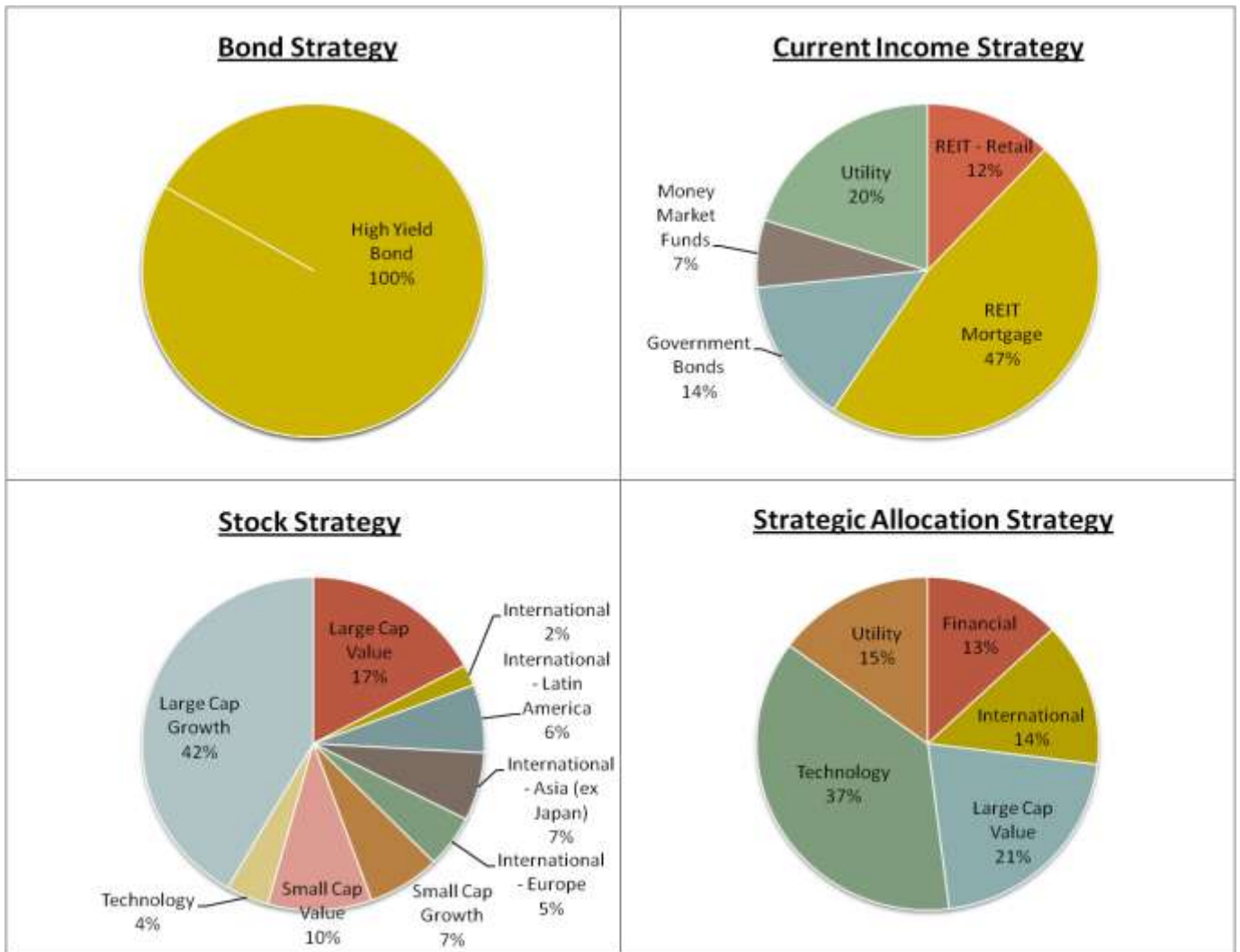
**Risk and Return Statistics 1/1/2002 - 3/31/2007**

	Annualized Return	Standard Deviation	Standard Return	Sharpe Ratio
<b>Bond Strategy</b>	10.3%	3.0%	3.5%	2.6%
<b>Current Income Strategy</b>	8.2%	4.4%	1.9%	1.3%
<b>Strategic Allocation Strategy</b>	16.1%	6.0%	2.7%	2.3%
<b>Stock Strategy</b>	4.8%	7.2%	0.7%	0.3%
<b>S&amp;P - 500 Stock Index</b>	4.2%	7.4%	0.6%	0.2%
<b>Dow Jones US Corp Bond Index</b>	6.5%	2.8%	2.3%	1.4%
<b>Shearson Treasury Bond Index</b>	6.7%	4.5%	1.5%	0.9%
<b>Berkshire Hathaway Inc (BRKA)</b>	7.2%	7.4%	1.0%	0.6%
<b>Exxon Mobile Corp (XOM)</b>	15.8%	9.2%	1.7%	1.4%
<b>General Electric Co (GE)</b>	0.3%	8.1%	0.0%	-0.3%
<b>Microsoft Corp (MSFT)</b>	-0.8%	10.4%	-0.1%	-0.3%
<b>Wal-Mart Stores Inc (WMT)</b>	-3.1%	6.5%	-0.5%	-0.9%

All returns are shown after fees for all investment strategies. Past performance cannot guarantee future results.

Source for index and stock data: Investor's Fast Track

# Current Investment Management Strategy Allocations



There were no dramatic changes to our investment strategy allocations this month. However, there were some minor adjustments made in order to tweak things as the economic cycle continues to roll forward.

## Bond Strategy

This strategy remains 100% invested in high yield bonds. This continues to provide superior returns while keeping risk to a minimum.

## Current Income Strategy

This strategy continues to benefit from its positions in both Utilities and REITs. As utilities have climbed to higher levels we have re-allocated some of those gains into higher income positions in order to raise the yield a bit.

## Stock Strategy

This strategy saw the most activity right at month-end. The incredible gains in the Asian markets, particularly in China have caused us to now reduce our exposure there. We re-allocated half of our position there into Latin America. We also continued the shift from small cap stocks and into large cap. Summer is typically a slow time for tech stocks, so we will be watching for buying opportunities to add to that sector.

## Strategic Allocation Strategy

The overall sector allocation remain the same for this strategy, but we have made some shifts within those sectors. In the international holdings, we shifted from a global growth focus to a Latin America focus. Within the Financial sector we shifted to a Financial Services and Brokerage focus.