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summaries

SIGMA INVESTMENT COUNSELORS

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The Economic and Market Environment

In Sum: Global equity markets began to soften somewhat in early June, in apparent response to inflation concerns. This also caused interest rates to rise. Russian relations with many European countries and the US have stiffened. Economic growth has been sustained throughout most of the developed world, with growth in the US moderating this year. Many major central banks have raised interest rates, while the Federal Reserve Board has held steady. Government budgets are improving. The major risk appears to be investor psychology given the recent spate of weakness in equity markets following a strong advance.

Geo-political: The relationship between Russia and the US/Europe has worsened in the past several months. The catalyst appeared to be the announcement by the Bush Administration of its intent to place interceptor missiles in Poland and the Czech Republic as a component of their common defense strategy. As a practical matter, Russian/West relations began to sour three or four years ago when it became evident that Russian President Vladimir Putin was pursuing tactics that were considered un-democratic. While relations have not deteriorated to the point where economic activity has been affected (Russia's premier airline, Aeroflot, recently announced a multi-billion dollar order for Boeing jets), a more constructive environment is desired. This is particularly true if progress is going to be made in resolving issues with Iran and North Korea, as well as improving the situation in Iraq.

Economic: Global economic growth has been robust enough to warrant interest rate increases in many developed nations in order to contain inflationary pressures. Fuel cost increases have been garnering most headlines, but industrial metals and certain agricultural products have also seen notable price increases. The sustainability of these increases is foremost in investors' minds. A reasonably poignant analysis regarding overblown inflation fears appeared in the June 12, 2007 issue of the *Financial Times*. The key point was that the relationship between food prices and inflation has been losing cohesiveness during the past few decades. We believe that natural financial governors will prevent a return to spiraling inflation.

Monetary: While several central banks around the globe have been raising interest rates, the Federal Reserve Board has kept rates steady in the US for several months. Domestic economic growth moderated as the prior interest rate increases began to "bite." Economic and inflation data will be watched closely over the next several weeks to determine whether a policy reversal is in order, or whether the current course of watching and waiting is the appropriate response.

Fiscal Policy: As the year has unfolded, further improvement has been registered in the US federal budget deficit for 2007. *The New York Times* recently reported healthy finances amongst the individual states so far this year. Earmarks, the term applied to specific spending requests lodged by individual members of congress to benefit their regions, continue to garner close attention from the US House Appropriations Committee. It would appear that this discipline may enable legislators to continue to manage spending and allow for a focus on longer term funding issues such as growing entitlements.

Equity markets: After several months of strong global equity market price appreciation, early June saw the onset of a broad, but contained, pullback in securities prices. Seasonal patterns have persisted for decades which generally show summer common stock price weakness. It is still too early to determine if this corrective phase will mimic past periods of seasonal weakness, or if a changed economic outlook is precipitating said weakness persisting beyond summer.

Fixed income markets: Interest rates have risen materially in the past few weeks as concerns over inflation heightened. There was a generalized expectation that the hitherto “flat” yield curve would resume its normal upward sloping shape reflecting the fact that longer dated fixed income securities would provide higher interest rates than shorter term securities. This process is materializing. As rates on the longer end of the maturity spectrum rise, it may be appropriate to consider investing in these issues if personal circumstances warrant it.

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Please remember to contact Sigma Investment Counselors if there are any changes in your financial situation or investment objectives.

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