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summaries

SIGMA
INVESTMENT COUNSELORS

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How Quickly Perceptions Can Change!

As a child, I remember going to the circus with my parents and looking up to watch the tightrope walker high above. At one moment they looked fine. But then, seemingly from nowhere, they would appear to lose their balance. We would watch them flail around for what seemed like an eternity, then regain their balance and continue along their walk. This sequence of activity would be repeated two or three times before safely reaching the other side. The audience perception of the tightrope walker's safety or danger changed rapidly. This analogy can be quite appropriate when observing investor perceptions of the Federal Reserve's ability to walk the tightrope between inflation and recession. Market actions are a direct reflection of investor perceptions of where the economy is headed at any moment in time. As we all know, perceptions can differ from reality and perceptions can also change quickly. One of our responsibilities as your investment counsel is to seek out data and information that will assist us in determining realities and misconceptions about the economy.

In our view, the Federal Reserve continues to successfully walk the tightrope, navigating the economy between recession and renewed inflation levels. This was not the perception just a few short weeks ago. February twenty-seventh we experienced the biggest one-day decline in the Dow Jones Industrial Average since the aftermath of the September eleventh tragedy. The February market decline centered on investor fears of tightening credit by the Chinese government combined with former Federal Reserve Chairman Alan Greenspan's comments suggesting the "R" word, recession, was on the horizon.

How quickly perceptions can change! At the close of trading on May 11th the Dow Jones Industrial Average had been up 26 of the last 31 sessions and was trading at all time highs. The S&P 500 traded just 22 points shy of its all time high set back in March of 2000.

Which perception is correct, that of late February or that of mid-May? The economic data over the past few months has been mixed but from our perspective still more than convincing enough to be in the camp of low growth, not recession. First quarter corporate profits have been reported well above expectations. Commodity prices continue to rise. The inflation rate has remained above 2% and for a fourth straight week unemployment claims declined to under 300,000. Activity readings in April for both the manufacturing and service sectors improved. Offsetting this information are ongoing concerns about the consumer (most notably the reported weakness in housing), concerns about consumer debt levels, consumer bankruptcies, and weakness in recently reported retail sales activity.

summaries

We believe that neither the February downdraft nor the almost unabated upward climb accurately portrays the current economic environment. Rather, after a long and strong economic recovery, we are operating in a more tenuous economic environment. But on balance, we continue to believe the glass is half full, not half empty. As stated above, we believe we are in a period of slower economic growth, not a period of recession.

As you may recall, in our February Sigma Summaries we discussed market themes and the opportunities for U.S. companies with overseas sales and operations. We wrote:

> "Our expectation is that companies with sales and operations overseas will benefit as foreign profits are translated back at higher dollar values. This will be of particular benefit for mid and large-cap companies in the U.S."

Overseas activities have in fact played a significant role in corporate profits, which were up 8.5% in the first quarter versus analyst expectations of 3.5%. This upside earning surprise for many companies has helped to drive the recent equity market activity.

We expect the underpinning of this earnings growth will continue to provide attractive opportunities for equity investors. However, the rising tide will not lift all boats. Not all companies will be treated equally. As we have seen, companies unable to meet expectations or demonstrate to investors their ability to grow and sustain increased margins have experienced significant stock price declines. Understanding the themes that are at play in the economy will continue to be a key to successful equity investments. We continue to believe that companies with overseas sales and operations will continue to do well in this economic environment. In addition, those companies with exposure to industrial and commercial products and services will continue to be areas where we will focus attention and overweight sectors. As we stated in February, we continue to see valuation disparities between large and small capitalization stocks that favor investment in larger companies. This dovetails with our thesis about the importance of international exposure.

With regard to interest rates, in February we suggested that the inverted yield curve was not a sign of pending recession but rather a short term aberration that would be corrected by a reduction in short term rates. At the time of this writing spreads between short and long term rates remain tight, but we have begun to see a slight decrease in short term rates. As we move forward we believe the overall economic data will likely indicate that we are in a slow growth environment and that the "predominant" concerns of the Federal Reserve will remain that of inflation, not recession. The Federal Reserve has maintained the federal funds rate at 5.25% for the past 11 months. Our expectation is that they will not lower rates in June. It will be mid to late summer before we would anticipate any rate reductions by the Federal Reserve.

In short, we continue to be optimistic about the equity markets and believe the underpinnings for the economy will lead to a slower growth environment than we have experienced in the past few years, but still a growth economy. Our challenge as your investment advisor is to stay the course and interpret the data without being swayed by the emotions of the market.

Denise M. Farkas, CFA

Hard Work and Commitment

Sigma Investment Counselors is pleased to announce that we have been identified as one of the "Best Managed Firms"* based on a study that was recently completed by Moss Adams, a leading accounting and consulting firm. Charles Schwab routinely commissions Moss Adams to conduct studies regarding the organizational effectiveness of independent investment advisors.

The staff at Sigma is very proud of the fact that our firm ranked so high in this study relative to our peers. However, we also recognize that the job is never done. We are continuously improving our operational efficiency, as this allows us to free up valuable resources to better serve our clients.

We recognize that organizational effectiveness does not necessarily translate into superior customer service or investment performance. Nevertheless, we would like to think that the time and energy that we have spent improving our operational effectiveness is indicative of our desire to constantly improve all aspects of how we are running our company, most importantly, how we service our clients and improve our investment performance.

We are also proud of our long running inclusion in the list of the largest money managers in the Detroit community published by *Crain's Detroit Business**. This feat represents 34 years of hard work and commitment. As we set our sights to the future, we are not pursuing growth merely for growth's sake. Instead, we are focusing our energy in serving our clients to the best of our ability, confident that if we continue to excel in this regard we will attract additional clients via word of mouth and public recognition.

Clearly, these achievements reflect the cumulative effort of all of the employees of Sigma and we recognize that our people are indeed our most valuable asset. Of course, well trained and motivated professionals migrate to effectively managed companies and we would like to think that this was the reason we were able to attract our highly regarded Chief Investment Officer, Denise Farkas, CFA earlier in the year. In the same spirit, we are pleased to introduce another addition to our team, Chris Frayne. Chris worked for us as a summer intern following his junior year of college in 2006. This past month, Chris graduated magna cum laude from the University of Michigan, Ann Arbor with a BSE in mechanical engineering. Chris was recognized by the dean's office for outstanding academic performance on four occasions and was awarded all-Greek academic honors by the University of Michigan Office of Greek Life. Chris joined Sigma full-time this month where his current responsibilities include research, investment analysis, and providing daily support to Sigma's portfolio management team.

Christopher J. Kress, CFA

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The views in this publication are as of May 2007 and are for informational purposes only. The information presented has been gathered from sources believed to be reliable. Statements concerning financial market outlook are based on current market conditions, which will fluctuate. Keep in mind that each sector of the market entails risk.

* Inclusion in the *Crain's Detroit Business* list is unsolicited; however each entrant is required to complete a questionnaire in order to be considered. Firms considered for inclusion in the Moss Adams white paper were those who custody assets at Charles Schwab and complete a comprehensive survey detailing business operational characteristics. The best managed companies represent the top 15% of all of the firms that completed the survey, based a variety of specific criteria.

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