

SELECTOR[®] Money Management

2005 Second Quarter Review

The second quarter of 2005 was better than the first quarter, but year-to-date, major market indexes are still slightly lower. The S&P 500, Russell 2000 and the NASDAQ Composite increased by 0.9%, 4.0%, and 2.9%, respectively, in the second quarter. The month of April was very rough for equities, but the damage was repaired during the months of May and June. Year-to-date the S&P 500 is now down 1.7%, with the Russell 2000 down 1.25% and the NASDAQ Composite down 5.4%. International equities fell by less than 2% in the second quarter as measured by the EAFE and the Dow Jones World indexes, but remain in positive territory for the year.

Economic reports were generally positive during the second quarter, but the spotlight was stolen by oil prices. Oil topped \$60 a barrel for the first time in history, before settling at \$56.50 at quarter's end. In the past, higher oil prices translated immediately to higher inflation. Today, industrial oil consumers use futures contracts to 'buy forward' so the impact of higher prices does not drop right to the bottom line for their customers. Those of us who buy gasoline at the pumps feel that 'spot price' impact, and eventually high oil prices will impact the general economy. But for the time being, inflation numbers have been holding steady at very tolerable levels of 1.9%, as measured by the Consumer Price Index, or CPI, for May.

The Federal Reserve Board continued to raise their federal funds and discount rate targets, with two additional hikes during the 2nd quarter. We have now seen 9 consecutive increases by the Fed, with these short term rates now at 3.25%. Economists anticipate further increases this year. Interestingly, working interest rates such as the interest rates paid by intermediate and long-term corporate bonds, government and agency issues, and tax-exempt bonds, continue to decline. The benchmark 10-year Treasury note was yielding 4.2 % at the start of the year, and 4.5% after the first quarter. At the close of the second quarter the yield had dropped to 3.9%. Lower intermediate and long-term interest rates correspond to higher bond prices, which is good for bond investors. Lower rates also contribute towards a favorable environment for equities, and the economy in general.

In May, SELECTOR[®] Money Management added high quality bond positions to most portfolios. These adjustments were in response to technical weakness that emerged in April, and increased volatility in equities during the 2nd Quarter. **SELECTOR[®] Aggressive Growth** allocations remain 100% invested in equities. **SELECTOR[®] Growth** is now 80% equities, 20% bonds. **SELECTOR[®] Conservative Growth** portfolios are 60% equities, 40% bonds. **SELECTOR[®] Balanced Growth** allocations were shifted to 60% bonds, 40% equities, and **SELECTOR[®] Income & Growth** allocations are now 80% bonds, 20% equities.

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