

SELECTOR[®] Money Management

2006 Year End Review

2006 was a good year for domestic equities markets. The S&P 500 closed +15.79% for the year, while the NASDAQ Composite closed +9.52%, and the Dow Jones Industrial Average closed +19.05%. Small cap stocks had an even more impressive year as the Russell 2000 Index closed +18.37% at year's end. The majority of these gains were realized the last three months of 2006 as equity markets enjoyed a strong rally with surprisingly little volatility. These numbers are especially gratifying when one considers that at mid-year the S&P 500 had advanced by a mere +1.7% and the NASDAQ was -1.5%. Value equities had significantly stronger performances versus Growth, in all capitalization groups.

International equity markets took the honors for 2006. The MSCI EAFE (Europe, Australia, Far East) Index finished the year with a gain of +26.3%. The MSCI Emerging Markets Index was up +32.2%. These markets experienced considerably more volatility than domestic markets during 2006, especially during the mid-year correction. But the fourth quarter was good to international markets, both developed and emerging, soothing the excessive volatility that was such a concern earlier in the year.

Much of the credit for 2006's advances belongs to the Federal Reserve Board. Their decision to level off short-term interest rates had a positive impact on both equity and bond markets in 2006. The central bank's actions, against a backdrop of moderately rising inflation and housing industry concerns, led to a stronger than expected bond performance in 2006. Late in 2006, a growing belief that the Federal Reserve Board may reduce short-term rates in 2007 helped to fuel the rally in both equity and bond markets. For 2006, the Lehman Brothers U.S. Aggregate Bond Index was +4.33%. Lipper Analytical reported that the best performing domestic bond sector was high yield bonds, +10% for the year.

SELECTOR[®] allocations had a final adjustment for the year during November as profits were taken in real estate and natural resources equities. Portfolio allocations continue to favor the existing Bull Market environment for domestic and international equities. SELECTOR[®] Aggressive Growth and SELECTOR[®] Growth model allocations remain 100% invested in equities. SELECTOR[®] Conservative Growth model portfolios are 80% equities/20% bonds, while SELECTOR[®] Balanced Growth model portfolios are 60% equities/40% bonds, and SELECTOR[®] Income & Growth model portfolios are 40% equities/60% bonds. Actual account allocations may vary according to funds/subaccount availability.

The only problem with the extended year-end rally was the reduced opportunity to put new money to work at favorable prices. This is a classic short-term dilemma during Bull Markets, and a very healthy indicator for the longer term. Equity markets are overbought, but every pullback is met with a rising demand for equities despite higher prices. We are in the latter stages of this long-term Bull Market, and historically this is when the greatest advances are seen.

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