GV Financial Advisors E-Update

In With the New
January 11, 2006

A very happy New Year to one and all! The markets have opened the year with effervescence befitting a fine Veuve Cliquot, this after most major US indices fought their way to hold gains for the year as they reached the 2005 finish line. The Dow didn't quite make it, slipping back in the final trading days to register a 0.6% loss for the year. The broader S&P 500 index had a better run, managing to close out 3% up for 2005, while the NASDAQ index saw the year off with a 1.4% gain.

Since this year's opening bell on January 3 the S&P is up 3% with the Dow crossing the 11,000 level on January 9 for the first time since 9/11. The market pundits are out in force again with the January Effect, one of those much-loved anomalies with supposed predictive powers that spice up the TV market talk shows. As E.S. Browning writes ("The Chill of January's Crystal Ball", *Wall Street Journal* 3 January 2006), the January Effect is sort of an "if-then" pretzel of scenarios depending on whether the last five days in December were down, or if the first five days in January are up, and what that means if gains are sustained throughout January, and whether predictive power has fallen since 1986 and so on. So far so good -- the first five trading days of January are supposed to be up 71% of the time if the last five days in December were down. We'll leave further "analysis" on this to the talk shows.

The year-end downturn witnessed that exotic bird, the inverted yield curve. Stock markets like inverted curves about as much as children like coal in their Christmas stockings, since they have predicted every significant US recession since 1950 (with only one false signal in 1967) with about a four to six quarter lead time[1]. During the last week of December the 2-year Treasury note yielded a couple basis points more than the 10-year bond – on the year's final trading day the 2-year was yielding 4.41% and the 10-year 4.39%.

In his testimony to the Joint Houses of Congress on November 3 last year outgoing Fed chairman Alan Greenspan indicated that the yield curve had lost its ability as a recession predictor since today's financial markets are more complex. An opinion in *The Outlook* by Standard and Poor's ("Let the Bears Sleep" Vol 78/1 January 4 2006) agrees, attributing yield curve shape primarily to the demand by foreign central banks and other large international holders of Treasuries for particular maturities at particular times.

Investors in any case will be paying close attention to the bond markets as Greenspan prepares to hand the baton off to incoming chairman Benjamin Bernanke. Most observers have concluded from the minutes of the December 13 Federal Open Market Committee meeting that the Fed's rate hikes are drawing to a close. Core inflation is within, albeit at the high end of, the 1-2% "comfort zone" that Bernanke has previously expressed ("Bernanke

---

[1] Source: Arturo Estrella, "The Yield Curve as a Leading Indicator" October 2005, New York Federal Reserve website www.ny.frb.org/research/capital_markets

Faces Challenges in his Freshman Year" by Greg Ip, *Wall Street Journal* 3 January 2006). But unemployment is down at 5% and capacity utilization up at 80%, meaning the economy is utilizing most of its productive resources, so any economic growth beyond the long-run trend of 3.5% or so may trigger wage-price increases and thus further rate hikes.

2005 may be looked back on as the Year of the International. Investors who maintained a US-centric outlook missed out on many of the year's big stories. Japan and the Latin America Region both registered double-digit growth. The MSCI EAFE Index, measuring global developed market equity performance excluding the US and Canada, gained 11.3%. Noteworthy also is the MSCI All Country World Index, which returned 9.5% when the US market was included and 14.4% ex-US. China continues to astound while voraciously consuming all manner of commodities to fuel its growth. Both emerging markets and commodities have in fact put in strong performances as asset classes for several years now.

During the fast-paced economic changes of the early 1970s Richard Nixon once remarked "we are all Keynesians now" after the 1930s British economist whose theories underpinned wage-price controls, demand-side management and other issues of the day. Today we could say "we are all globalists now" with the backdrop for our economic reasoning being the world at large. To make sense of what may come means that we have to understand what is happening in faraway places with unfamiliar customs and languages. It's a complex and fast-changing world, for sure. Perhaps an appropriate New Year's greeting this year would be the old Chinese saying: May you live in interesting times.

With warm personal regards,

Masood Vojdani	*Katrina Lamb, CFA*
President	Senior Investment Analyst

GVFA: 2006 0001
DOFU: January 2006

masood@gvfinancial.com

GV Financial Advisors
4520 East West Highway, Suite 400
Bethesda MD 20814
www.gvfinancial.com
(301) 656-6545
(301) 656-2722 fax