

# Portfolio Navigator

Kipp Brant Drummond & Associates

2<sup>nd</sup> Qtr, 2006

## Wow!! What a First Quarter.

The Dow Jones Industrial Average made its best yearly start since 2002. The Dow and the Standard and Poor's 500 Index both gained 3.7% for the first quarter of 2006. The NASDAQ composite index did even better, increasing 6.1%.

Bullishness in the stock market rose during the first quarter as the Federal Reserve Board appeared to be nearing the end of its series of interest rate increases. Many investors reason that once borrowing costs level off, many businesses may resume long-delayed purchases of computers and other equipment.

One of the reasons for this is that the Commerce Department reported that its core inflation index, excluding food and energy prices, showed that prices were up only 0.1% in February on a monthly basis and up 1.8% from one year ago. Both of these numbers were within the top limit of the Fed's target zone for inflation, which is around 2%.

It appears that the first quarter returns were very good because the market overcame two problem areas:

1. *Interest rates (which the Fed continued to raise)*
2. *Oil prices (which remained high)*

Another good indicator is the nation's unemployment rate, which fell to 4.7% at the end of the quarter, its lowest level in more than four years.

Still another reason that the stock market appears to be strong at this time is that companies have accumulated record piles of cash. Cash at the top tech companies amounted to 25% of their assets at the end of 2005, up from 12% in 1991, according to Vadim Zlotnikov, the chief investment strategist for Stanford C. Bernstein and Co.

There is a record-high liquidity of US corporations' money supply at \$10.3 trillion and a record net-worth of Americans at \$52.1

trillion. In addition to this, the global economy is swimming in a sea of record liquidity.

There are a number of reasons for hoarding all this cash:

1. *The technology sector is extremely volatile. Companies often cannot sustain competitive advantages over long periods of time, and therefore need to constantly reinvest large amounts and keep cash around for the bad times.*
2. *Many tech companies spend money on acquisitions.*
3. *Psychologically, a company that stockpiles cash is usually perceived as a growth company. If the company gives away money through a dividend, it may seem like a concession that their growth spurt is over.*

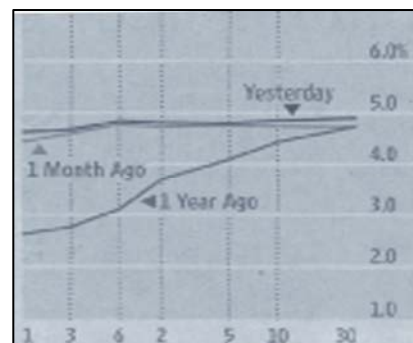
One of the possible unfortunate outcomes is that if a company is mismanaged and has a significant amount of excess cash, it could make itself a target for a buyout as well.

## INTEREST RATE CHANGES

The upbeat mood continued into the second quarter, as optimism about the economy and interest rates continued. Several Federal Reserve Board officials have been suggesting that the Fed could soon end its interest-rate increases that began in June of 2004. For example, on Tuesday, April 4, Thomas Honig, president of the Kansas City Federal Reserve Bank, said the Fed is "very close to where we need to be" on interest rates.

Another major change that occurred during the first quarter is that Alan Greenspan resigned as chairman of the Federal Reserve Board, which now has a new pilot, Ben Bernanke. On February 16<sup>th</sup>, Mr. Bernanke made his first appearance before the House Financial Services Committee. Bernanke maintained his prior belief when he said that the US economy remains strong despite a slower 4<sup>th</sup> quarter of 2005. Bernanke also stated that the economy is strong enough to overcome an inverted yield curve because

interest rates are lower than they would need to be for this condition to threaten a recession.



Source: Wall Street Journal, April 5, 2006

Since June of 2004, the Fed has raised its target for the federal-funds rate charged on overnight loans between banks from 1% up to 4.75% as of the end of March, 2006. However, long-term treasury yields have remained between 3.75% and 4.75%. As you can see from the chart above, long-term interest rates are now barely above short-term rates, creating a "flat-yield curve," which in the past has often presaged a slowdown or even a recession.

Mr. Bernanke, like many other officials, has argued that the yield curve did not seem to be foreshadowing a slowdown, noting it has usually required higher short-term rates than are presently in place for that to occur. Mr. Bernanke has also reviewed several structural factors that could be holding down long-term rates. Economic growth and inflation have become less volatile, so investors may not demand as much of a cushion with unexpected moves in interest rates in the future.

In addition to this, he said pension funds may demand more long-term bonds to fund the benefits of future retirees, while at the same time the issuance of very-long-term United States bonds have diminished.

On the 28<sup>th</sup> of March, the Fed increased its short-term interest-rate target to 4.75% from 4.5%. More importantly, it also signaled

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that at its next policy-making meeting on May 10<sup>th</sup>, it is most likely to raise interest rates to 5%. This announcement helped spark a rise in the 10-year note yield to 4.78% on Friday, March 31<sup>st</sup> from 4.71% only a week earlier. Because the 10-year Treasury is a benchmark for rates on many kinds of consumer and business loans, interest rates are creeping higher and higher on a widening range of loans, which is a trend that could eventually slow the nation's expansion.

Although many investors continue to assume that interest rates may peak very shortly, many others think that this is not the case and see short-term interest rates climbing past 5%. As a result, interest rates on 30-year mortgages and corporate bonds have also started to increase from extraordinarily low levels.

For example, for nearly two years, many long-term interest rates stayed stubbornly low even as the Federal Reserve board increased shorter-term rates on a consistent basis. However, it appears the Fed finally seems to be having some effect over long-term rates, which are now pushing up even longer borrowing costs. A booming US economy, along with improved economic prospects in Japan and Europe, has prompted central bankers in all three places to increase their interest rates, which is a very common policy typically aimed at reducing the possibility of inflation that tends to accompany growth.

Many of the commentators on the financial channels are still telling us the economy will be slowing in 2006. However, at the same time, Trimtabs investment research firm has provided daily coverage of stock market liquidity and reported that the US Treasury tax receipts were indicating significant economic growth. For example, based on actual tax receipts by the US Treasury, take-home pay of all taxpayers jumped 7.4% year-over-year in February.

If the Fed stops raising interest rates, that would mean that Bernanke and the other members would most likely feel they have struck a balance that would allow the economy to grow and create jobs without the risk of serious inflation. In the last 23 years, the Fed has come to similar conclusions 5 different times. The average stock market response was a rise of 16% in the Standard

and Poor's 500 Index in the 12 months following the end of the interest rate increases.

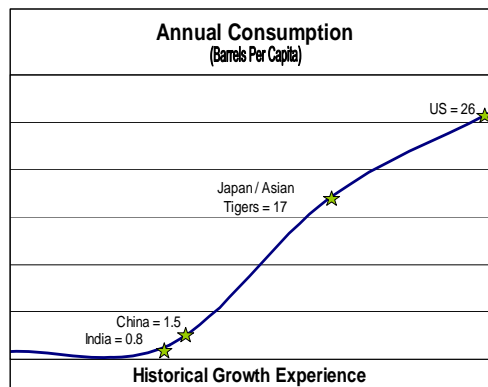
### ECONOMIC GROWTH

So why has the stock market performed so well over the last couple of years? There appear to be a few major reasons for this.

The homebuilding industry has been a major contributor to the S&P 500's recent profit growth. Affordable financing and demand for real estate have driven the housing market to an abnormal high.

However, housing, just like anything else, is a function of supply and demand. Excess demand creates a shortage of homes and therefore homebuilding companies have enjoyed tremendous earnings growth as they have continued to build new houses to meet the demand of home buyers. Many buyers are trading up to larger houses or are first-time home buyers who have finally been able to afford a mortgage while interest rates have been extremely low prior to the beginning of the interest rate hikes by the Fed two years ago. However, even with these recent interest rate increases, these rates still remain lower than their normal historical averages of 5% - 7%.

The second major contributor to the recent growth in the US stock market has been the record high prices of crude oil for the past two years, which were exasperated by Hurricane Katrina last year.



Risk-Controlled Investing April, 2006

Had oil companies not done so well in 2005, the S&P 500 could have had a negative 10% return compared to the S&P 500's 2005 actual positive return of 4.9%.

In addition to this, the demand for crude oil continues to rise, not only in the United States, but also in other countries such as Japan, India and China. These other countries are beginning to build more solid infrastructures, which will increase their demand for oil as their use of automobiles increases dramatically. Many companies have seen their profits decrease significantly due to rising energy costs.

Another major area of concern has been high energy prices. However, according to the last report, they have hardly even made a dent in consumer spending, as evidenced by January's report of solid personal consumption. New research from Thomson Financial indicates oil prices are not likely to hurt spending any time soon. Thomson studied consumer spending on energy going back to 1959 and concluded that US customers last year spent an average of 5.67% of personal income on energy products, which is less than the historical average of 5.78%.

The third and final major contributor to the growth of the US stock market over the last two years is in the rising costs of healthcare. The increasing cost of medical insurance has contributed to the extraordinary rise in the cost of healthcare, which of course has helped this industry as a whole significantly.

Unfortunately, these rising costs in medical expenses have affected many companies' overhead expenditures, which in turn may cause more layoffs, less hiring in the future, and greater use of foreign workers in low-wage third-world countries to provide firms the opportunity to cut costs.

These three factors may most likely cause at least a slowdown in profit growth, if not a decline in profits for the United States industry as a whole.

Notice the good news at first, and then the bad news. That's one great thing about investments – you never know exactly what's going to happen. That is one of the reasons we always want to remember the three rules of investing – diversify, diversify and diversify! Do not put all your eggs in one basket unless you want a double or nothing – which is one of the things we would like to avoid.

### OVERSEAS INVESTMENTS

International stocks continued to climb in the first quarter, despite persistently high

energy prices and various increases of interest rates by the central banks of the three largest economies in the world.

In fact, the Dow Jones World Stock Index (An index that measures the performance of more than 2000 companies world-wide that represents more than 80% of the equity capital.), excluding the United States, advanced 8.8% in the first 3 months of the year, which is significantly higher than the Dow Jones Industrial Average, which increased 3.7%.

However, many economists and investors are particularly concerned and are lowering their expectations of returns on these global stock markets. One of the biggest areas of economic growth is also referred to as BRIC, which stands for Brazil, Russia, India and China. These countries represent the four fastest growing emerging markets today. One of the major concerns is that emerging markets have outperformed the United States stock market 5 years in a row. Unfortunately, emerging market booms are often followed by busts.

Another area of concern on the international perspective is the problem of the United States' record \$725.75 billion trade deficit last year. The 2005 deficit was 17.5% wider than the 2004 gap, according to the Commerce Department report.

Many people are not aware of what caused this imbalance. One factor, as you might guess, was oil. US imports of petroleum products increased almost 40% in 2005, as oil prices surged world-wide and refineries along the Gulf of Mexico were damaged significantly by Hurricane Katrina.

However, oil was not the only factor affecting the US deficit. One of the major reasons is China – the Chinese export more goods to us than they allow us to import into their country. This deficit is likely to aggravate relations with China and renew steps for Beijing to ease the imbalance.

Unfortunately, China's stock markets still continue to perplex and frustrate many investors. For example, over the last decade, China's average annual GDP was 9.2%. This is astonishing since no other country even comes close. However, for investors, China's stock market has recently been one of the worst possible combinations - negative returns *and* high volatility. Since it

peaked in June of 2001, its Shanghai composite stock index fell by 44%!

There are many reasons for this unusual paradox. First of all, there is no private ownership of land in China - all land belongs to the government. Farmers are given small plots, where they can bring forth 2-3 harvests per season. The first harvest belongs to the government as an agricultural tax. Anything above that, the farmer may sell for personal profit.

The Government of China still controls about two-thirds of the shares of its 1,400 companies. There is significant concern over how the government will sell these securities without causing its stock market to drop significantly.

One of the other major areas of concern is that it is estimated that over 40% of these public companies' financial statements are unreliable.

There are many keys to success in China. Unfortunately, competition from Chinese imports threatens a number of US industries. However, economic ties with China will most likely continue to strengthen.

First of all, China is more than just an off-shore site for US businesses seeking to reduce their costs. In a globalized economy, it is very likely that more US firms will look to China not only as a crucial source of supplies and manufacturing, but also as a huge and promising market for US goods and a convenient gateway to other dynamic Asian markets.

In addition to this, their domestic market is exploding at an average economical growth, which is currently around 8%, and appears to be sustainable over the long term, according to many economists. In fact, by 2025 some economists predict that China's economy could equal that of the US in terms of annual output.

Cars also illustrate the market potential in China. Currently there are only 8 cars per 1,000 people, compared with the world average of 104 per 1,000. By 2020, incomes for China's 1.3 billion people will most likely rise enough to boost annual car demand to nearly 21 million from 4.4 million now.

One of the interesting observations with China, which is now the world's fourth largest economy, is that fast-growing middle class now numbers over 150 million. China's emerging middle class went from living at subsistence levels to having the means to dine out at least once a week at a mid-priced restaurant in less than 15 years. With that, the chart below shows just how much progress their middle class has made in the last 20 years.

The Birth of a Middle Class					
Per 100 urban households in China					
	Refrigs	Color TV's	Autos	Computers	Cell Phones
1985	6.6	17.2	-	-	-
1990	42.3	59	-	-	-
1995	66.2	89.8	-	-	-
2000	80.5	116.7	0.6	9.4	18.3
2004	90.2	113.4	2.2	33.1	111.4

*Source: China Strategy, March 2006*

Let us also look at the statistics about India. Over the past 15 years, India has been the second fastest-growing country in the world after China, averaging above 6% growth per year! From that, growth accelerated to 7.5% during 2005 and possibly hold at the same pace this year, according to many economists. Many observers even believe that India could continue this high growth rate over the next decade as well. In fact, Goldman Sachs prepared a study in 2003 that projects over the next 50 years India will be the fastest-growing of the world's major economies, largely because its work force will not age as fast as the others.

This report also calculates that in 10 years, India's economy will be larger than Italy's, and in 15 years will most likely overtake Britain's. The study also suggests that in 2040 it will boast the world's third largest economy and by 2050 it be 5 times the size of Japan's and its per capita income will have risen to 35 times its current level. Conditions like these are estimated based on compound growth and are certainly not guaranteed. However, it is worth noting that India's current growth rate is actually higher than the study assumed it would be.

Japan's economy is now growing in a way that could benefit the rest of the world. When Japan was building nearly 20 years ago, the biggest indications were Tokyo's rocketing stock and land prices. Japanese people usually did not buy as much from overseas as foreigners wanted. After a dec-

ade of slump in their economy, their recovery that began in 2002 was initially led by exports rather than domestic spending.

Now consumers and business are spending more. This is very important because their activity makes economic growth much more sustainable. Even if exports were slow because of problems in the United States or China's economies, domestic spending could keep Japan's economy chugging along just fine.

The new spending reflects major structural changes in Japan. Many local and foreign companies have taken advantage of the start of this significant reduction in land prices during the 1990s in order to buy stores and offices. Japan has also deregulated industries from financial services to food, loosened restrictions on large stores and opened the way for new types of financial products.

### **AVIAN BIRD FLU VIRUS**

The Avian bird flu virus, which is technically the H5N1 virus, is spreading to new parts of the globe every day. This could have significant impact on many countries, some for better, some for worse. Obviously, one industry that could be affected on a negative basis is the life insurance industry. In a recent report, Morgan Stanley Insurance analyst Nigel Daley said "a severe outbreak could have far-reaching repercussions for a large number of life insurers."

Among 14 public companies studied, the report singles out one industry giant, Met Life, along with many other smaller firms as being the most exposed to potential losses based on an analysis of the amount of life insurance they have underwritten.

There have been many comments regarding the similarities between an outbreak of the Avian bird flu and the 1918 influenza pandemic, which killed more than 40 million people worldwide. However, Eric Veivl, a life insurance analyst at the investment management firm of T. Rowe Price stated that this current situation looks like such a remote possibility that it is "immaterial."

However, let us put a few things in perspective.

The Avian Flu Virus has killed less than 200 people since 2003, according to the World

Health Organization (WHO). That is fewer than the number of deaths caused by lightning in the United States over an average three years – about 150 - according to the National Lightning Safety Institute statistics.

In order to become a global pandemic, the virus would have to mutate to a bug that could jump easily from human to human. Although generally considered unlikely, global consequences would certainly be drastic if that did in fact happen. For example, in their December report, the Congressional Budget Office concluded that a severe pandemic could cut real Growth Domestic Product over the following year.

However, since the current situation remains uncertain, the outlook for stock prices in general still isn't clear. It may be best to avoid investing in sectors that depend on human contact, such as restaurants, hotels, and travel-related entities. Instead, other sectors that help circumvent such contact, such as internet stocks, might be less affected.

However, not all investors seem overly concerned. For example, while stock prices at Met Life and Unum Provident are slightly lower than their closing prices on November 15 (which is the day before China reported its first human cases), stocks on some other life insurers have risen over that same period. John Calagna, who is a Met Life spokesman, said, "We have a very diversified portfolio product. We've dealt with this before." Met Life was the largest life insurer in the nation during the 1918 pandemic and survived, he also noted.

U.S. poultry farms face a real but limited threat from bird flu when spring migration starts. The strain of the virus that began in Southeast Asia and then spread to Europe could certainly come to the United States. It must be noted that Federal and State agents plan to expand their surveillance and testing of wild migratory birds and any outbreak in the U.S. is likely to be contained.

However, many State and local health departments probably aren't ready for a complete pandemic. If there is an outbreak, expect rationing of medical resources. Many items would possibly be in short supply, such as ventilators, intensive care unit beds, and other items specific to this problem.

So, what would it mean financially if this Bird Flu caused a world pandemic?

The World Bank has estimated that if the bird flu pandemic lasted a year, it could cost the global economy up to \$800 billion dollars. The economic toll on the world economy would be catastrophic and even a mild pandemic could wreck havoc with many investments.

If a global human pandemic breaks out, the International Monetary Fund (IMF) stated that "economic disruptions on the supply side would come directly from high absenteeism, as people would be asked to stay at home, or may choose to do so to care for sick relatives or because of fear of being exposed themselves". The top financial body also stated that there may also be "disruptions to transportation, trade, payment systems and major utilities. Moreover, demand could contract sharply, with consumer spending falling and investments being put on hold".

However, it must be noted that the IMF researchers stress that predictions are based on a "high degree of uncertainty," referring to, among others, the World Health Organization (WHO) reports indicating that accurate predictions of a pandemic's scope cannot be made before a virus emerges and begins to spread.

Nevertheless, the IMF states that on the basis of WHO information, "because of high global mobility and interconnection, illness could spread quickly, and, if the virus has a high fatality rate, threaten millions of lives around the world".

The possible Bird Flu pandemic is a phenomenon that investors should start to seriously contemplate. There are two levels of concern to study.

First of all, there is likelihood that the actual outbreak of bird flu may be limited, like SARS, but would likely still result in significant disruption of businesses. For example, in Hong Kong, SARS crippled local tourism and its domestic economy for a number of months.

Imagine if this impact were implicated in several key global cities simultaneously due to this Avian Bird Flu. There's a great pos-

sibility that panic might occur, with nobody wanting to fly anywhere and non-central business sectors would possibly face collapse in demand. As we saw in Hong Kong with SARS, equities and real estate would most likely come down under pressure from an investment perspective and it's very likely that money would flow to cash, bonds, and precious metals.

The second level of concern would be a deadly outbreak of the flu as a major pandemic. This type of pandemic has taken place several times in the past couple of centuries, killing millions of people.

This is certainly a stage well beyond the scare of SARS, and a serious breakdown in certain supply chains, and inflation of prices, could occur in various areas. This could also cause a depression in tourism, transport sectors and a risk of major economic instability, especially with risks to financial markets.

In such a grim scenario, we believe money would likely flow into precious metals and havens of safety such as treasury bonds, especially inflation-protected bonds. In addition, equity markets in real estate would possibly collapse in the face of sharply falling company profits and reduced consumer demand.

#### **SO WHAT SHOULD AN INVESTOR DO?**

As an investor, your first course of action is to stay informed. A bird flu pandemic may not happen for years, if at all. However, there are always other current issues to deal with today, such as natural disasters and terrorism!

One of the biggest issues to remember is to be prepared. Even repositioning a small portion of your assets and stocking up on essential food and supplies may be a prudent move.

Investors should not panic and assume the worst. It would seem prudent to take a cautious view to your future in the plan for economic survival under all circumstances, including any other potential catastrophes.

Diversification into more conservative investment options would also appear to be a sensible option, so that if the worst happens, at least part of your investment portfolio

would possibly surge in value and also allow for liquidity, compensating for falling real estate and equity investments. Maintaining an adequate emergency fund is always a good idea, too.

The current gold price is to some extent an index of fear. Its rise to record heights suggests that some investors are getting nervous and want to spread their risk as well. One of the interesting observations is that much of the gold buying is coming from Asia and the Middle East, while many western investors appear less convinced for the need to diversify. However, it is important to not overlook that one of the reasons for the growing interest in the demand for gold is the weakness of the outlook for global growth in the face of higher oil prices and inflation.

One of the other issues is whether or not we are even prepared to handle an outbreak in the event that one should occur.

A report issued in December by the Trust for America's Health, a public health advocacy group in Washington, included that 40% of the States lack enough back up medical supplies to cope with a pandemic flu or other major disease outbreak.

The US government says it is addressing the problem, elevating the possibility of a flu outbreak to a national security concern. President Bush asked congress for \$7.1 billion to fund preparation for the possibility of this pandemic, and in December 2005 Congress appropriated \$3.8 billion to help the Nation prepare.

According to the Secretary of Health and Human Services (HHS) Michael Leavitt, "Let me be clear. It is only a matter of time before we discover H5N1 in America. The migration patterns of the wild fowl that carry the virus make its appearance here almost inevitable."

One of the ways to combat this flu is through antivirals, which are drugs that lessen the impact of flu. It appears as though there are currently two FDA approved antivirals that have shown effectiveness against this flu.

The immediate goal is to stockpile enough antivirals to treat 20 million people. The longer term goal is to be able to treat at least 75 million people, or 25% of the US popula-

tion. Achieving this goal depends on many factors, such as future pandemic flu appropriations, manufacturing capacity and participation by the various States.

In addition to this, the HHS is committing at least \$200 million to the development of additional antivirals and also is discussing with the States whether these antivirals should be centrally located or warehoused locally in order to distribute them properly, should the need arise. For the most current information about avian influenza and cumulative case numbers, see the World Health Organization (WHO) avian influenza website.

As of the date of this letter, the spread of the H5N1 virus from person to person has been limited and has not continued beyond one person. One of the common questions that arises is "Why doesn't the Avian Bird Flu spread easily among people?"

Scientists believe they may have found a reason. There was a study done recently at the University of Wisconsin – Madison by virologist Yoshihiro Kawaoka, along with his colleagues in Japan and, according to the study, the virus prefers to infect cells in the lungs instead of areas like the nose and the windpipe. Therefore, it is not easily coughed or sneezed out into the air, according to this new research. Nonetheless, because all influenza viruses have the ability to change very rapidly, many scientists are concerned that this virus might one day be able to infect humans and spread rapidly from one person to another which would signal the beginning of a pandemic. For more information about influenza pandemic, please see the CDC pandemic influenza website (<http://www.cdc.gov/flu/avian/>) and [www.pandemicflu.gov](http://www.pandemicflu.gov) and refer to the section called "questions and answers".

Unfortunately, the worry and fear about a pandemic can often be worse than the problem itself. An interesting study relating to this particular strain of avian flu, which was first identified in South Korea in 2003, helps put things in perspective. (All statistics are as of November 17, 2005)

*Number of birds destroyed: 150,000,000  
Number of human cases diagnosed: 126  
Number of human cases outside Asia: 64  
Number of children in Africa who die of Malaria every single day: 2,000*

It is very important to always follow three rules before making an important choice:

1. *Gather the data*
2. *Analyze the information*
3. *Make an educated decision*

In the event that one does not have the proper information, or does not have adequate time to at least digest what this information means, incorrect decisions and actions are often taken.

On March 13<sup>th</sup>, 2006, the WHO stated that this Avian flu virus has killed 98 of 177 people since 2003. Unfortunately bird flu fears have caused a market slump for poultry farmers and many countries are planning to give new types of aid to these poultry farmers. For example, Italy has reported a 70% drop in poultry sales. However, according to WHO, poultry, when properly cooked, is safe to eat. Unfortunately, this is a very good example of how misinformation can cause unnecessary fear and incorrect conclusions and decisions.

#### **SO, WITH ALL OF THIS INFORMATION, WHAT SHOULD WE DO NOW?**

First of all, prepare a consolidated asset allocation report and determine what allocation you have in each investment category, especially with respect to emerging markets and adequate emergency reserves should a pandemic take off. It is very easy to have an over-concentration in one particular area, especially if it is performing so well.

Many economists believe that the US stock market is still one of the most undervalued stock markets in the world and the US economy is continuing its boom. Their arguments are certainly compelling:

1. *The Dow, S&P 500 and NASDAQ composite, together, have finally pushed through various resistance levels at 11,000, 1,300, and 2,300, respectively.*
2. *Record liquidity of US corporations*
3. *If you put a frog into a pot of cool water and slowly bring it to a boil, it will merely sit there until it is too late. Although that may be true when it comes to amphibians, it possibly may not be with respect to monetary policy. It is certainly behind the Fed's tightening campaign. New increases in the interest rates are beginning to show – the*

*money supply is rising more slowly than inflation, and unsold houses are piling up as cheap mortgage money dries up. It is so gradual that you might not notice it at first. However, the government would not attempt to stifle the economy by increasing interest rates if they did not feel that the economy could not withstand such an increase. Remember – the government does not want a recession either!*

However, as always, it is wise to base your own particular decisions on your own specific set of circumstances. This is one of the major reasons we believe it is best to meet on a regular basis in order to make sure your particular goals, needs, and objectives are addressed properly.

Thanks again for having the confidence in us to assist you with your finances. We look forward to seeing you with a big smile very soon!

Note: The views stated in this letter are not necessarily the opinion of National Planning Corporation and should not be construed, directly or indirectly, as an offer to buy or sell any securities mentioned herein. Due to volatility within the markets mentioned, opinions are subject to change without notice. Information is based on sources believed to be reliable; however, their accuracy or completeness cannot be guaranteed. Past performance does not guarantee future results.

In general, bond market is volatile, bond prices rise when interest rates fall and vice versa. This effect is usually pronounced for longer-term securities. Any fixed income security sold or redeemed prior to maturity may be subject to a substantial gain or loss.

The price of gold is subject to substantial price fluctuations over short periods of time and may be affected by unpredictable international monetary and political policies.

There is no guarantee that a diversified portfolio will outperform a non-diversified portfolio in any given market environment.

Indexes cannot be invested in directly, are unmanaged and do not incur management fees, costs or expenses. No investment strategy, such as asset allocation, can guarantee a profit or protect against loss in periods of declining values. International investing involves special risks not present with U.S. investments due to factors such as increased volatility, currency fluctuation, and differences in auditing and other financial standards. These risks can be accentuated in emerging markets.

Fixed income investments are subject to various risks including changes in interest rates, credit quality, inflation risk, market valuations, prepayments, corporate events, tax ramifications and other factors.

\*\*The facts and figures stated in the above letter were

taken from The Wall Street Journal (1/12/06, 2/11-12/06, 3/21/06,3/29/06,4/1-2/06, 2/11/06,4/3/06, 4/4/06, 4/6/06),Robert Hsu's China Strategy (3/2006), Risk-Controlled Investing Newsletter (4/2006), Newsweek (3/6/06), Forbes (2/27/06), Kiplinger Letter (1/20/2006), Department of Health and Human Services Pandemic Planning Update (3/13/06)

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