

Sound Investments Inc. / Ken Gilpin CFP

Second Quarter 2005

In this quarterly commentary we discuss how the economy is doing better than the market. We believe it is just a matter of time before the stock market will rise.

Stock valuations are reasonable, helped by strong earnings growth, and our return expectation for stocks over the next three to five years is decent: in the high single-digit to low double-digit range.

Inflation and deflation are inter-related, and we think in coming years we could be in for a balancing act as policy makers try to protect against too much inflation without creating deflationary forces (such as high debt levels leading to decreasing spending).

The Investment Letter is mailed quarterly to our clients and friends. The intent of this publication is to share some of our more interesting views and research with our clients.

Quarterly Investment Commentary:

Last quarter, the broad market or S&P 500 was up 2%, the Dow Jones index was flat and the NASDAQ enjoyed a 3.6% gain. For both the month of June and for the quarter the best performing index was the small cap index, Russell 2000. Still, stocks hit the mid point with little to show for the past 6 months. At the year's halfway point, both stocks and bonds tied cash yielding between zero and 2%.

We have some concentration in Mid Cap funds that we are up an average of 3%. Also small cap funds that we hold outperformed large caps by a wide margin. Funds such as American Century Small Cap, Artisan Mid Cap Value and Dodge and Cox International have performed very well. We have been recently adding Neuberger Partners and the I shares S & P 400 Value fund.

International funds did well last year and still show positive returns for 2005. However as a group have moved down in rank primarily due to resurgence and the lackluster performance of the major European economies. We continue to believe in the future of Foreign Fund and expect a recovery as the dollar is peaking. We will continue to monitor the situation.

We try to upgrade our investments into funds that are moving. Let me give any example in the 1990's investors were taught that investing was simple; all anyone had to do to be successful was invest in the S&P 500 index. Here's what happened: \$1000 invested in the S&P 500 on June 2nd 2000 decreased in value to \$887.00 or a decreased in value of 2.5% per year. In the last 5 years \$1000 Invested in the Russell Small Cap index would be worth \$1285 or any annual gain of 5.7%. Many of our no load funds did much better.

There is a body of research that shows:

- Holding just 5 funds can still provide top returns

- We don't need to react to every blip in the markets; we can profit off of confirmed trends
- We can balance risk and reward by our exposure to various asset classes
- We can benefit from exchanged traded funds in our portfolios.

The Latest Economic Reports

In last quarter commentary I made the point that the economy was on a substantial footing and earning would likely improve. To date earnings have improved and real gross domestic product was moving at annual rate of 3.4% ahead of projections. New home sales also sold briskly hitting annualized rate of 1.37 million in June. This figure was up 4% over the prior month and 14.0% year over year. Like homeowners, businesses were on a shopping spree as well, buying computers, electrical products and machinery at a record pace. Only new orders for nondefence capital goods fell 1.9%.

The Labor Departments employment report was positive, with both unemployment rate remaining at 5% and a better than forecast 207,000 increase in payrolls. Most industries had employment gains especially in the service-providing industries, professional and technical services, financial activities, food service and health care. The only decline was in manufacturing activity caused by shutdowns in the auto industry.

Personal incomes rose 0.5% in June, which was above analyst expectations. Disposable personal incomes also rose 0.5%. However personal spending grew faster at 0.8% while personal savings fell to 0.0%. Core inflation remained unchanged. There was a decline in construction spending by 0.3% but overall we are only a positive trend. Even the Federal Reserve Board reported that in all 12 of its districts business activity continued to expand in June. Reports from most districts describe growing retail sales, increased demand for services and solid growth in manufacturing activity.

So Why Isn't The Stock Market Moving Higher?

We believe the stock markets will move higher and, in fact, as I write this article at the end of July the markets has moved up with the S&P 500 up 3% anyd the smaller cap and NASDAQ up over 6%. So we heading in the right direction and are invested in the right places. I wrote a rather positive report this quarter and could have just as easily being more negative with the cost of oil and the war but I think we will move ahead. As always we be monitoring the situation closely and will take appropriate action.

Best Regards

Ken Gilpin CFP

Once a year I am required by law to offer to mail my ADV form, which is filed with Kansas Securities Commission. This form explains how I operate as a Registered Investment Advisor. I would be happy to mail or meet with you to explain it.