

Fagan Financial Report

VOLUME 9, ISSUE 3

SECOND QUARTER 2006

Fagan Financial Report

Published by
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*Fagan Associates
provides investment
advice and money
management services
to individuals,
corporations, labor
unions, estates and
organizations.*

"Fagan Financial Report"

- EVERY SUNDAY in
The Record
- SUNDAY EVENINGS
LIVE on Radio810
WGY 6:00 p.m.-
7:00 p.m.
- WEEKDAYS on
Radio810 WGY
before the 4:30 p.m.
news

To Our Clients:

The **Second Quarter of 2006** was more or less a mirror image of the first with **stocks** giving up the vast majority of their gains earned during the first, which, by the way, was the best opening calendar quarter for the Standard & Poor's 500 since 1998. At the beginning of the year we predicted that market performance during 2006 would be saucer-shaped, the best two quarters being the first and fourth with the second and third quarters lagging.

Even though we anticipate a weak market during this period, it is not prudent to raise a lot of cash. We believe that the trough will be fairly shallow and it will present an opportunity to purchase quality equities on temporary weakness.


Historically, this period of time, notably the second year of the second term of the U.S. Presidency, has resulted in sub-par performance of the stock market. Furthermore, add to the fact that we have a new Chairman of the Federal Reserve in Ben Bernanke; continuing geo-political concerns in Iraq, Iran, and North Korea; high energy prices and worries over the slowing economy and you can see why stocks have had a hard time making any headway over the past three months. Despite all of these negatives, the old adage that "stocks climb a wall of worry" will once again prove prescient during the latter part of the Autumn season.

Given the above, and given the fact that constantly trading or "turning a portfolio over" has negative tax and total return implications for investors, we are content with the business prospects of the vast majority of our holdings, but we will continue to look to upgrade portfolios as opportunities arise.

Fixed income securities, more commonly known as **bonds**, are continuing to edge higher in yield as the Federal Reserve raises interest rates. Since June 2004, the Fed has raised rates by ¼% at seventeen consecutive meetings thereby pushing the short-end of the yield curve up at a much more rapid pace than the long end thereby flattening out the relationship between short-term and long-term interest rates. *We are finding value in high-grade bonds that mature in approximately five years.*

In conclusion, please note that there are many times during the lifetime of an investor during which portfolios are flat or even decline. Given the brutal bear market experienced during the early part of this decade, we are not surprised that every pullback brings with it a high level of anxiety. That said, we caution investors that by reacting to this anxiety by panic selling is precisely what historically has led to failure. The bear market of the early decade is over. Rather than get caught up in reflecting on and reacting to the past, we are focused on the future and finding investments that will help you achieve your future financial objectives.

Should you have any questions, concerns or comments, please don't hesitate to contact us. Enjoy the remainder of the Summer season.



Dennis P. Fagan, President

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Fagan Associates, Inc
 Your *independent* registered financial adviser.

- Locally owned and managed since 1989
- No outsourcing to institutional money managers
- Separately managed portfolios
- Outstanding service

July 7, 2006... Stocks declined, spooked by the fear of stagflation – a period of relatively benign economic growth accompanied by inflation, a la the 1970’s. This fear was personified in the June Non-Farm Payroll report which showed only 121,000 jobs created but with an up-tick of 0.5% in Average Hourly Earnings. We believe this fear will not be realized, but the wage growth is welcome, given the lack of real growth in income since the recovery began four years ago. We continue to remain in a trading range and will most likely be there until October, the end of a historically challenging seasonal period for stock investors. We continue to believe that the risk/reward ratio of holding stocks, especially over the next twenty-four months remains positive. We are strategically upgrading portfolios with strong companies in dominant positions and sound balance sheets. We are judicious in what we are willing to pay for a stock. This discipline will be the difference between success and failure.

Index	Weekly Change	Closing Value	% Change Prior Week	Year-to-Date % Change	Trailing 12 Mo. % Change
Dow Jones Ind. Avg.	-59.55	11090.67	-0.53%	+3.48%	+6.14%
S&P 500	-4.72	1265.48	-0.37%	+1.38%	+4.42%
NASDAQ Comp.	-42.03	2130.06	-1.94%	-3.41%	+0.81%
DJ Wilshire 5000	-88.95	12760.34	-0.69%	+1.94%	+5.32%
Russell 2000	-15.37	709.30	-2.12%	+5.36%	+7.12%
Dow Utilities	+2.70	416.65	+0.65%	+2.85%	+6.72%
Dow Transports	-85.69	4843.20	-1.74%	+15.42%	+34.91%

As of July 7, 2006

Federal Reserve Release



Press Release

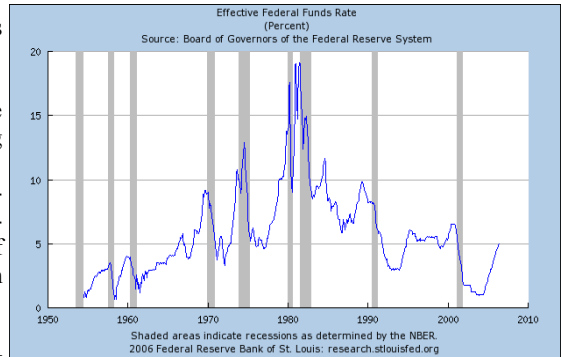
June 29, 2006...The Federal Open Market Committee decided today to raise its target for the federal funds rate by 25 basis points to 5-1/4 percent.

Recent indicators suggest that economic growth is moderating from its quite strong pace earlier this year, partly reflecting a gradual cooling of the housing market and the lagged effects of increases in interest rates and energy prices. Readings on core inflation have been elevated in recent months. Ongoing productivity gains have held down the rise in unit labor costs, and inflation expectations remain contained. However, the high levels of resource utilization and of the prices of energy and other commodities have the potential to sustain inflation pressures.

Although the moderation in the growth of aggregate demand should help to limit inflation pressures over time, the Committee judges that some inflation risks remain. The extent and timing of any additional firming that may be needed to address these risks will depend on the evolution of the outlook for both inflation and economic growth, as implied by incoming information. In any event, the Committee will respond to changes in economic prospects as needed to support the attainment of its objectives.

Voting for the FOMC monetary policy action were: Ben S. Bernanke, Chairman; Timothy F. Geithner, Vice Chairman; Susan S. Bies; Jack Guynn; Donald L. Kohn; Randall S. Kroszner; Jeffrey M. Lacker; Sandra Pianalto; Kevin M. Warsh; and Janet L. Yellen.

In a related action, the Board of Governors unanimously approved a 25-basis-point increase in the discount rate to 6-1/4 percent. In taking this action, the Board approved the requests submitted by the Boards of Directors of the Federal Reserve Banks of Boston, New York, Philadelphia, Cleveland, Richmond, Atlanta, Chicago, St. Louis, Minneapolis, and Dallas.



STOCKS: WHAT WE BUY, WHEN WE SELL

The equity portion of your portfolio consists of stocks selected and monitored closely by Fagan Associates, Inc. A stock is acquired following a thorough examination of company ratios, business data, industry factors, monetary policy, and economic conditions. From these equity holdings we select stocks for individual portfolios based on the client's goals, risk tolerance, time horizons, and current asset allocation. The holdings are then examined daily, including the direction of the stock price, money flows, institutional sponsorship, and industry strength.

At the time of the purchase, we also assign an exit strategy (stop/loss targets). Our goal is to preserve capital in bear markets and grow capital at a faster pace than the market during bull markets. Stop/loss orders can be a mental or "soft" stop/loss order as opposed to a "hard" stop/loss order placed with your broker. The former allows for a situation in which a stock could open lower as a result of company specific or industry news as well as a result of geo-political events such as those we have been witnessing lately. In these cases, the move may be transitory and the "soft" stop gives us time to analyze the data. Go to www.faganasset.com to view our largest holdings.

THE CASH PORTION OF YOUR PORTFOLIO

Cash and cash equivalent investments, such as money market funds, CDs and Treasury bills are low-risk investments that pay interest and they are an important portion of a well-balanced portfolio.

Cash or money market balances are maintained in our client portfolios as a "holding tank" for either the future cash flow needs (perhaps to meet a financial obligation such as an upcoming college tuition payment or wedding) or future investment opportunities. Cash also accrues in the money market until we find a holding that is appropriate to the specific needs of an individual client. It is quite possible that in this interest rate environment money market assets may become large so that cash will be available to put to work at a later date into potentially higher return investments.

Additionally, the investor should look at the amount in the money market not only as a dollar balance, but as a percent of their total investment assets.

Should you have questions as to the balance in the money market, please don't hesitate to give us a call.

FAGAN ASSOCIATES, INC

PROTECT YOUR FUTURE EXPLORE YOUR OPTIONS PLAN WISELY

THE IMPACT OF RISING RATES ON BONDS

An investor in bonds should recognize that the price of a bond responds inversely to interest rates. For example, let us assume that you purchased a thirty year U.S. Treasury Bond (both principal and interest payments backed by the full faith and credit of the U.S. Government; widely accepted as the most secure fixed income investment in the world) for \$10,000 and that bond pays a yield or interest rate of 5.1% semi-annually. Therefore, you would receive \$510 per year or \$255 every six months with your principal guaranteed upon maturity in thirty years.

Now let us assume that after purchasing the bond, interest rates on thirty year U.S. Treasury Bonds rise

to 6.70%. Therefore, if you purchased this bond, you would receive interest payments of \$670 per year or \$335 every six months. Even with the rise in interest rates, the interest payments of \$255 semi-annually on your original bond purchase will remain the same for the balance of the life of the bond or until its maturity. However, the principal value of that bond if sold prior to its maturity has declined. After all, who would give you \$10,000 for a bond yielding 5.10% when they can go out today and buy their own bond that pays 6.70%?

So, remember, your bond or bond fund can decline in price or net asset value. *As interest rates go up, the value of bonds go down and*

as interest rates go down, the value of bonds go up. However, this does not affect the interest payments.

Asset allocation works best over the long haul. Invest in bonds for income and stocks for growth. (Asset allocation is defined as the percentage of your total financial assets that you allocate to equity, fixed income and cash investments. For the purpose of this column, investment real estate should fall under the fixed income heading.)

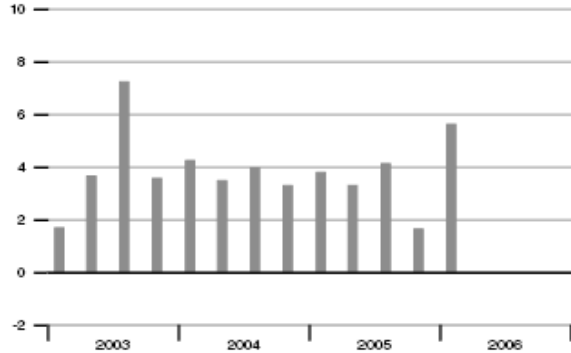
We referred to the yield curve above. We prefer the intermediate part of the yield curve. That would include bonds maturing between three and twelve years. By so doing, you will receive nearly all of the interest of a thirty year bond with less

than fifty percent of the principal risk should you wish to sell your bonds prior to their maturity.

Generally speaking, bonds react inversely to one to two-year historical performance. This means that the more meager the returns during the past, the more lucrative the future may be. One final thought, when measuring performance, always compare your bond or bond funds to similar investments. Do not compare your bond or bond fund to the stock market. Remember, asset allocation provides predictable returns and quantifies your risk. Give us a call if you have any questions.

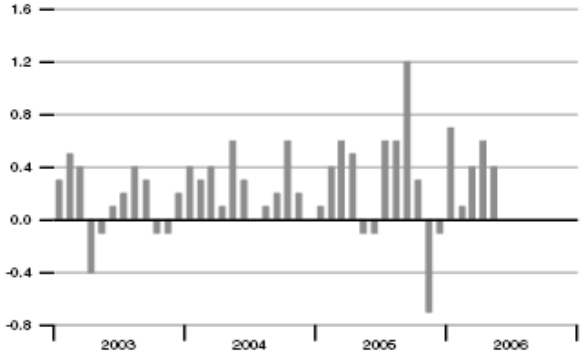
Real GDP Growth

Compounded annual rates of change



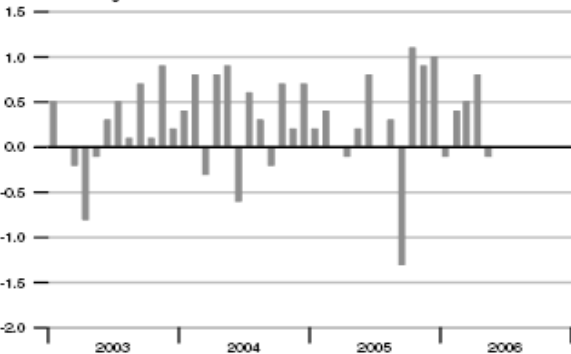
Consumer Price Index

Percent change



Industrial Production

Percent change



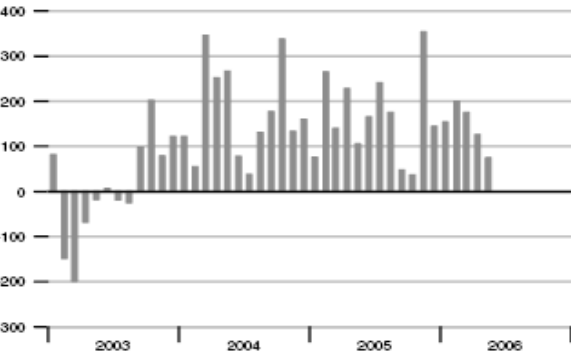
Interest Rates

Percent



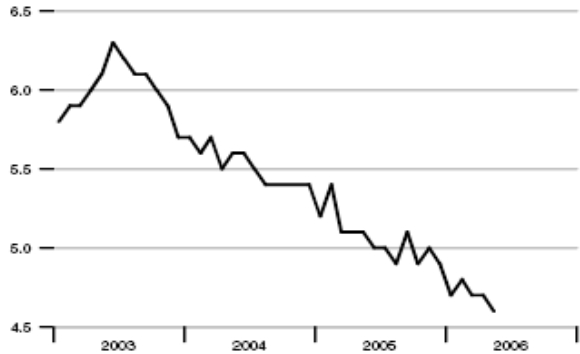
Change in Nonfarm Payrolls

Thousands



Unemployment Rate

Percent of labor force



Fagan Associates, Inc is the proud underwriter of WMHT's local business series, The Bottom Line with Wally Altis. Tune in Monday evenings at 7:30 p.m. or catch the rebroadcast on Sunday at 12:30 p.m.