

Even though Wall Street was fueled by good news and market-friendly economic data this week, the markets continued trading at thin volumes. The Dow gained 1.6%, the S&P 500 added 1.2%, and the Nasdaq increased 2.5% for the week. A sharp decline in energy prices was one of the market makers. As Tropical Storm Ernesto moved away from the Gulf of Mexico and with the summer driving season winding down, oil prices dropped to \$69.19 per barrel and the price of gasoline fell to \$1.73 per gallon. The Treasury bond market also put together a solid performance while investors built up more confidence in the Fed's hold on the interest rate hike. The 10-year Treasury note yielded at 4.72%.

The better-than-expected news on jobs from the Labor Department demonstrated a continuous robust labor market. Initial jobless claims for the week ended August 26 decreased 2000 to a seasonally adjusted 316,000. Unemployment rate fell to 4.7%, down from 4.8% in July. The U.S. economy added 128,000 non-farm payrolls in August, better than the consensus expectation of 125,000 new jobs. As for the key indicator of inflation, average hourly earnings rose by 0.1%, down from 0.5% last month and lower than the expectation of 0.2%.

Furthermore, both personal income and consumption for July reported by the Commerce Department matched the forecasts of 0.5% and 0.8%. Personal consumption grew twice as fast in July compared with the previous month and was also the largest spending gain since January.

Despite the cheerful data from the labor market and consumer spending, a 7.4% fall on Consumer Confidence Index in August will probably overshadow July's exciting sales and dampen investors' spirits. Examples of other chill factors would be the revised 2.9% GDP number (up from 2.5% original number) for the second quarter, which was still a bit lower than most expected. In addition, weak readings from construction spending and housing markets might cool down investors' mood even further. Factory orders fell 0.6% in July, with both durable and non-durable goods down from last month. The Mortgage Applications Index from the Mortgage Bankers' Association was down 0.9% while the Purchase Index dropped 1.7%, the lowest level in 3 years.

With a flood of conflicting economic data and news springing out everyday, the markets are in no doubt standing at an inflationary turning point. Take Caterpillar (CAT) as an example, the Dow's leader and the world's leading manufacturer of earth-moving and farm machinery equipment. Even with a weak earning report, the company's decision to raise prices 5% to 7% was in correspondence to the inflationary concern. Nevertheless, on a broader view, corporate expenses with

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70% in labor cost did not increase much since average hourly earning was up only a little. This is a signal that suggests an anti-inflationary economy. At this contradicting and directionless time, traders and investors are betting on all kinds of sectors hoping to see some winners from this tug-of-war between the bullish leads and bearish drags.

According to Barron's interviews with 12 top equity strategists at Wall Street's major firms, 4-5 strategists see a bearish end for 2006 while about 8 strategists suggest the opposite. Looking back in history and beyond three major indices, some arguments might be able to support the bullish view. S&P 500's P/E ratio is currently at 15.5, which is within the 65-year-old standard range of 14-16. Earning yield of S&P 500 is approximately at 6.4% compared to 10-year Treasury note's yield at 4.7%. When earning yield is higher than treasury yield, recession usually doesn't happen since people have more incentive to put their money in equity. It is a trend that was observed back in the 70's. Moreover, historically, it is very rare to see S&P 500's P/E ratio has a four-straight-year contraction. Since 2004, S&P 500's P/E ratio dropped 10% and then another 9% and 6% in the following two years. Based on the observation from the past, investors probably will perceive an expansion in the near future.

Whether bullish leads will win over bearish drags or the other way around, investors should be very cautious in the coming weeks as the Fed will be meeting and we are approaching another earning season. Instead of sector hopping or trying to cover them all, looking into individual company's fundamental analysis and business model will probably give investors a better picture. Examples would be the technology company in gambling business such as International Game Technology (IGT). It is an industrial trend to replace the old slot machines to a more efficient technology. IGT can be a potential buy for the investors. However, if a company's business model is fundamentally wrong, investors should proportionally increase their short positions when the markets are up.

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