Stamper Capital & Investments, Inc.

"Focusing on Upside Potential with Downside Protection Since 1995."

January 2006 Market Commentary

(In this discussion we will go over Stamper Capital's Upside Potential/Downside Protection Analysis on the Economy, Equities, Real Estate, Gold & Silver, High Yield Bonds, High Grade Bonds, and Municipal Bonds.)

First, what happened in 2005?
Returns of riskier assets (other than commodities) were similar to but even less than that earned for 2004

- **sub par for the risk that was taken:**

The Dow Jones Industrial Average returned only 1.7% (including dividends reinvested)

- down 0.6% without the dividends

The S&P 500 returned about 4.9% (including dividends reinvested)
The NASDAQ returned about 2.3% (including dividends reinvested)
The S&P Small Cap Index returned 7.7% compared to a rise 21% in 2004

Short term interest rates rose by about 190 basis points (3 Month T-Bill)
Five year U.S. Treasury Rates were up by about 69 basis points
Ten year U.S. Treasury Rates were almost unchanged at up 15 basis points
Thirty year U.S. Treasury Rates were a bit lower at down by 28 basis points

Credit quality yield spreads for corporate issuers widened while credit quality yield spreads for high yield municipal bonds tightened slightly. Thus, high yield corporate bonds underperformed while high yield municipal bonds outperformed on average..

Gold rose by about 18% to a rebound top
Silver rose by about 34% to a rebound top

Our performance: We believe the open-ended Mutual Fund we manage performed extremely well in the Morningstar Short Term Municipal Bond Fund category (1st out of 139 competitors, see below) - and also, very importantly, it outperformed most risky asset classes (stocks, real estate, and low quality bonds) on a pre-Federal-tax basis for 2005. **You decide if the return was superior for the risk that was taken.** The Fund's average credit quality over the last several years has been AA or higher and its duration (a measure of interest rate risk) has been less than three years (of course there are numerous other risks for all investments that we detail on this site):

Morningstar Rankings

Short-term Municipal Bond Funds
Period ending December 31, 2005

PERIOD	Stamper Capital Sub-advised Fund Rank	NUMBER OF COMPETITORS	CATEGORY AVG. TOTAL RETURN	SCI Managed Fund TAX-FREE TOTAL RETURNS	Fund PRE-TAX EQUIVALENT TOTAL RETURN	SCI Managed Fund Share Class
1-YEAR	1	139	1.23%	3.46%	5.32%	I
3-YEARS	2	103	1.60%	3.17%	4.88%	I
5-YEARS	2	84	2.97%	4.07%	6.26%	I
10-YEARS	1	57	3.50%	4.42%	6.80%	A

The pre-tax equivalents are based on the highest federal tax bracket of 35%.
Please see Disclaimer Section Below.

OK, those are the raw numbers but what really happened in 2005? In a sentence: **What we think you really need to know is that prices of riskier assets (except commodities) underperformed in 2005 after outperforming marginally in 2004. Importantly, coming up from the 2002 bottom, only 2003 offered investors in risky assets returns commensurate with the risk they were taking - on a risk-adjusted basis, risky assets underperformed in 2004 and performed even worse in 2005. Below we will review what we expect for 2006.**

Where we are now (January 2006) - Importantly, the upside potential/downside protection characteristics that we analyzed in our 2004 and 2005 January Market Commentaries still hold actually, worse than that, the upside potential/downside protection characteristics of risky asset classes are generally worse now than they were then: "Thus, our January 2004 analysis still holds but even more so. In fact, the situation is in many ways worse now than at the 2000 equity market top. Equity valuation levels on everything but Tech and the NASDAQ are similar or are worse now than they were at the 2000 peak. Compound that overvaluation with debt levels that are higher than they were during 2000 for almost everyone in general the U.S. Government, States, Cities, Municipalities, corporations, and individuals. In addition, we are now a couple of years closer to the pension fund and Social Security/Medicare problems that are, unfortunately, succumbing to the power of compound interest and forty years or so of over-promising. Not only that but we now have an incredible real estate bubble (we have documented residential real estate values are 2x to 3x too high based on rental income and stagnant salaries/personal income). This real estate bubble is dramatically larger than the stock market bubble in terms of total valuation and the number of people directly affected by it. In addition to our previous annual January Market Commentaries, we have done a considerable amount of documentation and analysis of most of these factors throughout 2004 [and 2005] that can be found on our **Deflation Watch** page, our **Elements of Market Tops** page, and our **Major Trend Change Indications** page." (You can find those pages here: http://www.risk-adjusted.com/Weblogs.html) That was a direct quote from our 2005 forecast and it still holds.

More quotes from last year's forecast that showed merit and are still applicable:

"Importantly, based on the lack of income growth and essentially unchanged employment levels, whether there has actually been a recovery is still debatable. Either way, we still believe that deflation is a bigger risk than inflation. The primary reason is extremely high levels of debt combined with interest rates that will most likely continue to rise. We believe interest rates will likely rise as the borrowers including the Federal Government have to pay more to get foreigners to lend to them. Another way you can look at it is that rates will have to rise to protect the U.S. dollar. Thus, rising U.S. interest rates combined with huge debt levels will likely push us back into a recession. (Please note that because the European Common Market is restricting budget deficits, they are unable to inflate compared to historical levels. This fact and the huge debt levels may be swinging the world economies towards deflation as opposed to inflation)."

"A few times previously, we have discussed our contention that the entire "structure" will be a **"Sideways Right-tilted W."** We still believe our case that the first leg was down from the 2000 top; that we are just ending the "middle upward leg" (or the "eye of the perfect storm") that started from the late 2002 bottom; and that the next leg downward is from the middle peak where we are right now. Importantly, we believe the entire "W" structure will be tilted to the right with the second down leg we are due to enter being longer than the first leg down. That "tilt" actually makes sense in that the valuation levels now are worse than they were from the beginning of the "structure" so, of course, values will drop even further (unfortunately if we are correct). Also, very important to us, especially in light of our Upside Potential/Downside Protection Analysis, is that this down leg could have happened at any time since around the middle of 2003 (when we initially thought it would begin). Because it has taken longer and because the valuation levels are even more out of whack, we believe the negative move in the prices of risky assets will most likely be tremendous."

Importantly, besides our forecast for the "Sideways Right-tilted W" structure of the economy since the 2000 top still being intact (2005 being lower than 2000 with the 2002 bottom in between), **the momentum of the rebound from the 2002 bottom ("the middle upward leg of the W") has been waning since 2003** - prices of risky assets and the economy did well in 2003 but didn't compensate for the risk in 2004 and were almost flat or negative in 2005. Thus, **we believe the rebound has about reached its apex and we expect it is about to head downward hard in the second leg downward of the W structure.** We have put a huge amount of time into our **Deflation Watch** webpage, our **Elements of Market Tops** webpage, and our **Major Trend Change Indications** webpage documenting reasons why we believe the economy (and prices or risky assets) will be dropping hard shortly. (You can find those pages here: http://www.risk-adjusted.com/Weblogs.html) In a nutshell, incredibly high asset valuations levels in most sectors, combined with record high debt levels sets the stage - Triggers are rising interest rates especially for lower quality borrowers; increased borrowing by the Federal government to support the war, fund recoveries from natural disasters, and finance its record debt; and the Pension Time Bomb which must be accounted for starting in 2007 but is already getting a lot of attention in the press and, will, in 2006, likely be the key issue for most governmental bodies. We believe we are right now experiencing “reality recognition" by the media and the public (and investors) of these problems - unfortunately, this rather sudden "reality recognition" will likely increase the speed of the declines. Importantly, our "right-tilt" means that the next bottom should be below the 2002 bottom, in terms of values of risky assets (like stocks, low quality bonds, real estate, etc.) and the accompanying recession will be worse than the one in 2001.

Our 2006 Forecast - Based on Stamper Capital's Upside Potential/Downside Protection Analysis, in part, on the macro level as explained above, and, in part, on a micro basis at the actual investment level, like last year, we essentially see very little upside potential and very poor downside protection in the prices of riskier asset classes including: U.S. equities (which are still at very high valuation levels especially when the record debt levels are considered), lower quality bonds (i.e. junk bonds, which began to widen out in 2005 - think G.M., Delta, Delphi, etc.), Gold & Silver (which have recently risen to rebound peaks and will likely begin to fall as deflation becomes evident), and definitely residential real estate (which we have demonstrated is, in general, 2x to 3x overvalued based on rents in most markets, is most incredibly over-financed, and we believe plateaued in some areas as early as mid-2004 and has started down hard in a few in 2005 - see articles on the Boston area (down 20%) on our **Elements of Market Tops** and **Deflation Watch** weblogs) (You can find those pages here: http://www.risk-adjusted.com/Weblogs.html). Interest rates are now a tougher matter than last year. We do believe interest rates for riskier credits will continue upward whether those rates are short term or intermediate term or long term - this could likely be the case for all issuers rated A or lower. Over the last couple of years we correctly forecast that short term rates would rise. Interest Rates of The Highest Quality Issuers: Now, if the economy weakens substantially as we are forecasting, the Federal Reserve will likely stop raising short rates and being to lower them again. As for interest rates of longer terms, we believe the highest quality long term interest rates could actually go down as there is a flight to quality; however, the easier call to us is that long term interest rates of weaker credits will go up as credit quality for all but the strongest credits becomes a major concern. Last year, we correctly forecast a rising U.S. Dollar which we attributed to the Fed raising short term interest rates. This year we believe the U.S. Dollar will continue to rise due to a "flight to quality" at least initially during the increasing global economic slowdown (most of the other industrial countries are already in recessions - see articles we reviewed on Italy, Spain, Germany, France, Japan, and China (yes China) on our **Elements of Market Tops** and **Deflation Watch** weblogs) (You can find those pages here: http://www.risk-adjusted.com/Weblogs.html). It may also be the case that the Fed has to keep short term interest rates up in order to protect the U.S. Dollar which is owned by a huge proportion of foreigners.

Accordingly, we continue to believe high quality, short duration bonds are still about the best place to be invested.

To many, our forecast includes a curious scenario of basically "the perfect economic storm" - a tough recession and dramatically declining prices of risky assets including equities, real estate and commodities (including gold and silver) accompanied with rising interest rates (at least of lower quality issuer/borrowers). We have a few explanations for this: First, this entire process is the reverse of the credit explosion (more and more credit issued = more and more debt borrowed) that began at least since 1982. Second, our debts are being financed by a huge proportion by foreigners and the Fed may have try to keep short rates up (even during recession) to protect the U.S. Dollar and so that the record debt can be rolled over. However, an equally valid scenario to us is that the Fed lowers interest rates to try to stop the recession. Thus, we are in a bit of a pickle on this one - it maybe that first they try one approach and then switch to the other later. Third, we expect prices of precious metals will fall because we are in a deflationary recession and a credit contraction (as opposed to inflation) in part caused by the excessive, record debt levels contracting and in part caused by budget deficit restrictions of the European Common Market which preclude them from inflating (at least for now). Accordingly, we believe the flight to quality will be to short term U.S. governments (and possibly longer term U.S. governments or other very high quality issuers) at least initially rather than to precious metals which are already at rebound high levels. I think the bottom line of all this is to stick with the highest quality, lowest risk investments (and this doesn't mean "high quality growth stocks").

As previously, for us "safety" continues to be the watchword for this decade.

(Posted January 14, 2006)
