

A Sampling of Advisory Opinion

Edited by ANITA PELTONEN

On the Up and Up

E-Memo by the Fortress Partners Banc Ventures

700 Walnut Ridge Dr., Hartland, Wis. 53029

July 17: Despite regular corrections, the long-term trend of the equity markets -- including small-cap bank stocks -- is up. Why? Because the value of a business is based on the underlying earnings stream that it generates and, domestically, corporate profits have increased at an average annual rate around 7% for the last 40 years. But banks, according to data from the FDIC, have increased their earnings at an average yearly rate of almost 10% over that span.

That 40-year time horizon includes periods when the economy was booming and times when it was in recession, as well as periods of high inflation and low.

In banking, [there was] the savings and loan debacle, and multiple credit "crises" in the international, agricultural, energy and commercial real-estate sectors. Interest rates cycled up and down, credit spreads expanded and contracted and the yield curve cycled from normal to steep to inverted and back again.

-- Jon Bruss and Robert Ollech

Manufacturing Gives High Sign

Macro Brief by MKM Economic Research

1 Sound Shore Drive, Greenwich, Conn. 06830

July 17: Industrial production and manufacturing are staging a rebound after weakness in late '06. Recent trends [echo] the 14-month high in the ISM Manufacturing Index and a strong rebound in trade and manufacturing sales. With capacity-utilization rates rising, profits/cash flows high, and credit spreads still relatively narrow, we...look for a rebound in business spending to offset any consumer weakness....

Technology stocks have been outperforming and transports have risen to new all-time highs in the face of \$75 oil. If there is a risk factor we think is being underplayed, it's probably on the inflation side: The dollar is at 15-year lows, liquidity is booming and commodity indicators are strong. Inflation spreads remain contained, but...above their 10-year moving average...Core producer-price inflation [has hit its] highest three-year average since 1994. We expect the next Fed move to be up, but not until 2008. In the interim, we expect stocks to strongly outperform bonds as the valuation gap between the two compresses.

-- Michael Darda

Eagerly Awaiting Earnings

Portfolio Strategy by Principles of the Stock Market

P.O. Box 1236, New Paltz, N.Y. 12561

July 17: For now, we're dependent on what happens to second-quarter earnings, which started out on a down note with Alcoa disappointing...Still, if we again do better than the forecast 4%-plus earnings-per-share growth, the stock market overall should go higher, especially if long-term interest rates stay down and thus takeout offers continue to abound.

-- *Richard Schwartz*

Core Statistics Mask Inflation

Investment Strategy by Raymond James

880 Carillon Parkway, St. Petersburg, Fla. 33716

July 17: Disingenuously, our government excludes food and energy [from] the nation's "core" inflation statistics because of their alleged "short-term" volatility, but consider this. Since August of '04 crude oil has averaged well above \$50 a barrel. Surely, three years is long enough to admit that...high oil prices are here to stay and ought to be included in the [consumer-price index]...Grain prices' rise is only a year old, [but] it's hard for us to envision that higher food prices are not permanent, too. Indeed, the producer-price index shows the raw-food component up 25% in April and 30%-plus in May. When you get these sorts of increases, it's just a matter of time until they bleed over into prices at the supermarket. We think you're going to see this trend increasingly reflected in 4Q07 and continuing for the foreseeable future.

-- *Jeffrey Saut*

Water, Water Everywhere

Water Works Weekly by Brean Murray Carret & Co.

570 Lexington Ave., New York, N.Y. 10022

July 16: Another week of solid performance for water-industry stocks. In an all-too-familiar pattern, all of our water-industry subsegments once again outperformed our market benchmarks [recently], with the exception of the distribution segment. The flow-technology and water solutions segments are now extending their gains substantially over our market benchmarks year to date, in what is shaping up to be an outstanding year. The distribution group continues to be hampered by poor weather conditions among the California-based water utilities; significant rain has not yet occurred to remove drought conditions in the Golden State.

-- *Michael Gaugler*

Right on the Money

Option Queen

Box 1952, New York Board of Trade, 1 North End Ave., New York, N.Y. 10282

July 15: Put-sellers continue to sell their puts, at ever higher strike prices. These guys are selling naked and so far, they have been "right on the money." Even when the market retreated, they continued to sell puts. We are referring to the puts on the Russell 1000, Russell 2000 and the Standard & Poor's 500 puts. Interestingly, we haven't seen any call-sellers appearing, just put-sellers. Clearly, these sellers don't want to risk the upside and felt comfortably certain that the market will not move to the downside.

Speaking of options, one cannot help but notice that the volatility index [VIX] isn't retreating much, even on the huge rally days. This is serving to signal that some uncertainty is leaking its way into the markets, causing a little more premium to be paid for those puts and calls on the S&P 500. It is customary to see the VIX retreat on huge rally days.

-- Jeanette Schwarz Young