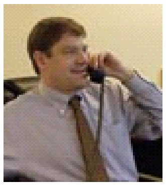
INVESTMENT UPDATE
NEWSLETTER

ALLEN TRUST COMPANY

JULY 2006



William A. Harris, CFA
Portfolio Manager

Mid-Year review

The second quarter of 2006 found the stock market giving back much of its gains from the prior period, and the bond market continuing to lose. Altogether, your stock portfolios have drawn about even with the S&P 500 composite for the year, with a 2.73% total return. Your collective bond portfolios, on the other hand, have pulled ahead of the Lehman Aggregate Bond index by more than 2%.

Total Return, First Half 2006	
Allen Trust Equities	2.73%
S&P 500	*2.71%*
Allen Trust Bonds	1.44%
Lehman Agg Bond	*-0.72%*

While good relative performance in an "up" market is nice (i.e. meeting or beating benchmark returns when asset values are rising), achieving positive *absolute* returns in a falling market is especially satisfying (i.e. making *any* money instead of losing *less* money – for most of us, this states the obvious, but portfolio managers need to remind themselves that relative returns aren't everything in all seasons).

What's Moving the Bond Market?

Previously I have discussed a recent lack of volatility in the capital markets (stock and bond alike), a seeming calm we could partly attribute to the Fed's robotic pace of upward ratcheting (17 consecutive 25bp increases, from a 1.00% Fed Funds rate in June 2004, to a 5.25% rate today). There is comfort in thinking you know what's just around the corner; it makes investors large and small alike less jumpy.

But now, investors are trying to figure out what it means to have an untested new Fed chairman, a change in the wording of the most recent Fed decision, plus stirrings of inflation (which might augur further hikes) vying against hints of a slowing economy (which might bode well for a pause in hikes). Throw in Middle East boil-overs and a likely first rate hike by the Bank of Japan (the beginning of the end for the "carry" trade whereby one could borrow Yen cheaply and lend US dollars at a significantly higher rate), and any certitude is gone.

This affects the short and longer ends of the Treasury yield curve differently, as seen in two numbers: +2.19% and -3.83%. These are, respectively, the year-to-date returns on 3-month and 10-year US Treasuries. The Fed's power to damage total return on "safer" short holdings via 25bp hikes is far less at 5.25% than it was at 1.00% – whereas the most recent hike represented just a 5% proportion of yield, the first move represented a 25% proportion of yield (25bp/500bp vs. 25bp/100bp) – and longer prices are dependent less on the Fed's influence than they are on the perhaps now waning kindness of strangers.

Stock Market: Mostly Slipping

While most areas of the stock market did well in the First Quarter, in the Second Quarter, 7 of 10 S&P 500 sectors lost value. Notable also is that while the best performing sector (Utilities) is the second smallest, the two worst sectors are the second and third largest (Information Technology and Health Care). Pain was felt more broadly and deeply than gain.

S&P 500 Sector	2Qtr06	Weight
Energy	3.9%	10.2%
Materials	-1.0%	3.1%
Industrials	-0.5%	11.7%
Consumer Discretionary	-0.7%	10.2%
Consumer Staples	2.3%	9.6%
Health Care	-5.4%	12.3%
Financials	-0.8%	21.4%
Information Technology	-9.8%	14.9%
Telecommunications	-1.4%	3.3%
Utilities	4.7%	3.4%

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Firm News

On July 19th, Stuart Allen and Bill Harris are leading a seminar for the Oregon State Bar. "Counsel at the Crossroads: Ethics and Your Clients' Investments" will help equip attorneys at the intersection of the financial and legal worlds. Learn more at: http://www.osbar.org/_docs/cle/programs/seminars/CI06.pdf.

We have more exciting news: Trust Officer Helen Robinson has earned her CTFA credential from the ABA's Institute of Certified Bankers. Becoming a Certified Trust and Financial Advisor demands mastering a core body of knowledge including fiduciary and trust issues, financial planning, tax law and ethics, as well as professional experience and integrity. It's quite an accomplishment. Way to go, Helen!