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July 12, 2006

According to the Standard & Poor's website, the annualized total return of the S&P 500 index between January 1926 and March of this year was 10.46%. This number reminds us of the oft quoted statistic that over long periods stocks tend to return about 10% per year. From this, many investors mistakenly assume that stocks go up about 10% **each** and every year. Nothing could be further from the truth.

During the past 15 years (1991-2005), for example, the annual total yearly return of the S&P 500 index has ranged from a high of a 33.4% gain in 1997 to a 22.1% loss in 2002. During 9 of these 15 years, the yearly return exceeded 10% while in 3 years the return was negative and during 3 more the return was in the single digits (the same patterns occurred during the 15 years prior – e.g. 1976-1990). In short, volatility is pretty common in the stock market.

So far, 2006 has been consistent in this regard as the S&P 500 index has been on a roller coaster ride going up by 6.2% between January 1st and May 5th and then falling 7.7% from May 5th to June 13th.

What accounts for this roller coaster ride? Frankly, not much. Sure, if we interviewed 10 economists and 10 so-called stock market experts, they would all give you their opinions about this and that economic issue that supposedly sent the stock market up or down. In reality, though, what is most remarkable about this ride was not that it occurred, but rather that neither the up nor the down had much to do with solid economic news.

In fact, the first six months of 2006 saw a continuation of most of the news from 2005 including Federal Reserve interest rate increases, high oil prices, unsettled international news, concerns about housing weakness and an economy that continues to chug along.

In short, the roller coaster wasn't due to anything new but rather due to investor optimism or pessimism, depending upon the day, of what *might* happen in the future. Where is our crystal ball when we need it?

The result has been an excellent opportunity to buy solid companies whose futures look very promising – regardless of whether the optimists or pessimists are right – for less than their intrinsic net worth (a pattern that continues to this day). While most are large, mature, multi-national corporations that provide us with both a solid dividend yield and the promise of capital appreciation, a few are large, but less mature companies who are still growing quickly, but have fallen out of favor with the market. I have also emphasized companies that will benefit from a falling dollar which could become a bigger problem down the road. Finally, as I await good values, I have taken steps to maximize the earnings power of cash through the selective use of money market funds.

Thank you for your continued confidence. Have a great summer.

P. S. I wanted to give you a heads up that my office will be closed during the first two weeks of September while Marylou and I travel to Italy where we will hike the Dolomites and visit in and around Venice.

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