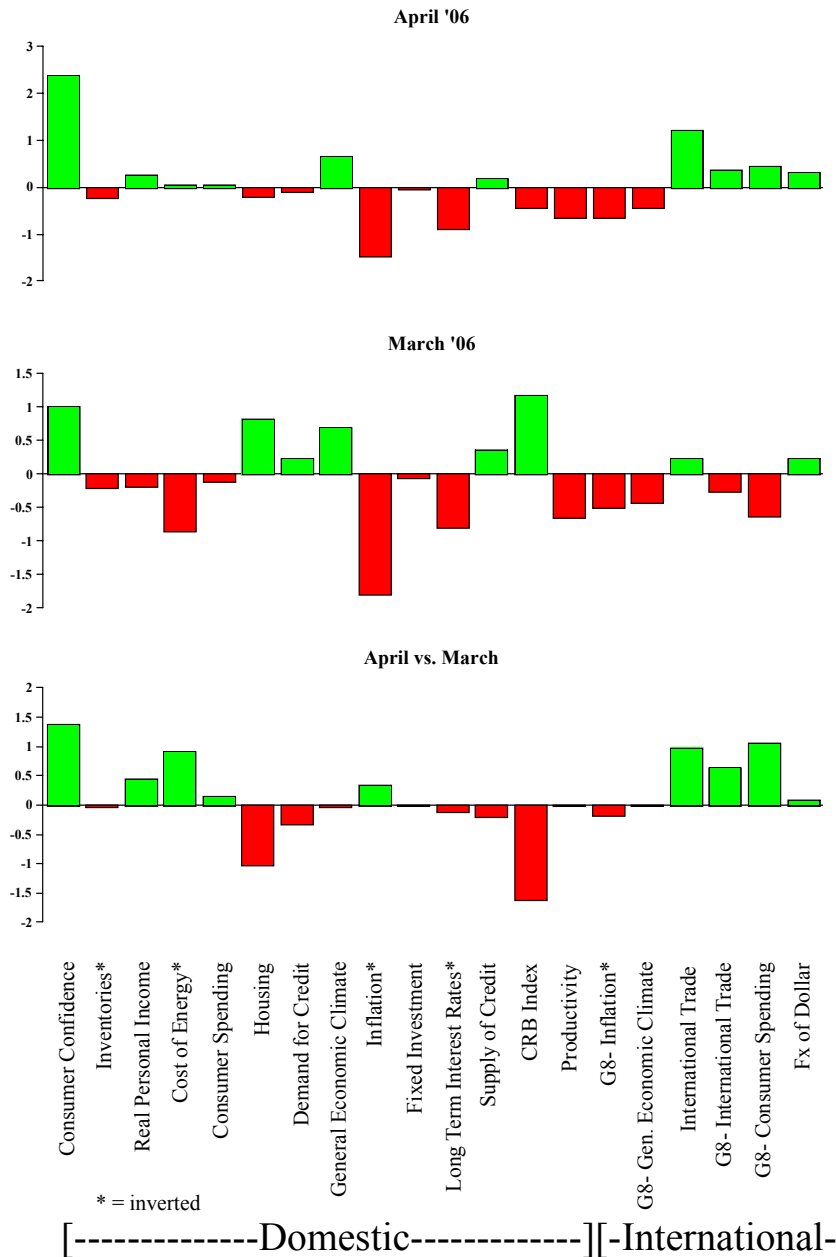


Gradual Shift Away from Commodity Groups Seen

April 19, 2006

The following charts show fact based trends in ASC Economic factors as of April 2006 as compared to March 2006 and changes expressed in standard deviations around the norm, hereinafter referred to as “units.”



ASC Factor indicators of future activity show that real growth in the US firmed up slightly last month. Following are significant changes in trends last month expressed in standard deviations around the average rate of change or "units." Initial Unemployment Claims fell by 1.38 units. Real Income rose by .44 units. Cost of Energy fell by .91 units. Housing fell by 1.01 units. Inflation fell by .33 units. The CRB Index fell by 1.61 units. Productivity rose by .98 units. G8 Consumption rose by 1.06 units. The summation index is currently at 100.9 as compared to 98.4 in March 2006.

The new development among influential economic factors is the trend toward higher interest rates. World economic growth could withstand Fed tightening as long as long rates did not rise. Now long rates have begun to trend higher. The ASC model suggests that current economic trends are not sustainable with long rates heading higher. Some extrapolation may add clarity. Imagine the world economy six months hence when the ECB and Bank of Japan join in with the US Fed in nudging short term rates higher, resulting in a trend toward higher rates world wide. For those who have suggested that mortgage rates of 6.5% are low in comparison to past levels, they should examine current inflation levels in relation to the past. In the 80's when mortgage rates were over 10%, inflation was over 4% and rising. One could prosper by borrowing and investing in real estate. Despite the warnings this service has been giving about inflation, it is likely to remain at around 3% because of the pressure on wages from foreign sources. In the current environment, in particular with housing prices undergoing a significant correction, higher borrowing costs are likely to have a negative effect on economic growth. Along with higher energy prices, increased long term rates are likely to lead to a slow down

in global demand.

With the increase in rank of interest sensitive industry groups suggesting a slowing in the US economy, one might logically ask where is the slowing going to occur. An area that is already somewhat slow is automotive, in particular US makers and their suppliers. The other area that appears to be gathering downward momentum is housing, both in terms of building activity and as a source of credit. Currently, the sentiment has shifted toward an over heating US economy that is likely to keep the Fed on its path of raising short rates until the over heating risks have been dealt with fully. By which time, the US economy may have actually begun to weaken, highlighting the risk of a Fed induced slowdown and the risks associated with one. Last month we raised the subject that current conditions resemble the pre Oct 1987 financial environment, namely the economy is showing signs of over heating, the Fed is tightening, the US dollar is weakening and long bond yields are rising. All of the conditions we discussed were in evidence last month except for a weakening US dollar.

The current consensus of an over heating US economy and strong performance by gold and other commodities creates an environment in which one can rebalance by selling into strength and move to safer groups. At some point long rates are going to rise enough to start a significant draft in the economy to change the psychology. Whether a slowdown in economic activity leads to a gradual changing of sentiment or, if the over heating continues until a financial response precipitates a sudden reaction, one should start preparing by gradually moving away from commodity driven groups toward more defensive groups such as health care, interest sensitive and consumer staples.

One of the sources of strength in the US economy is still residential construction. In many markets, inventories have gone from around one month of inventory or listings that sell in the same week in which they were listed to five months on hand. Clearly, inventories of unsold houses are increasing sharply, yet large construction projects remain underway. In addition, suppliers to the construction companies such as earth moving and other goods are experiencing strong demand. Indeed the ASC housing group is currently highly ranked. Generally when such a group is highly ranked it is deeply depressed by concurrent adverse economic conditions. Not so this cycle. There appears to be a bust coming, as in previous hot housing markets, it is a question of timing. Not only is the slump in building activity likely to be a depressant, but for a lot of households the home equity ATM is likely to be replaced by a collection agent.

As long as the US economy is viewed to be over heating and commodities are strong, the Fed is unlikely to stop tightening. There would need to be a significant sign of slowing based on coincident indicators for the Fed to tighten one more time and stop. Such indicators are quite strong currently. Weakness is showing up on leading indicators which are not given as much weight as coincident ones. Those who have been optimistic about the Fed stopping before now, have been consistently wrong. What might occur is more time between tightening, i.e., they might skip an opportunity to raise rates to see more data. However, if further data were to indicate concurrent strength, then additional tightening would be likely.

ASC's recession proxy, the foods, remained at rank 17th. Interest sensitive groups such as Insurance, Housing and Fi-

nancial Cyclical were ranked at 10th, 9th and 12th respectively, last month. The Metals and Mining group is currently ranked 43rd out of 45. Energy is ranked 36th. The ASC model seems to be suggesting that the industry groups that are appropriate for current economic trends would be those that would benefit from a slowing US economy, accompanied by somewhat lower interest rates and an easing off of inflationary pressures.

Investment Strategy

Equities:

The industry that is well positioned is health care. Over weights in S&P groups are advised in Health Care and Consumer Discretionary. Market weights are advised in Energy, Consumer Staples, Materials, Information Technology and Financials. Under weighted are Industrials and Utilities. Materials and Industrials were downgraded; Financials were upgraded this month.

Fixed Income:

With the US economy appearing to slow somewhat, our previous cautious stance on long bonds needs a slight adjustment. Over the intermediate term, the yield on the long bond is not likely to go a lot higher. Regarding the issue of duration, on a scale of 1 to 10, with 10 representing a maximum position in shorter term debt and 1 representing a maximum position in Long Treasuries, we would rate the current environment as a 6, down from 10 last month, suggesting an average maturity of 3-5 years.

Hedge Funds:

We are covering our short in Financials

yet remain short Utilities. We are long Health Care and Consumer Discretionary.

As for Global macro bets, we are staying with Indonesia, Thailand and Malaysia. Now that Japan has discounted progress on bank reform and its recovery and there are politicians talking about another consumption tax that had dire consequences in 1997, one should be wary of Japanese securities.

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