

INSIDE THIS ISSUE

- Information Overload
- Interest Rates
- New Market Transcript

Reminiscences

PUBLISHED BY BIRINYI ASSOCIATES, INC.

VOLUME 14, NUMBER 6

June 2006

MARKET COMMENTARY: June 2006

Sports Illustrated is not usually found in financial circles, but recent issues have some relevance to today's investors. After the NBA finished the regular season, *SI* wrote glowingly about the Detroit Pistons, the team with the league's best record. But in the playoffs against the Cleveland Cavaliers, the Pistons barely won. That week, *SI* discussed the Pistons' weaknesses, failings, and shortcomings.

Investors too alternate between hot and cold. On April 18th, the DJIA rallied nearly 200 points on the "prospect that the Fed will stop raising rates". Good news continued over the next several weeks, but it was curiously inconsistent. If the Fed was indeed at or near the end of the cycle, the bullish scenario was predicated on a slowing or at least moderating economy.

But at the end of April, Q1 GDP showed growth of 4.8%, its strongest level in three years, and in early May both the ISM (Institute of Supply Management, the old NAPM) and Industrial Production were stronger than expected.

"No matter how experienced a trader is, the possibility of his making losing plays is always present because speculation cannot be made 100 percent safe."

Reminiscences of a Stock Operator
by Edwin Lefevre

The main focus became inflation. If the economy continued to do well, wouldn't inflation reappear?

Not to worry. As the *New York Times* reported, the mid-month inflation data was benign: "Wholesale Prices and Housing Cool Inflation Worry". The same day, however, the consumer price index was 0.1% higher than expected and a 200+ point decline ensued.¹

But by month's end that fear abated when the PCE report for April, the Fed's so-called preferred measure of inflation, was inline with expectations. As the *New York Times* again reported, "Revised Growth Data Eases Inflation Fear", and while the S&P is down over 3% for the month, it was, in our opinion, recovering.

For those who, unlike ourselves, are not intimately involved with the market, one could legitimately ask, "What is going on?" and "What can I, as an individual, cope with and invest in a market which has such seemingly large and capricious mood swings?"

The answer is not simple and is related to the world at large and not just finance. For one, *there is just more information*. One of this month's inserts is a reproduction of an early version of the trading calendar which we introduced thirty years ago. Amazingly, before then investors didn't know when earnings were due or when economic indicators were announced.

¹Interestingly that piece of news might have been a net positive. The largest component of the CPI is housing. But the Bureau of Labor Statistics measures not the cost of houses but the rental cost of apartments. With house prices stabilizing, or in some cases slumping, the demand for apartments might have increased as individuals hesitate to buy into a declining market. And cooling the housing market is one of the objectives of the Fed.

I guess birthdays aren't for parties afterall. On the day when traders celebrated the 214th birthday of the New York Stock Exchange, the Dow Jones Industrial Average celebrated by falling 214 points.

Note too, that there were only a handful of notable economic releases. Today, as can be seen on our "Dissecting the Economy" insert, we regularly monitor over forty indicators each and every month.

Secondly, *the data is better and quicker*. Everyone has read stories written about Wal-Mart and their inventory tracking systems which tell managers when the Dayton store is running low on paper towels or that the stores in Sacramento are not selling lawn chairs. Not too many years ago, investors didn't act or react in part because the information either wasn't available, or if it was, it was two weeks old and therefore stale.

Today too, media sources have expanded which leads to greater - but not necessarily better - dissemination of information. It also leads to competition and hype. On May 23rd, the market was down 5.2% from its May 5th peak, but by the sounds of some of the news reports one would think a minor crash had occurred.

In May, the Enron saga continued and it reminded us of the lack of perspective and quality which we see too often in the media. In their July 2000 issue, *Fortune* published a list of ten stocks for the next decade. Some months ago we read a story which suggested that investors should consider buying the ten stocks from that list now as they had collectively fallen sharply from their July 2000 levels.

Ten Stocks For The Next Decade: Fortune July 2000			
Ticker	Company	7/19/2000	% Chg
BRCM	Broadcom	158.08	-78.79
SCHW	Charles Schwab	36.38	-54.72
ENE	Enron	72.56	-100.00
DNA	Genentech	37.53	119.15
MS	Morgan Stanley	88.25	-33.03
NOK	Nokia	53.13	-59.68
NT	Nortel Networks	76.50	-96.86
ORCL	Oracle	36.88	-61.95
UVN	Univision	56.63	-37.11
CBS	Viacom	50.21	-48.64
	Average		-45.16
	S&P 500		-14.67

To suggest that they were a mild disaster is probably an understatement as six of the names are down 50% or more, another three are down 30%, and only one of the ten is up since publication.

The story suggested that since these stocks have been beaten down, all the bad news is probably out and they might be candidates for a turnaround. Sadly, one of the ten was Enron which we all know no longer exists. Nevertheless, here was one source advising that investors buy a list of stocks which included the non-existent Enron!

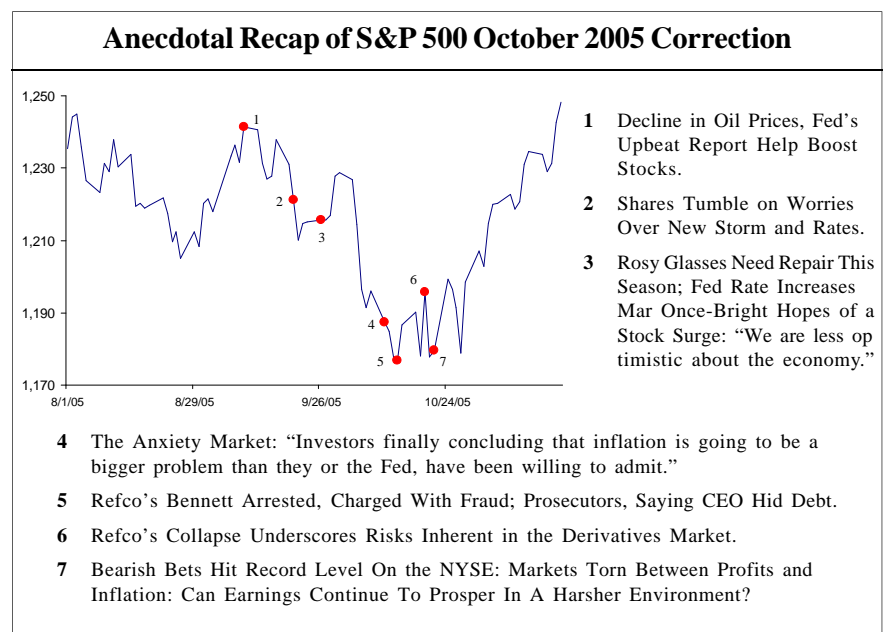
The psychology of investors as well as individuals has also been affected. As a result of technological and other developments, investing has given way to trading and trading by its very nature is short-term. The hedge fund as well as the trader at Goldman Sachs or Lehman is not focused on long-term capital gains. If he doesn't make money in the short-term, he won't be around long-term.

In *Alice in Wonderland* the saying was "Jam tomorrow, jam tomorrow, never jam today." Having spent a dozen years on the Salomon Brothers trading desk when it was the epicenter of the financial trading world, we know it is jam today and we'll worry about tomorrow's jam tomorrow, as evidenced by one of our favorite stories.

Sometime in the late 1970's or perhaps early '80s, we were asked to bid on a large block of iron ore producer Mesabi Trust (MSB). As we recall, it was trading around \$9 and the head of the desk, one Michael Bloomberg, asked me and the head bank trader where we could move the block. We sold the block at \$7 ½ and made a tidy profit between commissions and holding some in inventory. A day or two later we discovered that Mesabi Trust was not a Japanese bank but a mining company in Michigan.

We are not dissuaded from our positive stance by the events of May. We contend that some perspective should be maintained and that unlike traders whose memory extends only to yesterday or at most last week, the underlying trend of the economy and the stock market continues to be positive.

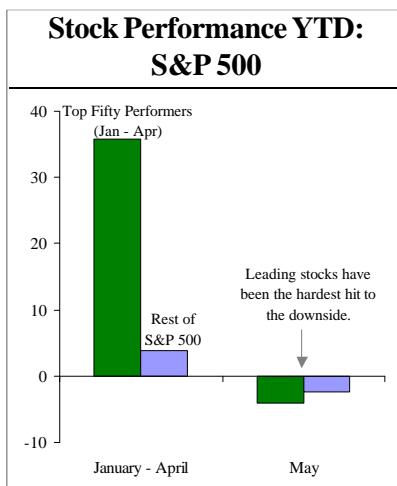
One example of some perspective might be noted in the fact that of all the accounts, all the reports, and all the columns that we read, there is little mention that we had a similar development last October when the market had a 5.4% decline:



Perspective on some elements of May is also positive. For one, the decline in commodity prices, while real, was attributed to “bubbles” in that sector. Since 2000, every significant rise in any asset is quickly classified in those terms. Housing was in a “bubble” then gold, oil, emerging markets, and Picasso paintings.

While there were some speculative ingredients, we should remember that many of those increases were - until May - considered economic realities. Oil was up because Japan and China are prospering and Japan, for one, has to import all of its oil. Anyone who has ever seen Tokyo at night realizes that Japan uses a lot of energy.

Our view is that the events of May were simply a correction as evidenced by the fact that the top performing decile of S&P 500 stocks during the first four months of the year have also declined the most since May. This suggests to us that a major element of the decline was that many investors had realized that they overstayed their welcome and were looking for an excuse - any excuse - to take profits.



Wall Street has generally not shared our conclusion that this is only a correction, and we have seen some very articulate and intelligent arguments counseling caution. We disagree largely because the advice is based on long-term historical perspectives and indicators. *Simply put, we think it is different this time.*

The reflex response to this argument, from even a neophyte investor, will be the old cliché: the most dangerous (and expensive) words in the market are: “it is different this time”. *However, in reality it is always different.*

Several years ago we published *Market Cycles*, the most complete, exhaustive, and thorough analysis ever undertaken on stock market (and economic as well as interest rate) cycles. We are confident in that statement because had such a study been available, we would not have gone to the trouble and expense of doing it ourselves.

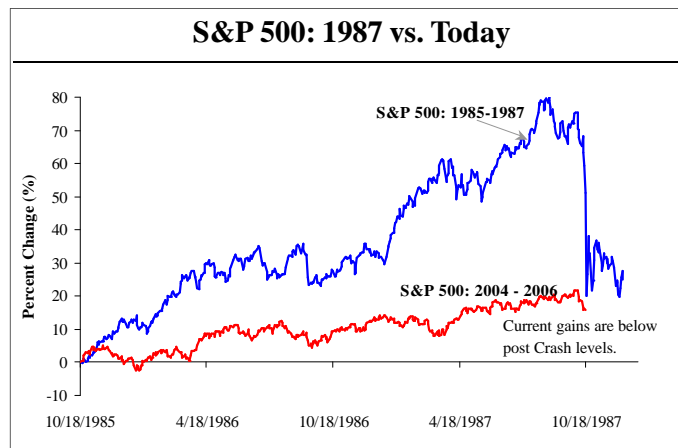
We found that while there were an abundance of useful tendencies, trends, and historical antecedents, every cycle was different and unique in its own characteristics. One example which we have often discussed is the issue of rotation.

Rotation might be considered the holy grail of stock market research. Surely there must be some systematic, conclusive tendency of stocks as they progress through the cycle.

Rotation obviously exists, but it is totally random, and the idea that certain areas of the market do well toward the beginning (or end) of the economic cycle, or as rates go up or down, is extremely elusive. One of our more surprising conclusions - which is important today - is that *interest rates are considerably more important to the market than are corporate earnings.*

As a result of *Market Cycles* and continued observation and analysis, we are more and more of the view that the longer the perspective and depth of history, the less useful conclusions from those efforts seem to be. The market, after all, “learns” from its past, and *it really is different this time.*

Continuing on that theme, concerns have surfaced that we might have a replay of 1987 (39% of respondents to a recent *Kudlow and Co* poll recently thought so). While there are some similarities between now and then, there is also one major difference. In the two years before October 1987, the market was up over 80%, while during the last two years the S&P 500 has only gained 18%.



Market Cycles is one of a series of what we term topical studies, where we engage in detailed, in-depth studies with a view not toward conclusion- i.e., buy drugs, sell utilities- but rather illumination. In 1999, for example, while many analysts were concerned about the lack of breadth in the market, we wrote *Market Breadth*, which concluded that it wasn't how many stocks went up or down but rather which ones.

The S&P is marketcap weighted, and currently Exxon Mobil, GE, and 54 other stocks have a weighting equal to the other 444 stocks combined. Thus, if the 56 top names go up 1%, and the other 444 names fall 1%, the overall index would be flat even though over 88% of the stocks in the index were down. (As Al Gore would attest from the 2000 election it's not a matter of how many, but more importantly, which ones.)

Our most recent study was an update of one we wrote in 1996, *The Failure of Technical Analysis*. As a result of the update and subsequent articles, *we are actually encouraged about the market's prospects*.

In the short term, *chartists are generally negative to downright bearish*. What we view as noteworthy is the paucity or weakness of the bearish arguments. If they were brought before a court on the charge of bearishness, they would - we think- be found not guilty. Consider the following statement, for example: "investors are using rallies to cut loose some underperforming positions which may hint at trouble ahead."

"May hint" is hardly going out on a limb and also suggests "may not hint". And what is wrong with selling underperforming positions? Aren't you supposed to sell losers?

Or consider the chart we presented in our updated *Failure*. Insider selling is allegedly a negative sign and is tracked by chartists and - to be fair - other analysts. But a review of headlines on the subject shows that insiders were selling at the bottom and at other points, but irregardless, it was considered a negative.

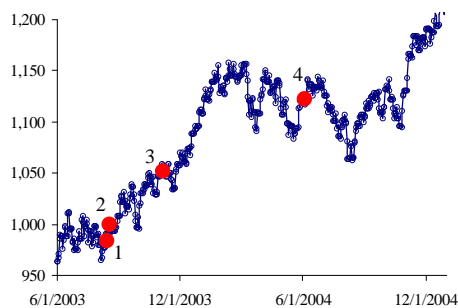
This is not to suggest that all the news is good and we have the responsibility to present some of the negatives. One is the year-over-year change in bonds. Historically speaking, when the ten-year treasury experiences a year-over-year change in yield of 20% or more as it has recently, it has been a reliable precursor for a pickup in inflation, and inflation, as the table below details, is generally not a conducive environment for equities.

While the overall conclusion is unsettling we would again note that emphasis should be placed on the more recent experiences which have resulted in positive equity returns.

CPI Before and After 20% Y/Y Change in Ten-Year Treasury Yields: 1962 - 2006

First Date Above 20%	Inflation			S&P 500 Next Year
	Prior Year	Next Year	Change	
7/11/66	2.5	2.8	0.3	5.8
1/19/68	3.0	4.7	1.7	7.1
7/7/69	5.5	6.0	0.5	-28.1
7/27/73	6.0	10.9	4.9	-24.8
7/14/78	7.4	10.9	3.5	4.9
10/15/77	6.6	8.3	1.7	11.9
3/16/84	4.6	3.5	-1.1	10.8
5/1/87	3.8	3.9	0.1	-9.3
4/18/94	2.5	2.9	0.4	14.2
9/8/99	2.3	3.4	1.1	11.8
5/4/04	2.3	3.5	1.2	5.0
3/9/05	3.0	3.6	0.6	5.4
4/20/06	3.4			
Average	4.1	5.4	1.2	1.2

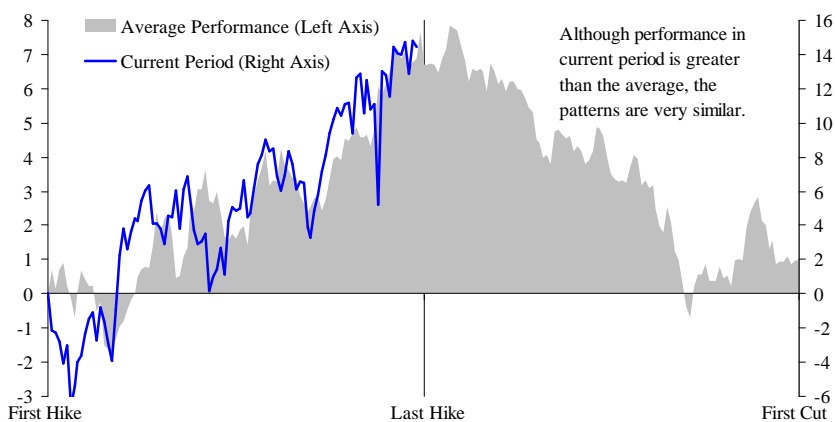
Insider Selling Anecdotal: 6/03 - 12/04



- 1 8/13/2003 Lack of Insider Stock Purchases Sends a Warning to the Market - "The message that insiders are sending to the market in one word: Sell."
- 2 8/18/2003 Insiders' Moves In Face of Rally Spark Concern - "...they are selling their company's stock at levels not seen in more than a year - a potentially ominous sign for the market in the months ahead."
- 3 11/5/2003 Insider's Bearish Sentiment Hits Record Level Despite Stock Gains - "A widely followed indicator of insider sales plunged to unprecedented bearish levels."
- 4 6/30/2004 Insiders' Return to Bearish Stance As Share Purchases Fall Sharply - "...insiders sold more than \$34 worth of stock for every dollar's worth bought - a ratio of sales to purchases well above the 20-to-1 ratio considered 'very bearish'."

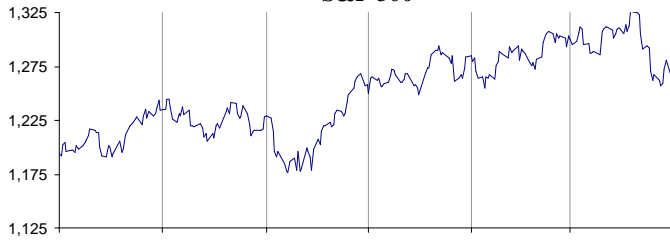
Investors are also concerned about the pace of short-term interest rates and are searching for any indication that the Fed will put an end to its string of sixteen consecutive rate increases. *However, we should be careful what we wish for*. The chart below highlights the average S&P 500 performance during Fed rate cycles from the first hike in rates to the last cut. In general, the market tends to rise while the Fed is in the process of raising rates, but once the Fed is done, the market gives up most of the gains (gray shading), and while the gains in the current period have been stronger than average, the pattern bears a striking resemblance.

S&P 500 Average Performance During Fed Rate Hike Cycles: 1962 - 2006

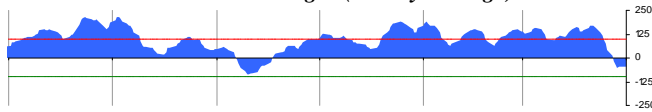


Market Indicators - June 2006

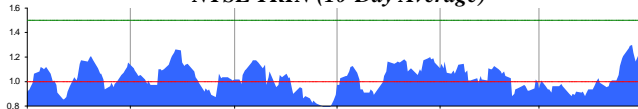
S&P 500



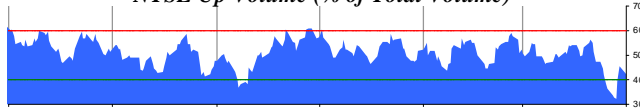
NYSE Net New Highs (10-Day Average)



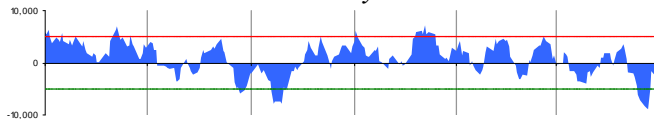
NYSE TRIN (10-Day Average)



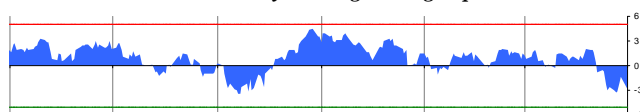
NYSE Up Volume (% of Total Volume)



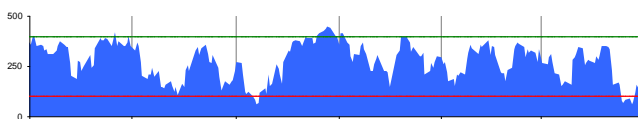
NYSE 10-Day A/D Line



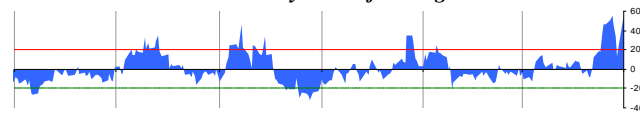
S&P 500 50-Day Moving Average Spread



S&P 500 Stocks Above 20-DMA



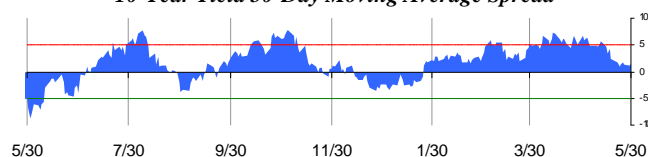
VIX 20-Day Rare of Change



OEX Index - Equity Put/Call Spread



10-Year Yield 50-Day Moving Average Spread



For more detailed explanations of the above indicators please contact our office.

Subscriber Questions

If you are reading this month's newsletter in the proper page order, you have probably already noticed the new "Birinyi Market Transcript" in the centerfold. While subscribers have found the "Birinyi 50" and "Birinyi Stock Ratings" to be helpful in finding specific stock ideas, readers also frequently ask us what groups they should be looking to for ideas, and what groups they should avoid. The "Birinyi Market Transcript" highlights the most and least attractive market groups based on the following eight disciplines:

- Money Flows
- Fundamentals
- Sentiment
- Technical/Timing
- Relative Strength
- Valuation
- Seasonal Patterns
- Economic Patterns

The shaded areas on the left and right sides of the center page highlight the most and least attractive groups according to each specific discipline, while the center of the page highlights the complete list of groups we track, along with their grades under each discipline. The list is sorted based on each group's overall score from best to worst. This month, for example, Capital Goods is the highest scoring group with an overall grade of a B, while Consumer Durables and Apparel take up the rear with an overall score of F. Groups appearing above the bolded S&P 1500 line are rated above average while groups under the S&P 1500 are below average.

Along with each group's grade by discipline, we have also provided YTD performance and impact results. The impact figures are included to show how important each group is to the overall market. As mentioned earlier in the text of this month's *Reminiscences*, it isn't how many stocks/groups that go up, but rather which ones. For example, transportation stocks are up over 8% year to date, yet they are only responsible for 11% of the market's gains. Diversified Financials, on the other hand, are up less than 4%, yet they are responsible for over a third of the year's gains.

Finally, the far right hand column of the Overall Group Grades table highlights the most attractive stock in each group based on our money flow ratings and other proprietary disciplines.

The "Birinyi Market Transcript" will be updated in each month's issue of *Reminiscences*, and we hope that readers will find it to be a useful addition to their investing process. As always, we welcome any questions or comments that readers may have regarding this or any of our other services.

Next month's changes to the portfolios will be available on June 28th on our web site, www.Birinyi.com.

Changes to the Portfolios

To the Conservative portfolio we have made the following changes:

Removed	Added
Hovnanian (HOV)	Ingersoll Rand (IR)

To the Growth portfolio we have made the following changes:

Removed	Added
Adv. Medical (EYE)	Int'l Rectifier (IRF)
M. Stanley (MS)	T.RowePrice (TROW)
St. Joe (JOE)	Fed Ex (FDX)

PORTFOLIOS

Conservative

	Price 5/31	Change Since Last Publication
ALLTEL (AT)	\$61.67	-3.5%
Avon Products (AVP)	31.66	1.4
Caterpillar (CAT)	72.48	-4.6
Cummins (CMI)	109.72	-2.4
Fidelity National Fin'l (FNF)	41.38	18.3
Ingersoll-Rand (IR)	43.42	-
Intel (INTC)	18.11	-7.1
Murphy Oil (MUR)	52.23	5.1
San Juan Basin Trust (SJT)	37.11	-3.7
US Tobacco (UST)	43.96	-1.1

Growth

	Price 5/31	Change Since Last Publication
AMR Corp. (AMR)	\$24.73	1.1%
Best Buy (BBY)	52.61	-7.8
Cleveland Cliffs (CLF)	72.87	-14.6
Fed Ex (FDX)	108.68	-
Halliburton (HAL)	73.17	-6.7
International Rectifier (IRF)	44.31	-
Nabors (NBR)	35.37	-5.4
Nike (NKE)	80.37	-1.1
Sony Corp (SNE)	45.07	-13.8
T. Rowe Price (TROW)	78.51	-

Trading

	Price 5/31	Objective	Downside Limit
Biotech HOLDRs (BBH)	\$177.30	\$184.95	\$169.85
CIT Group (CIT)	51.40	54.00	49.25
CSX Corp (CSX)	66.81	72.40	61.70
Transocean (RIG)	81.06	89.90	74.20

© Copyright 2006, Birinyi Associates, Inc.

Reminiscences is published monthly for \$225 per year by Birinyi Associates, Inc., PO Box 711, Westport, CT 06881. The information herein was obtained from sources which Birinyi Associates, Inc. believes reliable, but we do not guarantee its accuracy. Neither the information, nor any opinion expressed, constitutes a solicitation of the purchase or sale of any securities or commodities.

Please note that Birinyi Associates, Inc. or its principals may already have invested or may from time to time invest in securities that are recommended or otherwise covered in this report. Neither Birinyi Associates, Inc. nor its principals intend to disclose the extent of any current holdings or future transactions with respect to any particular security. You should consider this possibility before investing in any security based upon statements and information contained in any report or recommendation you receive from us.

*The performance figures shown in the table reflect the percentage change in the aggregate market value of all securities recommended by Birinyi Associates, Inc. from time to time for inclusion in the applicable portfolio during the period indicated. It is assumed that 100 shares were bought on the recommended date without regard to the price of such security. A list of all such securities will be provided by Birinyi Associates, Inc. upon request. Thus, some distortion in reported performance may result from the addition or removal of relatively high priced or low priced securities, but it is not believed that such distortions are material. It should not be assumed that recommendations made in the future will be profitable or equal to the performance of the securities in this list.

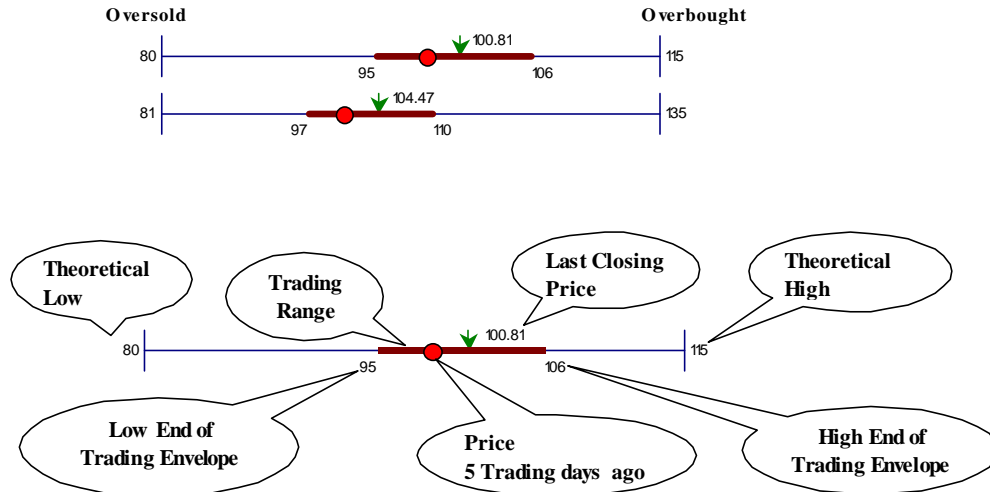
PORTFOLIO PERFORMANCE*

	Month ¹	YTD ²
Conservative	-2.10%	-2.05%
Growth	-7.86	-8.15
Trading	-4.46	8.41
S&P 500	-3.11	0.56

¹ Return is from last publication.

² Return is from 12/29/05 - 5/31/06

Newsletter Trading Ranges - June 2006



Normalization Factor: The number of standard deviations that the stock is presently trading from its 50 day moving average, as well as the direction +/- $L = (E-50 \text{ day})/\text{standard deviation}$

Theoretical High: Takes the largest normalization factor during the last 52 weeks and multiplies that by the current standard deviation before adding the product to the 50 day moving average.

Theoretical Low: Takes the smallest normalization factor during the last 52 weeks and multiplies that by the current standard deviation before adding the product to the 50 day moving average.

