

Courier Capital Corporation

Market Review & Update

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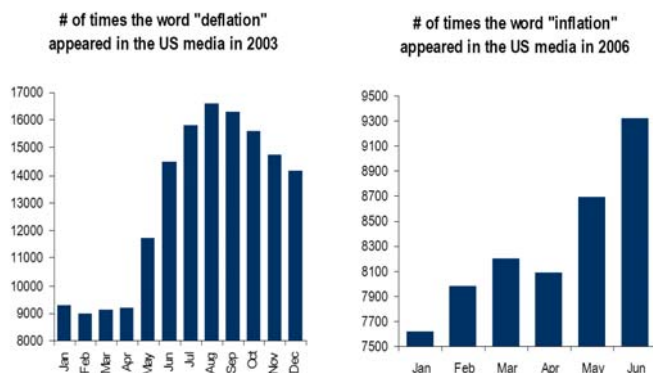
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The 1st quarter of 2006 manifested a strength of positive equity performance not witnessed since 1999. This robust activity had at its roots the powerful trend of global growth that we discussed at length over the past year, led by China and India. Market history would have easily foretold the volatility that followed in May and June, a weakness not seen since 2003. In hindsight, a very understandable push-pull of the market's opposing forces, fear & greed.

This activity provides us with a great opportunity to deconstruct the underlying short term inflections in the market that often seem to run counter to the reality of the data. As we know, global growth is intact (China's central bank predicts a 10% GDP for '06, if anything that's too strong, and certainly not indicative of a slowing world economy). So let's peek at the forces of hyperbole. The markets are the ultimate soapbox for the Vox Populi and it is assumed that the media is the wise Uncle, guiding us back from our emotional excesses. Well, Walter Cronkite has long since retired and media, after all, has but one goal- to increase ad revenue by increasing viewers by making its offerings most attractive to its audience. Given this, what can we glean from the voice of the people and the echo of the media? Figure 1 is an example of media predictions contrasted with the equity market. Given the disconnect of these

Figure 1. Media Predictions



pronouncements, we can either conclude there is little wisdom, or the wisdom is applied to pander to an audience eager to read what reflects the aforementioned fears & greeds. The oft mentioned deflation never materialized, will inflation dialogue likewise fade?

Aided by the media, how does the Vox Populi fare in their ability to judge, time, and prosper from the market's twists and turns? The best view of this activity is to examine the flows of money individual investors place into mutual funds as this screens out most institutional activity.

Figure 2. Record inflows to Emerging Market Equities



Source: Emergingportfolio.com

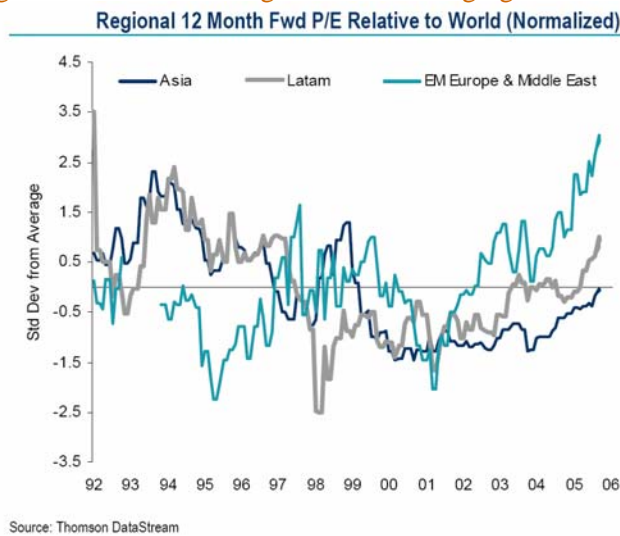
Figure 2 shows the last several years of fund flows to Emerging Markets. As you can see, the last few quarters has shown record inflows to emerging funds, which coincides with a record number of media articles on China, India, Chindia and the related global influences on energy, commodities and labor. If Dorothy represents the individual investor, she was definitely not in Kansas anymore...

What does this activity inspire? Figure 3 shows the relative valuations by P/E of various overseas components, with Asia showing the highest level of absolute

valuation. It would not surprise you to also know that similar patterns are present in commodities, real estate, and smaller cap companies. In short, the individual investor, escorted by the media, often trots in the direction of what was the most compelling trend (with emphasis given to the word "was"), accumulating more of what was already not that cheap.

After record inflows by the individual investor, the worst performing groups during the May/June period were: emerging markets, energy, real estate and commodities. The term Contrary Indicator is very apt here. If the media and flows of funds have anything to tell us, it is to

Figure 3. Price to Earnings ratios of Emerging Markets



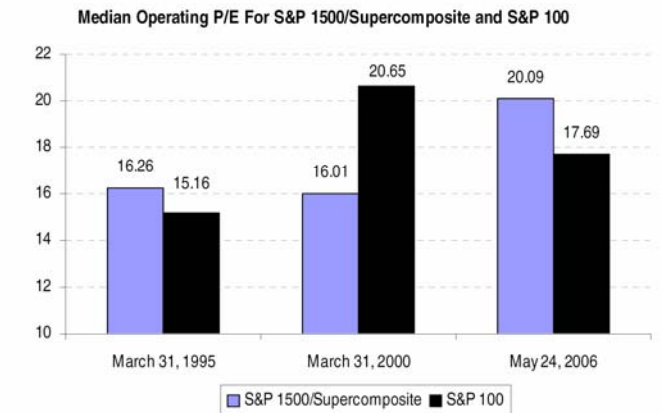
approach investments that are highly acclaimed, and at the height of popularity, with an increasingly jaundiced eye. Figure 4 compares P/E ratios for larger versus smaller companies evidencing a continual shifting in the relative valuations of larger vs. smaller companies. What does all of this now mean to us? Let's take a closer look.

Our past few quarterly outlooks have focused on data we were seeing that pointed to large and mega cap companies as increasingly good values on a relative basis when viewed by historical P/E or cash levels. Both measures are more attractive than they have been in decades. Figure 5 shows the historical change in these trends, but the message should be obvious at this juncture, what has been too loved has become expensive compared to what has been virtually ignored. Makes sense in our supply & demand world though, doesn't it? Many other factors are adding to this view. We have witnessed a dramatically increased level of stock & debt buybacks and merger & acquisition activity, as well as dividend increases and new hiring (resulting in an unusually low

unemployment level of about 4.6%). These are all good things, very good things. And, if Dorothy is capable of paying attention to something other than the herd, there may actually be "no place like home", at least where relative values are concerned.

When we look at domestic large cap stocks, and many stocks from EAFE countries as well, whether it is from an earnings perspective, or from a valuation perspective based on trailing P/E vs. bond yields, we can demonstrate as much as a 20% discount from historical averages. In this type of environment, earnings expectations models can predict a 90% chance of a positive market for the next 12 months and valuations point at eighty comparable periods in which the market was, in every case, up both 6 and 12 months later, averaging double-digit returns. The sources for these metrics are Economy.com and Citigroup Investment Research.

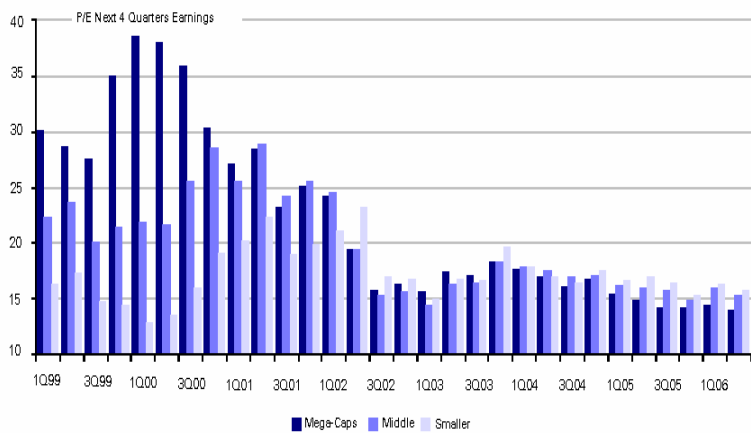
Figure 4. Price to Earnings ratios of larger companies



Source: FactSet and CIR – U.S. Equity Strategy

Figure 5. Change in Price to Earnings ratio by Market Capitalization

Chart 1: PE by Market Capitalization (Next Four Quarters' Earnings)

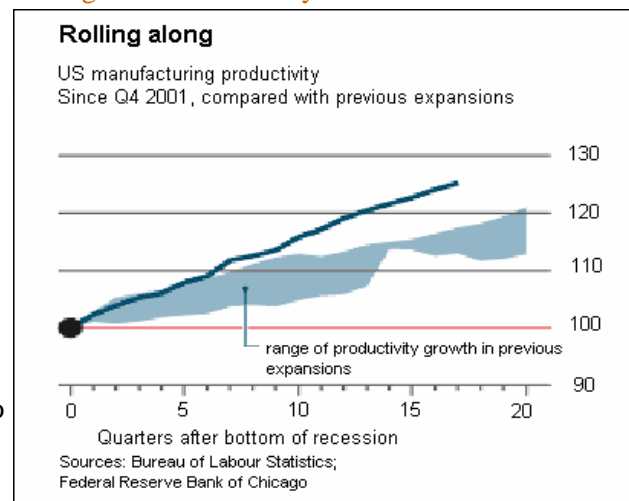


Prices and earnings as of May 22, 2006. Note: Mega-caps defined as first market cap decile, middle as second through fifth deciles, and smaller as the bottom five deciles. Source: FactSet and UBS

Sentiment/psychology does remain weak (remember the contrary indicator...) and coupled with a Fed that seems now, after 17 consecutive rate hikes, to be rounding the turn and heading for the clubhouse, should manifest in improving valuations. Barring any unforeseen shocks, the stage does seem to be set for the largest, globally positioned enterprises to post solid results. It's been a bit too long, but there may well indeed be no place like home...

All of this is occurring with solid global growth, which has been the foundation of the current expansion. US firms continue to demonstrate impressive productivity as seen in figure 6. And earnings, from the aforementioned companies with their historically clean balance sheets are coming in well ahead of expectations. In fact, we have just reached the 5 year mark for consecutive quarters of double digit growth, a feat not witnessed since the 1930's. But, it hasn't "felt" that good, has it?

Figure 6. Productivity has been robust



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