

## FIRST QUARTER 2006

The stock and bond markets parted ways in the first quarter of the year. Stocks moved higher in a continuation of the momentum begun in October of 2005. Bonds, however, fell as the cumulative effect of multiple rate increases by the Federal Reserve finally began to weigh on the market. In the equity markets, small and mid-cap stocks continued their out performance of their large cap brethren. The S&P 500 had a total return for the period of 4.21%. Positive returns were few and far between in the bond market. Short term Treasury Bills and junk bonds were among the disparate sectors enjoying positive returns.

## INTEREST RATES

Are we witnessing the death of the “conundrum”? The conundrum referred to herein is the adjective of choice used by Alan Greenspan on a number of occasions to describe the longer end of the treasury yield curve. More specifically, the fact that longer term bonds were not responding in the traditional manner to the multiple rate increases engineered by the Fed over the past 21 months. For a variety of previously discussed reasons, longer term interest rates appeared to be immune from the upward pressure of the Fed’s actions. That certainly changed in the first quarter of 2006 as yields rose steadily during the period to finish near four-year highs. The ten-year Treasury note began the year at 4.35% and ended the first quarter at 4.85%. The resulting total return for the ten-year was -2.75%.



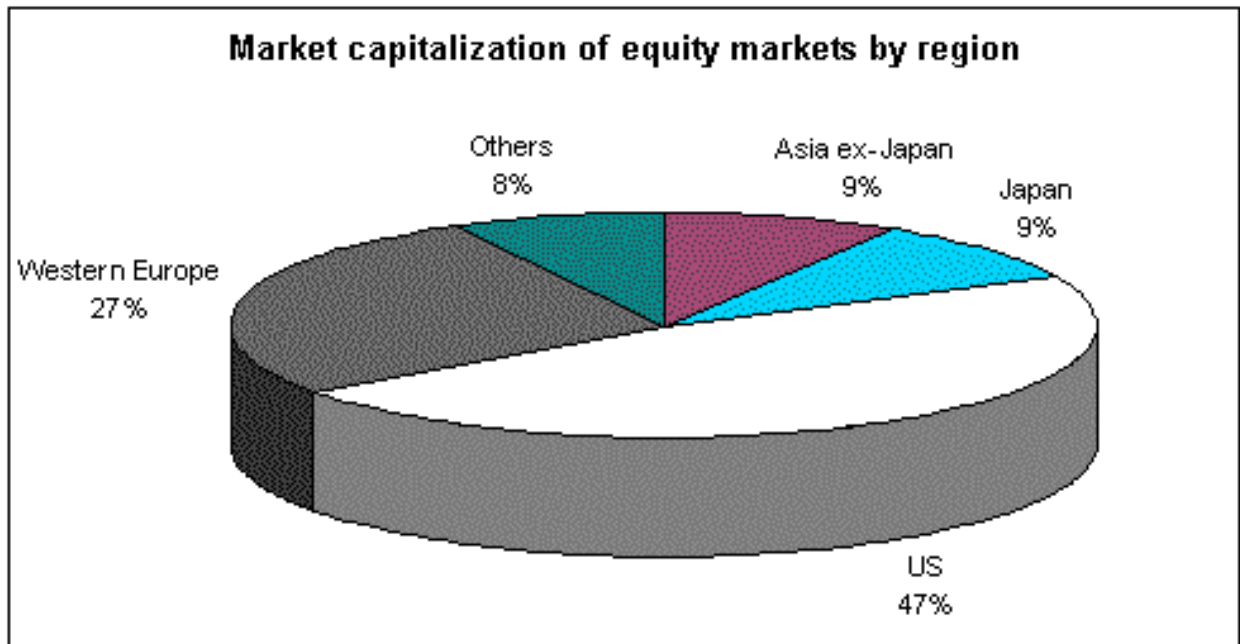
Economic growth rebounded from the revised 1.7% growth in the fourth quarter of 2005 to an expected increase of 4.5% in the first quarter of 2006. A new Fed chairman took over last week from longtime chairman Alan Greenspan and the result was similar, another rate increase. The Fed has now raised rates a total of 15 times and looks set to continue on that path for at least one or two more increases. This would take the target rate to 5-5¼%. The Federal Reserve is searching for that tricky balance between “sustainable economic growth and price stability”. The incoming economic data will dictate how much more firming will be needed from the Fed. The markets are hoping they will achieve this delicate balance without causing a more significant economic slowdown.

## INTERNATIONAL INVESTING

International trade and global interdependence have become an important fact of life in recent years. The seemingly insatiable demand for dollar-denominated debt by foreign countries has kept our own interest rates low and allowed the US to finance higher levels of government spending for military operations and recovery from last year's destructive hurricanes. Emerging economies have found eager buyers for their goods throughout the world as they benefit from the competitive advantages of lower labor costs. Emerging economies and international trade continue to flourish despite terrorism, tougher security, an oil price spike, and protectionist pressures. Globalization--i.e., the growing interdependence of international economies through the proliferation of free trade--is on a roll.

There has been much in the news lately about the advantages of adding international investments to portfolios. Stock market volatility is a major reason for investing globally. All countries go through ups and downs of economic cycles. However, countries typically are not simultaneously at the same point in their cycles. Investing in several different markets can help reduce the impact on your portfolio when one region experiences an economic downturn. This variety in market performance can work to smooth your total portfolio performance through the power of diversification. That said, it may be a mistake to automatically assume that whenever domestic stocks struggle, that foreign investments will pick up the slack. For example, the biggest constituents of the MSCI EAFE Index (the most popular foreign benchmark) have much in common with their counterparts in the S&P 500 Index, in that they're global firms competing in the same markets. Furthermore, it is difficult for a single country to sustain good performance for a prolonged period. While a region may perform extremely well one year, the next year's returns could be very different. Japan, for example, has had some extremely high returns, particularly in the late 1990's. However, following the real estate and banking crisis, Japan's economy has suffered in recent years. There are some indications that their economy may be finally back on track.

The list of overseas options is much bigger, broader, and better than it used to be. The overseas stock universe is larger and growing faster than the U.S. market. As illustrated in the graph below, stocks of US companies represent less than 1/2 of the world's market capitalization. The proliferation of Exchange Traded Funds in recent years has provided investors with a broad array of low-cost and efficient ways to take advantage of international opportunities.



Source: Financial Insights, 2005

Thank you for your interest in Northstar, we look forward to having an opportunity to serve you.

Note: Regulations limit our ability to share specific recommendations in this forum. For more information please contact Northstar Investment Advisors.

**Richard P. Kopp, CFA   Moses Taylor   Frederick B. Taylor  
Bob Van Wetter   Timothy J. Waymire, CFA**

**Cynthia Sack   Gina Spencer**

**Northstar Investment Advisors, LLC**

**700 17th Street**

**Suite 2350**

**Denver, CO. 80202**

**303-832-2300**

**800-204-6199**

**[www.northstarinvest.com](http://www.northstarinvest.com)**

to save for your retirement years, won't be paying FICA tax, and the kids should be out of the house.

Here are the Savings to Income Ratios

Age	Savings to Income Ratio
30	0.1
35	0.9
40	1.7
45	3.0
50	4.5
55	6.5
60	8.8
65	12

To use the chart, take your current income and then multiply it by the Savings to Income Ratio that corresponds with your age. For instance, if your income is \$150,000 and you are 50 years old, your Savings to Income Ratio should be 4.5. Thus, you should have approximately \$675,000 in investable assets (\$150,000 X 4.5).

If you would like to explore these concepts in greater detail as they may relate to your personal finances, please feel free to call your portfolio manager. Charlie's ratios were originally published in an article he wrote for the Journal of Financial Planning in January 2006, and have also appeared numerous times in the Wall Street Journal.

**Richard P. Kopp, CFA   Moses Taylor   Frederick B. Taylor**

**Bob Van Wetter   Charlie Farrell, J.D. LL.M.   Timothy J. Waymire, CFA**

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