



**GERALD L. RAY**  
 & ASSOCIATES, LTD.  
*Investment Advisors*

# THE RAY REPORT

September 22, 2005

## Bumps in the Road

The summer proved beneficial for the stock market. However, there remains significant obstacles ahead if the rally is to be sustained. The most obvious problem is oil that reaches new highs on a daily basis. \$67 oil creates a number of problems. First, oil as a raw material cost puts pressure on many companies. Airlines and chemical companies are just two of the major industries that have oil as a large component of their cost structure. Oil also affects the consumer. As gas prices increase, the consumer has less disposable income to spend on other items. Given that consumer's consumption rates compared to savings are high to begin with, this is a difficult situation. The problems with oil seem more long lasting than previously thought due to the impact of the hurricanes on the oil rigs and refineries.

Real estate values also represent another obstacle to the stock market. Earlier, soaring real estate pricings combined with extremely low interest rates had allowed individuals to cash out some equity in their home at a very low cost. However, as rates have risen, consumers now are faced with higher costs of such refinancing activities. Additionally, individuals who saw soaring prices for vacation and beach homes and thought they could cash in on the craze, may be faced with higher holding costs at a time where demand may have peaked.

This specter of soaring real estate prices, as well as, commodity inflation had led the Fed to march interest rates higher. The Fed has now raised

rates for 10 consecutive meetings. Chairman Greenspan through his congressional testimony has made it clear that much of his concern revolves around real estate valuations and the use of gimmicky mortgages. He has also expressed concern about the "conundrum" of long-term rates remaining low while short-term rates move steadily higher. The Fed also remains generally unsympathetic, to date, concerning the impact of Katrina. These comments, as well as, the Treasury's decision to re-issue the 30 year bond, show the general belief of the Fed and the government that long-term rates should be higher. The problem with this rationale is that the market is what the market is. That is to say, if long-term rates should be higher, they would be and as a result, the danger of an inverted yield curve from an over aggressive Fed and the likelihood of a recession that follows appears to be just as great as the prospects for rampant long-term inflation.

So far, despite some progress techni-

### Market Performance For The August 2005 Quarterly Period

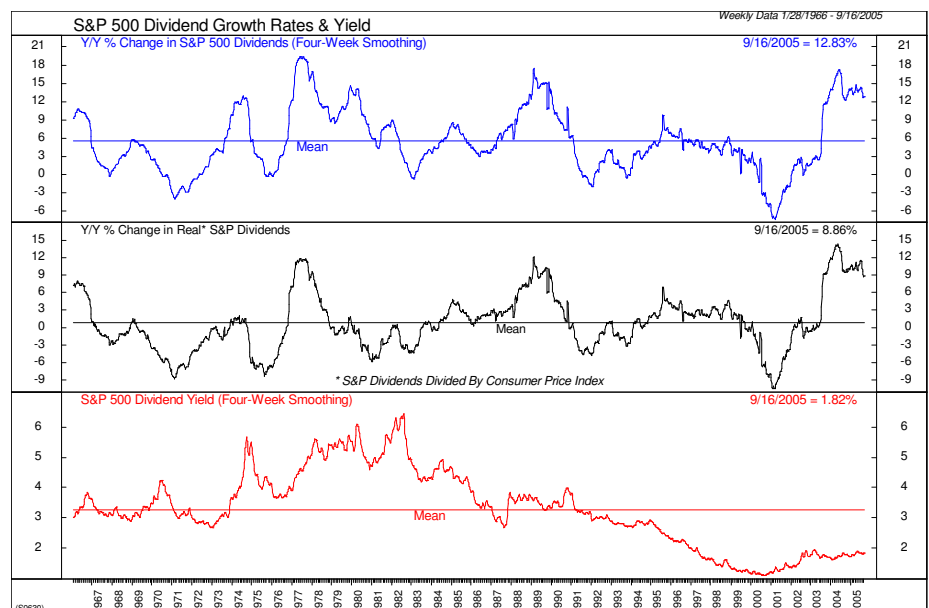
<i>Dow Jones Industrials</i>	<b>0.75%</b>
<i>Standard &amp; Poor's 500</i>	<b>2.88%</b>
<i>Russell 1000 Growth</i>	<b>2.89%</b>

cally, the market's remain very quiet except for a few stocks in commodity based industries, like energy. Signs that oil prices are abating, or thoughts that the Federal Reserve may be willing to pull back its hawkish stance would lead to a nice rally in the seasonally strong fourth quarter. However, until visibility on these issues crystallizes, I would expect the market to remain bumpy.

Sincerely,

Joseph H. Ray,  
 President

## Dividend Growth Expanding



Courtesy of: Ned Davis Research, Inc.

## Block Buybacks and Cash Dividends

Last year, we wrote an article on the enormous liquidity in corporate America. Many companies had built up cash post 9/11, as a safety net. Additionally, many CEO's looked at the inefficiencies in the tax system as a reason to plow profits back into their companies. However, a solid economy and the 2003 dividend tax cut has created an environment where the return to shareholders is higher than ever before.

The \$137.9 billion in share buybacks announced in the first six months of 2005 exceeds the pace of last year's \$238.5 billion. Corporate share buybacks have been criticized at times as illusory, as historically only 22% actually reduced share count. Most have only offset large corporate stock option plans. However, Howard Silverblatt of Standard & Poor's states over 34% of all buybacks in 2005 have actually reduced share count thereby positively impacting earnings per share.

Dividend growth has also been strong in early 2005. Through July, 1206 have increased dividend payout compared to 1062 companies in the first seven months of 2004, and less than 1000 in 2003 according to S&P.

Despite that improvement the yield on the S&P 500 stands at only 1.8%, well below the historical norms, but better than the 1.2% yield at the market top in March 2000.

It appears that the trend of increasing dividend hikes and stock buybacks should continue as long as earnings continue to grow strongly.

## Stocks in the News

Clear Channel has decided against paying a \$3 a share special dividend. They are, however, moving forward on spinning off its entertainment and part of its billboard business and using some of the proceeds for share buybacks and dividend increases. Although preferable to the last plan, I would endorse an outright sale of the entertainment business.

Time Warner also looks to alter its capital structure. Carl Icahn would like to see a split of the cable unit and institution of a \$20 billion buyback. Time Warner executives have less ambitious plans, which include a current \$5 billion buyback.

Amgen raised guidance significantly in its last quarter. Despite a \$20 jump in the stock price however, its P/E multiple remains little changed due to the big increase in earnings and the stock is still cheap compared to other biotechnology companies.

Citigroup looks to expand aggressively overseas once U.S. regulators allow it to do so. JP Morgan also seems likely to expand once it digests its acquisition of Banc One. JPM could be interested in brokerage operations.

Technology provided a mixed bag this earnings season. While Intel and Texas Instrument had fine quarters, Dell and Cisco disappointed investors with their conservative outlook. Cisco surprisingly struggled in China. Dell struggled with revenue growth and the move in some geographies to lower-end PC's. After an excellent July, this news should be enough to quiet the tech sector for awhile. Further visibility should come in October.

## Matching Time Horizons

A question we often get, as money managers, is when do we sell a stock. The answer, unfortunately is not as easy as the question. The decision to sell may be based on the nature of the stock and a number of other factors. If the company is a commodity based company or a company where we are expecting an industry turnaround, the holding period may be as short as a few months. Longer term growth stories may involve us holding the stock for longer periods of time. The stock may then be held as long as, the growth story remains intact. Turnaround stories can vary based on the speed and quality of the turnaround. It is important for us as managers to constantly remind ourselves why we bought the stock in the first place and to match the time horizon with the stock involved.