



GERALD L. RAY
& ASSOCIATES, LTD.
Investment Advisors

THE RAY REPORT

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Hail to the Bus Driver

Last year the market returns were dominated by just a few areas. Commodity related stocks lead the way. Steel was especially strong as was copper and gold. The thought was that worldwide demand was strong and that China would continue to supply demand for most raw materials. Oil stocks also soared as oil prices continued to defy gravity. Oil remained above \$60 a barrel despite record inventory levels even amidst concerns about potential supply disruptions related to a number of political issues in Iran, Iraq and Nigeria.

Biotech had some success in 2005 as well. Large cap companies like Genetech, Amgen and Genzyme all had pipeline successes and there were a number of small companies that reached profitability for the first time.

Many of the 2005 winners started off strong and after the first two weeks of 2006, it looked like the 2005 winners would be the winners in 2006 as well. February changed that thinking for many. For example, the Philly Steel Index is down 11% in the last month, as there are reports that China is able to satisfy more and more of their steel demand internally. The Philly Oil Services Index shows a similar decline, as investors appear more willing to look at the robust inventory data for both gas and oil. Biotech and small cap stocks have also pulled back sharply.

It is not coincidental that during this time, investors began to question whether the Federal Reserve will continue to relentlessly push rates higher despite a subpar 4th quarter GDP

number, which was obviously affected by the hurricanes and fourth quarter earnings at most companies which were on the surface okay, but many companies lacked sufficient clarity going forward. As a result, most companies guidance for 2006 was cautious.

So, as we examine 2006, after a year when commodities, oil and hurricanes all affected the market for weeks, or months, at a time, the Fed has returned to its rightful position of economic bus driver. The problem is that the driver, Bernanke, is new. Should he apply the brakes too hard, profitability will suffer. If the Fed stops raising rates too soon, inflation and price stability are at risk.

The decline in commodity based companies suggests that the market fears a hawkish Fed that will raise rates too much at the cost of a potential recession. Ironically, this pullback helps those who believe that we are approaching the end of the rate hikes.

Market Performance For The February 2006 Quarterly Period

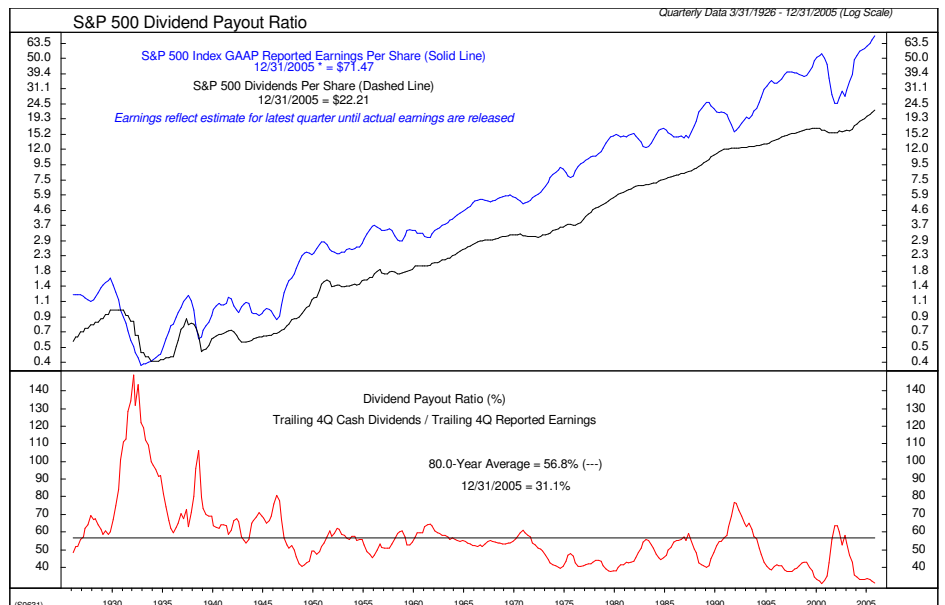
<i>Dow Jones Industrials</i>	2.40%
<i>Standard & Poor's 500</i>	2.94%
<i>Russell 1000 Growth</i>	0.95%

We believe that the Fed will be data driven, but that only one or two more hikes are likely. Once investors, as a whole, embrace that idea we will see improvement in stocks which showed a spark earlier this year when that was conventional wisdom. Groups like technology, financials and capital goods seem destined to improve once the Federal Reserve and Bernanke give the "all-clear." The question remains, at what cost to the economy.

Sincerely,

Joseph H. Ray,
President

Company Coffers Full



Courtesy of: Ned Davis Research, Inc.

Consumers Cash Out

There are many who look at record consumer debt levels and say that the consumer is tapped out. Consumers are however resourceful creatures and many have taken advantage of the strong housing market to get appreciation out of their home through cash out refinancings. 45% of all mortgages in the fourth quarter were refinancings and 80% of those were for cash out purposes. Freddie Mac estimates that \$70.3 billion was extracted in Q4. For 2005, the total of cash out refinancings were \$243 billion. Estimates for 2006 suggest a substantial falloff in this area, which would remove a valuable source of funds for the consumer. However, a precipitous decline is not evident as of yet.

Medicare Prescription Drug Coverage

It is surely too complicated. It is too confusing. It is still expensive. As a result, Medicare prescription drug coverage will not, in all likelihood, bring the immediate volume boom to pharmaceutical and drug distribution companies that some had hoped. Many analysts had hoped that volumes could be up 5-6%, as a result of more people being covered for more drugs. While ultimately those numbers could prove correct, I expect much less volume growth this year. Nevertheless, drug distributors remain an interesting sector of the market, due to a better business model and good demographics.

New Quarterly Reports

We have improved and expanded our quarterly reports beginning this period. There is additional data as it relates to sectors and top holdings and clients with fixed income portfolios have loads of additional information all in an exciting new look. If you have any questions, as always, feel free to call.

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