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THE RAY REPORT

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Always Learning

The old adage about those who do not learn from their mistakes are doomed to repeat them is important in every business, but it is incredibly important when looking for stocks. So often, there are similarities between individual companies and markets as a whole, it is hard to determine whether the company is doing well or responding to a bull market. One can look at past history to determine how a stock may respond to news. Technical analysis is the study of charts of past price movements to help determine whether to buy or sell stocks in the future. There are certain rules of technical analysis that practitioners consider in deciding whether to buy or sell a security. Technical analysis can add discipline to stock selection and can help us remain less emotional about an individual security. Yet despite the benefits of technical analysis, strong fundamentals, a dominant industry position and solid management remain even more important in our process of stock selection. Despite all our analysis, we can still over-think the issue of whether a stock is appropriate so it is important to learn each and every time we select or fail to select a security. For example, Apple should have been a company I gravitate to. Solid niche leader, recovering fundamentals, good management. Instead, I was worried about earnings metrics, which showed the stock as expensive and ahead of itself, that proved to be unimportant.

Lesson 1 - A stock can look expensive but it is not, if you look forward not back. Result: Despite its great past 2 years, Celgene has a lot ahead of it thus I am inclined to hang on. Momentum investing can work if the stock market and fundamentals of the company remain intact.

Lesson 2 - Despite Wall Street and Carl Icahn's belief that Cyberonics had a unique product for depression, we managed to avoid this stock because of our experience that despite having a unique product, a stock can become a disaster if the FDA label is awful after approval. Result: Knowing our client base, stick to profitable biotechs with multiple stories. Look closely at the label of each of a companies main products and the market's response to it.

Lesson 3 - Depressed market

Market Performance For The February 2007 Quarterly Period

<i>Dow Jones Industrials</i>	1.02%
<i>Standard & Poor's 500</i>	0.85%
<i>Russell 1000 Growth</i>	0.68%

leaders in technology can rebound strongly as players exit. Result: We believe Sandisk can be a clear winner in 2007 as marginal players leave the market due to their inability to make a profit. Intel had similar success as entrants left the semiconductor field.

These are just some of the lessons learned as we look forward to another great year.

Regards,

Joseph H. Ray,
President

Earnings Growth Remains Strong



Courtesy of: Ned Davis Research, Inc.

An Interesting take on P/E Ratios

Bear Stearns strategist Francois Trahan remains sanguine on 2007 for equities, however his rationale may be a bit different than some. He believes Price/Earnings ratios will rise in 2007. This is interesting because the Bear Stearns chief economist, David Malpass believes inflation is a real threat still (for the record, I do not) and rates will rise this year. Individual P/E ratios can rise because the prospects of a particular company improves, but it is unusual to have P/E ratios for the stock market as a whole to shift upward, unless interest rates fall. As interest rates fall, investors give greater value to future earnings, or so goes the theory. In numerous studies, interest rates have been found to effect P/E ratios to a much greater degree than dividend payouts, inflows into the stock market and a host of other economic factors. Clearly, Francois' call goes against his chief economist's, although he may not do so directly. As an equity investor who longs for lower rates, I hope he is right. Summarized from the Bear Stearns strategy note 1/8/07.

Thoughts on Technology

Cisco has a great quarter and provides clearer visibility than virtually any tech company out there. Since Cisco is involved at the heart of the network,

one should feel better about capital spending in technology than the market is suggesting. Yet the market, while up, still has a decent bit of skepticism to it. This ultimately is healthy and seasonals may be at fault. Again, February is a decent time to accumulate quality names.

Sandisk beats numbers easily, as I thought. 87 cents vs. 75 expected revenue ahead, Gross margins ahead but the stock is down. The official thought is that revenue may be below forecast next quarter which may be true. It should be noted however that first quarter is the slowest of the year for Sandisk. I believe the reason the stock is down has to do with presentation. First, its fourth quarter number included acquisition charges. Sandisk had bought M-systems and the operating number was difficult to find. Sandisk did not make it easier by failing to report the operating EPS. Wall Street was left doing the math. Just poor presentation. Second, Eli Harrari, long-time CEO, was not on the call as he was on vacation. I like vacation as much as the next guy, but come on. The problem was in the fact that the company presenters were awful. Bad as I have ever heard. The President who is a very bright man has the disadvantage of having an extremely heavy Indian accent. The CFO, a woman, seemed like she had a cold and seemed either tired or unpre-

pared. A stock set to open up opens down 3 points. The stock has come back some and Sandisk is an extremely interesting company in transition this first half of 2007. The inability to get the story out hurts, however. Let's hope the investors' day at the end of the month goes better.

Microsoft CEO Steve Ballmer has acknowledged that its new operating system is off to a bit of a slow start. The reason seems simple to me. Microsoft has failed to articulate why Vista is better than Windows and what the system can do for me as a consumer. Microsoft continues to struggle with basic marketing concepts such as why I would want to buy their products over someone else's (see the MP3 player Zune). Unfortunately they compete in many areas with Apple, a company that continues to define cool and understands the power of the consumer.

Speaking of Apple, it has been pulled back after the company lowered expectations at the first quarter conference call. Now that expectations have been tempered and the valuation pulled back some, the stock is much more intriguing.