



GERALD L. RAY
 & ASSOCIATES, LTD.
Investment Advisors

THE RAY REPORT

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Pick Your Poison

The issue of liquidity led to the demise of Bear Stearns in March. The belated, but appropriate, governmental response to open up the discount window to investment banks gave the market a reprieve that extended into May. As a result, we rallied over 11% off the March lows. The subsequent decline and failure to hold the March lows was because of the fundamental issue of write-offs of bad loans in financials and the fear that the write-offs may be so large that there is inadequate capitalization of most financial institutions, including the governments sponsored entities (GSEs), Fannie Mae and Freddy Mac. This fear of failure has permeated throughout the market despite reassurances from many institutions and regulators. However in the last week, we have the Federal Reserve providing a backstop for investment banks and the government sponsored entities like Fannie Mae and Freddie Mac.

We also have reasonable earnings at Wells Fargo who recently raised their dividend, assurances from BankAmerica that their Country-wide purchase is within expectations and JP Morgan's ability to be profitable even after purchasing Bear Stearns.

Investors fear that despite these assurances, the problems of the financials could extend further, due to the continued problems in housing, the high price of oil, a moribund dollar and inflation figures that limit future responses by the Federal Reserve.

While the economic environment is a difficult one, it seems to me the Federal Reserve and the US government have picked their poison. They have chosen to use both political and monetary policy to shore up the banking system and the housing industry and to address the dollar and inflation later. While you can argue the relative merits of this decision, it is diffi-

Market Performance For The June 2008 Quarterly Period

<i>Dow Jones Industrials</i>	-6.93%
<i>Standard & Poor's 500</i>	-2.73%
<i>Russell 1000 Growth</i>	.94%

cult to argue the power of government and their ability to throw money at a problem. When the government decided to attack the banking crises of the early 1990's, the surviving banks traded up 400-800% in just 3-5 years later. While there are a number of reasons why such returns are unlikely this time, it is clear that certain financial institutions will benefit greatly as a result of the increased government involvement. JP Morgan has already done so by the stealing of Bear Stearns.

Despite rhetoric to shore up the dollar, it seems clear that the government, in an election year, is more concerned with growth and housing than inflation and the
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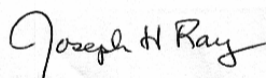


Courtesy of Economist.com

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falling dollar. Such attention could mean that stabilization of the financial markets could happen soon, although the high price of oil and its impact on the consumer could very well be the next area of focus both for the markets and the government.

Sincerely,



Joseph H. Ray, President

ECB Playing With Fire

The United States Federal Reserve has a dual mandate to balance inflation and growth. In times like these, the Fed is forced to perform a balancing act, as its attempts to attack inflation could result in recession. The European Central Bank, the (ECB), Europe's equivalent of the Federal Reserve, is concerned only with inflation and has no explicit mandate to stimulate growth in its member nations. As a result, monetary policy in Europe has historically been tight. This has caused unemployment to be higher than other parts of the world, while growth has been muted at times. In times like these, when the economy seems to be rolling over, while inflation remains elevated, the Federal Reserve has chosen to reduce interest rates and stabilize the banking system at the cost of a weaker dollar and elevated inflation. Currently in Europe, the ECB continues to raise interest

rates to fight inflation despite the obvious slowing of its economy. It can be argued that Europe's broad social safety net, which includes vast unemployment benefits and national health coverage can protect individuals enough to prevent a consumer collapse. While this is perhaps true, it will be interesting to see the extent to which individual countries are willing to shore up dislocations in banking and real estate should Europe follow the United States into a recessionary environment. It is interesting that Great Britain refused to raise rates internally despite their reluctant participation in the European Union. It seems to me that in order for European companies to sustain growth they will be forced to look at acquisitions outside of Europe, as the ECB's monetary growth policy virtually guarantees slow growth at best. Wise companies like Novartis and Santander used their strong currencies to buy growth in the United States and elsewhere. Companies that do not, will look at a slow growth environment that could last years, as a result of ECB's single minded fight against inflation.

Biotechnology Renaissance

Biotechnology stocks in the last month have become a bit of a "safe haven" from the carnage of the market. There are a number of reasons why biotechs work in this environment. First, the sale of their products are not reliant of the economy. Second, unlike large pharmaceutical companies, biotech companies have growth ahead of them and because many companies deal with cancer and other terrible diseases, they seem to be more favored and less a target by Medicare and other govern-

ment entities than drug companies who specialize in chronic diseases or lifestyle drugs. Third, because biotech pipelines are robust, they remain an attractive target to large pharmaceutical companies experiencing growth issues from patent expirations. A declining US dollar has also meant foreign entities can see them as an attractive purchase.

Some of the largest biotechs have fundamentally experienced accelerating or resurgent growth, which have contributed to the industry's positive vibe with investors. Genetech's recent quarter shows that Avastin, a major cancer drug, still has legs. Hopes for Denosomab, an osteoporosis treatment in late stage trials give some hope to Amgen investors who have endured the restrictions on Aranesp and who feared there was no pipeline help on the horizon. Biogen and Elan benefit from advances in MS, while Celgene's shrewd buy of Pharmion has made it the undisputed leader in hematological diseases. I suspect that smaller companies remain attractive as pipeline additions for both domestic and foreign healthcare companies going forward. Continued growth should mean that biotechs remain attractive in this uncertain economic time.

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1445 Ross Ave., Suite 5600
Dallas, Texas 75202
214.954.1900
214.954.1094 (fax)

Gerald L. Ray & Associates Ltd.
Registered Investment Advisor
1.800.954.2397
www.geraldray.com

201 Main St., Suite 600
Ft. Worth, Texas 76102
817.886.4447
817.886.3495 (fax)