



GERALD L. RAY
& ASSOCIATES, LTD.
Investment Advisors

THE RAY REPORT

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One Trick Pony

There was a time when the Federal Reserve was proactive, not reactive. There was a time when the Federal Reserve would look at the economic landscape and try to determine where the economy was going, not just where it has been or where it is now. There was a time when the Federal Reserve's action would actually impact the world markets. Yet, in a world increasingly affected by international factors outside the United States and the core United States banking system, the Federal Reserve must become more nimble and varied if it is to successfully influence American monetary policy.

For much of the Greenspan era and before, the Federal Reserve was able to control not only American, but worldwide growth, through its regulation of United States monetary policy. Using as its primary tools, the discount rate and open market operations, the Fed was able to regulate the great worldwide engine known as the United States economy. For decades, how the U.S. rolled, so went the world. As a result, the Fed was able to keep tighter control on the economy.

Yet, in the late 1990's international considerations and leverage used by investors began to make it more difficult for the Fed to exact control of the economy. In 1994, the peso collapsed and the Mexican stock market lost 50% of its value. In 1997, the currency of Thailand, the baht, collapsed. In 1999, Brazil and Argentina suffered currency crisis's. In all these cases, the Federal Reserve was forced to react to limit damage to the United States economy.

Yet, in 1998, Greenspan was forced to handle a new crisis—leverage. Long-term Capital Management was a large hedge fund who used leverage to control billions of investment dollars. Believed to be on the brink of failure, the Federal Reserve injected cash into the system and established, as a result, the “too big to fail” doctrine.

Shortly thereafter, the stock market began a tremendous run in 1999-2000 leading to all-time highs in the market indices and a speculative bubble, which would later collapse in 2001 and 2002.

In the midst of such a wild ride in the late 1990's and early this century, the Fed used interest rates as its primary tool. It failed to raise margin requirements for investors in 1999, when NASDAQ speculation was clearly excessive.

The Federal Reserve became increasingly reactive to current events and failed to look forward.

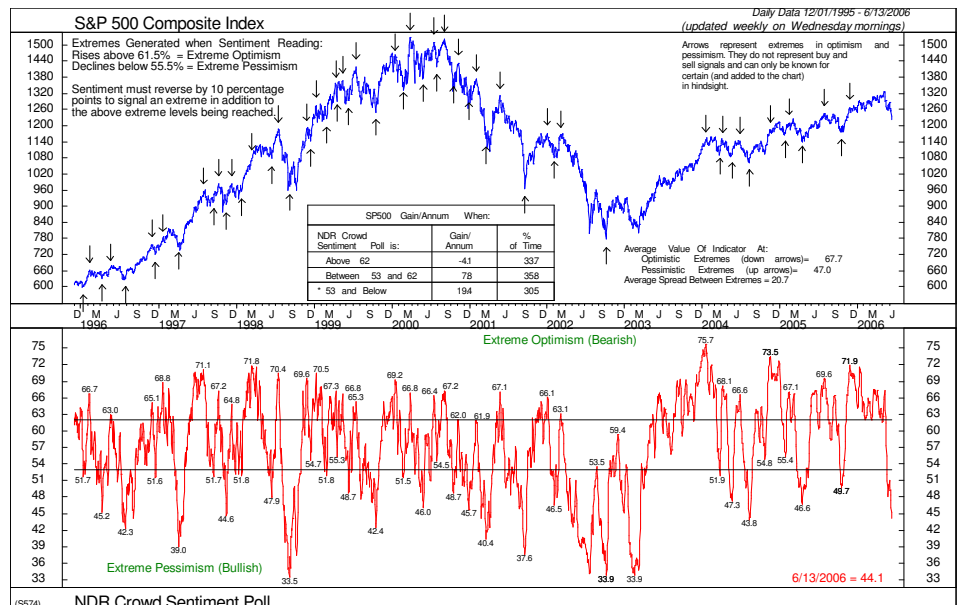
Market Performance For The May 2006 Quarterly Period

<i>Dow Jones Industrials</i>	2.12%
<i>Standard & Poor's 500</i>	-0.28%
<i>Russell 1000 Growth</i>	-1.32%

The reactive Federal Reserve that fails to utilize all the tools available to it continues today. Today's economy has been influenced greatly by international events as well as enormous leverage in the commodities markets. Much like the mid 1990's, demand for raw materials and strong economies in China and India has made the Federal Reserve powerless to control commodity pricing. The former engine to the world, the United States, is forced to react and hope that international events can be somewhat insulated by the Federal Reserve. Yet, is it wise policy to retard a slowing United States economy because Chinese growth is out of control, by a

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Market Sentiment Extremely Pessimistic



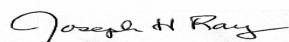
continual rise in interest rates?

In addition, speculation in the commodity markets, by hedge funds, exacerbates the problem. Yet, much like 1999-2000, there has been seemingly little thought by the Fed to raise margin requirements on the commodity exchange in order to limit speculation. So, despite the harsh lessons of 2001 and 2002, the Federal Reserve remains a one-trick pony, utilizing only monetary policy, as a means of regulating the economy.

Ben Bernanke today faces another problem. He is the new Federal Reserve Chairman. He feels compelled to present a hard line on inflation for the sake of credibility, despite signs of slowdown throughout the economy. Despite the unwinding of commodities, in recent weeks, as witnessed by gold's decline of nearly \$150 and a flat yield curve, the Federal Reserve Chairman seems to want to continue policies that indicate a reactive rather than prospective approach to monetary policy.

Bernanke's style to date, is clearly not fully formed and his discussion of inflation targeting one week, followed by data dependency the next, has created confusion and exacerbated stocks recent decline. If he is to be successful in this increasingly complex and internationally influenced world, he must use all the tools available to him in a consistent manner. It remains to be seen if he is willing to depart from the ways of the Federal Reserve over the last decade.

Regards,



Joseph H. Ray,
President

Catalysts

When we look at stocks, we are often looking for catalysts which could cause the stock to move appreciably in the next 12-18 months. Often these catalysts may be little known to the market or we believe misunderstood. For example, Celgene was a big winner last year. Yet, only one year before the market believed that Revlimid may have issues with toxicity, despite clear indications from Celgene that they were pleased with the compound. Now, Celgene continues to look good because analysts continue to ignore the European market for Revlimid.

Here are some other potential catalysts or things to look for in 2006 for some major stocks.

Citigroup has spent the last two plus years cleaning up regulatory issues. The government has given them the go ahead to do big deals again. Rumor has it that Wells Fargo or Washington Mutual could be of interest. Wells would be a good fit and provide needed management depth. A Washington Mutual purchase will likely be looked upon as tepidly as Wachovia's recent decision to purchase Golden-West, another S&L.

Amgen has struggled this year, as competition for Epogen could become a reality with Roche's CERA. There are, however, potential positive catalysts given the presumed problems with CERA in cancer and an expanding pipeline for Amgen which should be more visible late this year.

Microsoft's introduction of a new operating system could kickstart an area of technology that has been dormant over the last few years. Its success would help companies like Intel, EMC and Symantec, as well.

General Electric, under Jeff Immelt,

has worked to stimulate organic growth, by selling off slower growing businesses and buying businesses in areas like healthcare and entertainment that can grow faster than GDP. To date, GE's efforts have failed to capture Wall Street's attention, however, we expect GE will be rewarded.

The New Contrarian Investor

"Mad Money," Jim Cramer's show on CNBC, has become to some of us a great tool. Not because it has become a source of new ideas, or because we value JC's opinion on our particular holdings. No, "Mad Money" has become a visible display on crowd sentiment. Crowd sentiment, when people are way too pessimistic or optimistic, works best as a contrary indicator at extremes. In an episode about 4 weeks ago, such extreme optimism may have been exhibited in the "Lighting Round" session, when callers ask Cramer his thought on various stocks. Generally, a broad variety of firms are covered. Yet, in this episode of 11 calls, 8 were either about oil or some other commodity based company, 2 were foreign and one healthcare company was dismissed out of hand by Cramer himself. Given commodity companies represent about 15% of the market, such excitement over titanium by "Phil in Boise" seems excessive and may be worth noting. As an aside, energy related funds at Fidelity had 27% of the assets in all Fidelity related sector funds, or about 4 times average. Subsequently, energy related holdings have fallen 10% or more; another example of herd mentality

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