

MARKETPOINT



WHEN WATCHING THE WINTER OLYMPICS, we were impressed with how many outstanding athletes came from various corners of the world. The names of the competitors on the medal podium reminded us that athletics is indeed a global pursuit. In a similar manner, investors can no longer think of just the US as their investing universe, or just focus on US statistics to understand what is happening globally. Astute investors need to consider a broader landscape to understand today's markets and investment opportunities.

Facts that reinforce this notion of global investing include: the world's 40 biggest multinationals now employ roughly 55% of their workforces in foreign countries and earn 59% of their revenues abroad.¹ Foreign sales of the S&P 500 companies are 31% of the total, and for the largest 50 of these companies, foreign sales comprise 40% of the total.² And, Thomas Friedman's book *The World is Flat* provided us with many examples of outsourcing in industries you would never imagine (for example: tax return preparation).

With this, it should be no surprise that international themes dominated the market in the first quarter of 2006. Participants have been concerned with the underlying health of the worldwide economy, in particular focusing on the implications of current monetary tightening policies being pursued by the US Federal Reserve, the European Central Bank, and potentially the Bank of Japan. The uncertainty associated with rising global interest rates has permeated both the US stock and bond markets, resulting in choppy—yet positive—equity indices, slightly higher interest rates, and a significant flattening of the yield curve.

We are not surprised that the international marketplace is converging. We have always believed that the global backdrop is extremely important when making long-term investments. With populations outside the US evolving so rapidly, especially China and India, it is naïve to not pay heed to the impact of these economies and to try to benefit from their evolution. However, because of poor corporate governance in some countries and potential expropriation by foreign governments, risk should be managed carefully. For example, we invest in some individual stocks of US and Canadian companies that produce what China needs because these investments have more accounting transparency and better oversight than companies located in certain developing countries.

One asset that should increase in value as a result of macro trends is gold. We invest in stocks of gold companies because this metal remains cheap and its investment returns have almost no dependence on stock and bond returns.

“*We have always believed that the global backdrop is extremely important when making long-term investments.*”

¹ Source: Economist.com

² Source: Bloomberg



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ASSET MANAGEMENT COMPANY

“...we have a competitive devaluation situation where paper currencies across the globe will likely continue to lose value relative to the only currency with a finite supply.”

While the global purchasing power of the US dollar has held up relatively well over the last 25 years or so (after the high inflation of the late 70s and early 80s), over the long-term it has lost significant value through deliberate devaluation. The graph below illustrates the loss of purchasing power of dollars (for a barrel of oil as an example) relative to gold.

Currently, the US has two incentives to continue to lower the value of its own currency, and the Fed knows this. One incentive is to mark down the value of the debt held by (owed to) foreigners without actually paying it (lowering our *real* obligation). The second incentive is to make US industry more competitive

globally, and a declining dollar should make our exports more appealing abroad.

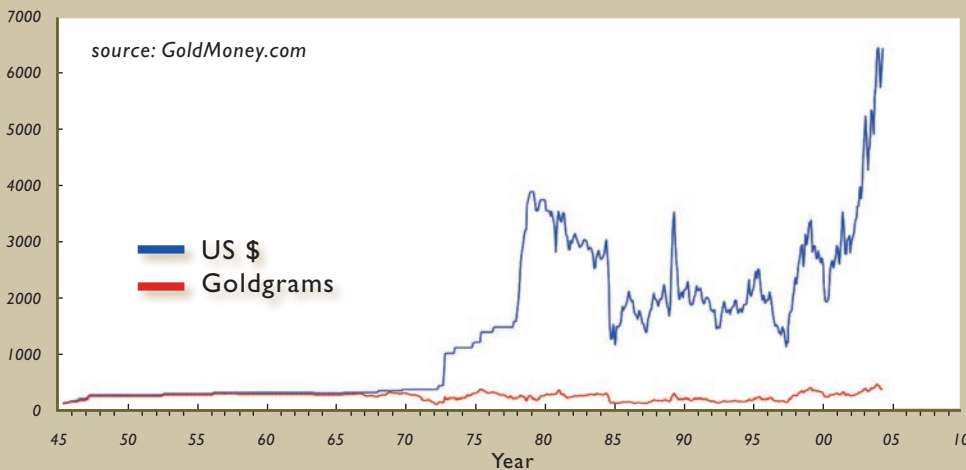
However the same incentives exist for foreign governments and central bankers, who want their own currencies devalued because they hold so much dollar-denominated debt (they don't want to lose the value of these receivables), and furthermore, because their economies depend on export strength. Hence, we have a competitive devaluation situation where paper currencies across the globe will likely continue to lose value relative to the only currency with a finite supply—and which doesn't represent anyone's liability—**gold**.

On the supply side the news gets even

better. It takes years to bring new production on-line even when ore bodies are known because mining is subject, more than most other industries, to labor disputes, violence from locals, weather, cave-ins and pit-wall problems, etc.

The fact is that the world needs gold. As developing countries gain wealth, the citizens, who have been burned by owning paper currency before (for example: Russia), prefer a store of value that cannot be marked down at the government's whim. It makes sense to hold gold to hedge our clients' exposure to these incentives and to serve as a diversifying asset that should perform well during difficult market cycles. ■

CRUDE OIL PRICES (Base of 100)
December 1945 through January 2006



This chart presents a base 100 analysis of crude oil prices in terms of dollars and grams of gold, i.e., goldgrams. In other words, this analysis assumes that one barrel of crude equals \$100 and 100 goldgrams as of December 1945, and then calculates the month-end price thereafter based on the actual dollar price of crude oil and the prevailing dollar-to-goldgram rate of exchange.



TOP OF MIND

BEHAVIORAL FINANCE: SKEWED REACTIONS TO PRICES MOVEMENTS

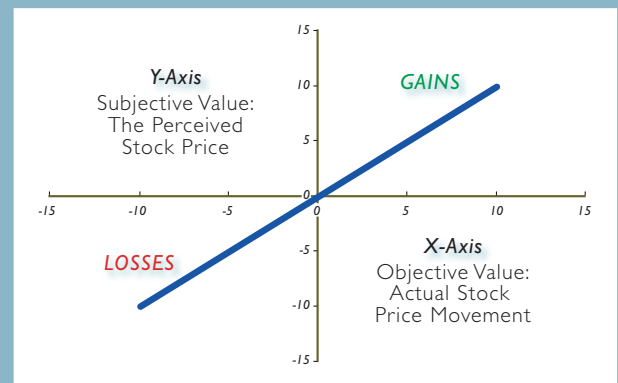
BEHAVIORAL FINANCE IS A BODY OF WORK that relates how emotions and cognitive errors influence investors and their decision-making process. We at Obermeyer study Behavioral Finance to be aware of these tendencies and to avoid the same mistakes as most investors. The more we understand how emotion spurs investors to react (and generally overreact), the better we can identify these biases to either weather market volatility or to capitalize upon emotionally driven events. The ultimate goal is to have good investor performance on top of investment performance, and to maximize our clients' risk-adjusted return.

Why is it that investors tend to get alarmed when a stock is down \$5, but become almost blasé about the same stock being up \$5? And, that these same investors assume that if the stock is down today, it must be heading down tomorrow. These skewed perceptions of price movements are illustrated in the graphs on the right: while people should theoretically react equally to gains and losses as depicted in the "Rational World," investors instead tend to get very anxious and panicky about price declines as shown in the "Real World." We know this is true because we get many more phone calls on days that the market is down, and rarely a call on the up days.

We as investment managers understand that security prices will sometimes have drastic short-term moves because they are bought and sold by individuals with emotions. We tend to stay away from hyped-up securities (example: Google) as these securities generally offer poor risk/return trade-offs and have daily swings that lead to heartburn and indigestion. Instead, we purchase stocks issued by companies that are trading at reasonable prices (for example, purchasing a stock we believe is worth \$100 for \$70). This **value-driven** approach tends to lead us to own investments that are less volatile than the general market.

Once we make the decision to invest in a company, we try to tune out daily stock price gyrations and instead focus on what it is really worth. And, if it is down \$5 on one day, we ask has anything changed at the company? If not, should we add to it? In essence, we recognize that several of our better investments were made at times of average investor overreaction. Equally as important, we recognize that all our investments (even the best investments) will go up and down, sometimes significantly. It is imperative that we limit our skewed reactions to market ups and downs and try to put ourselves squarely in the "Rational World." This way we stay focused on the fundamentals and making good investments for our clients, rather than reacting to daily headlines—a losing end game. ■

RATIONAL WORLD



REAL WORLD



In a purely "Rational World," investors would react the same to positive and negative price movements. So if a stock were down \$5 (as shown by the x-axis), they would perceive the stock as being down \$5 (shown by the y-axis). And if a stock were up \$5, they would perceive the stock being up \$5 dollars. Equal reactions to equal price movements. In the "Real World," however, investors sometimes exaggerate the losses and overlook the gains. So if a stock is down \$5 (x-axis), they feel a disproportionate amount of pain.

“*Our clients remain the focus of our business, and our growth has been geared to ensure you receive exceptional service and personal attention.*”



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OBERMEYER NEWS

THOSE OF YOU WHO HAVE VISITED our office in the past year have met the new people on our team. For clients who have not, you may have spoken to a new voice on the phone, or learned of our additions in recent letters. Our business has grown substantially over the past few years—both in terms of people and assets—and we wanted to give you an update on the company.

First, our mission remains the same—to provide intelligent and profitable investment management to our clients. Our clients remain the focus of our business, and our growth has been geared to ensure you receive exceptional service and personal attention. Our goal is to maintain and improve this high level of service even as we get bigger.

Our Investment Committee is currently made up of four professionals: Wally, John, Ali and Roger. By adding more diversity and industry expertise to the group that shapes our investment strategy, we are able to analyze more opportunities to ensure the discovery of long-term investments that can potentially generate substantial returns with a reasonable amount of risk. With a larger team, our Investment Committee members can travel to select conferences so we, as a firm, can stay abreast of market developments, opportunities and risks. Each of these conferences adds meaningful insight that we incorporate in our investment management practice.

Most of you know Chris and Sallie as they are often your first point of contact. Sallie and Chris are dedicated to managing every aspect of your account with Obermeyer—whether it be deposits, transfers, retirement distributions, etc. Questions are welcome and we are eager to help.

We have always been asked: how big do you want to get? We are not interested in growing for growth sake—we do not aim to be a large institution that does not know its clients. As we surpass \$500 million in assets under management, we remain focused on building select client relationships with people who believe in our investment approach and who trust us with their financial well-being. We firmly believe the current investment industry stacks the odds against individual investors, and that our independence and investment approach can enable clients to overcome this environment and to generate wealth over time. ■

Past performance may not be indicative of future results. Different types of investments involve varying degrees of risk, and there can be no assurance that any specific investment will be suitable for an existing or prospective client's investment portfolio. Therefore, no existing or prospective client should assume that future performance of any specific investment or investment strategy (including the investments or investment strategies recommended herein) will be profitable or equal any historical performance levels.

Certain portions of our newsletter may contain discussions of recommendations as of a specific prior date. Due to various factors, including changing market conditions, such discussions may no longer be reflective of current positions or recommendations. Information included herein should not be construed as the receipt of, or a substitute for, personalized individual advice. A copy of our current written disclosure statement discussing our business operations, services, and fees is available upon written request.