

# KAY INVESTMENTS

S E C R E G I S T E R E D I N V E S T M E N T A D V I S O R

June 11, 2007 Newsletter

The U.S. stock market ran into a brick wall last week and the drop rippled through most of our holdings. The immediate cause was the realization that interest rates are on the rise, not about to fall. The U.S. economy is simply not weak enough for the Fed to drop rates. There are other dynamics in play also: global rates are rising and that will pull U.S. rates up. Investors won't buy U.S. Treasuries if they can earn more interest elsewhere. Stocks don't like rising interest rates, of course. For one thing, they don't like the competition and for another, higher rates present more overhead to business and consumer alike. The bottom line is that rates are pretty much rising into historical norms, however. This period of weakness will *probably* play itself out and eventually lead to a resumption of the current bull cycle. We'll be watching.

There are areas that are very healthy and solidly on the move. We have been moving steadily into emerging markets (Asia outside Japan, Latin America, India, etc.) through our preferred funds. Among the industry sectors, we have parted ways with Utilities after a fine 8 month run. Utilities are now a casualty of rising interest rates, as well as historically high valuations. Investors buy utility stocks are largely because of their dividends. Today, those dividends would definitely be happier if interest rates would turn and go down, not rise. We recognize that the current bull market cycle has turned toward large and mega cap stocks and so our models reflect a definite bias to large cap. Within the industry sectors, we are focusing on energy, telecom, medical delivery and materials. We will be moving toward natural gas (see quote above) as well. These sector allocations are flexible and may adjust more or less often.

*Global capital spending is booming, with the developing world being the focal point. Historically, countries and sectors at the epicenter of investment booms have experienced stock market manias. Correspondingly, the current dynamics should be very beneficial for emerging market stocks.....BCA Research, 6/11/07*

*After three days of intense market decline this week, we may be forgiven for repeating that short term corrections are a normal, healthy part of every sustained market advance. They are essential to correct the excesses of the prior rally and to re-stimulate buying enthusiasm through discounted prices. Thus far, the recent market weakness appears to be well within the normal parameters of short term corrections, and not dissimilar to the last two market corrections in May-June'06 and Feb-Mar'07. Both of those cases proved to be good buying opportunities..... As a result, the overall probabilities drawn from our 74 year history continue to favor at least another four to six months of higher prices. Lowry's Research, 6/11/07*

*Energy shares have long been earmarked as a mania candidate by BCA. Energy stock valuations have only just begun to expand and we remain bullish on the entire energy spectrum, but expect some short-term volatility in the refining segment. Good value and still depressed earnings expectations argue for only a bull market correction, rather than a cyclical peak in refining stocks. The most excitement in the next year is likely to be in natural gas. The plunge in Canadian exploration activity heralds supply decreases..... BCA Research, 6/11/07*