Rutherford Investment Management Newsletter: Period Ending 03-31-2006

Rutherford Investment Management, LLC
10300 SW Greenburg Rd. Suite 115
Portland, OR 97223

Phone: (503) 452-1210

www.rutherfordinvestment.com

A Surprise Quarter

The first quarter of 2006 turned out to be full of surprises. As the year ended we saw rising interest rates, and oil prices. Inflation appeared on the horizon. We did not expect much for the market. The result was much better than anticipated. The S&P 500 index was up 4.2% for the quarter nearly matching its total return for the previous year. It was the best first quarter of the year since 1999.

Foreign stocks did even better as emerging market stocks enjoyed another rally. The average emerging market fund rose 12.3 percent. But it should be noted that these stocks have political and currency risk that do no exist in U.S. funds.

Bond portfolios did not do well as the average loss in long term bond funds was 3.5%, inflation protected funds were down 2.2% and intermediate term funds (our choice) were down .6%. Bond funds still face price erosion from rising interest rates as the Fed continues the tightening mode.

With the quarter behind us, what is next? The market is pricing in a 100% certainty that the Fed will raise rates at their next meeting in June 28. After that what happens? The Fed may pause in their rate increases, which would give an opportunity to assess the state of the economy. If the Fed pauses or stops increasing rates, and the economy stays strong, we could well see an explosive rally in equities. On the other hand, if they believe that inflationary pressures are too strong they may continue or resume rate increases. Or they may go too far, in which case, the equity, bond markets and the economy all suffer. The gold market, reaching new highs, is certainly challenging the notion that the Fed has inflation under control. With commodity prices at all time highs, one wonders a great deal about inflationary pressures.

At the same time, the Fed is tightening the money supply and oil is approaching new highs as tensions in the Middle East rise as well. This is a replay of the scenario that caused so much trouble in 2000.

Once again I have to caution that this is a very difficult scenario for the market in both equities and bonds. With home prices under pressure, mortgage delinquencies rising, and some high profile layoffs, (Ford and GM), one wonders how long we can count on the continuation of

Information herein is believed to be reliable and has been obtained from sources believed to be reliable, but its accuracy and completeness cannot be guaranteed. Opinions, estimates, and projections constitute our judgment and are subject to change without notice. Not every investment decision or recommendation made by Advisor will be profitable. Investment involves risk and may result in losses.

consumer spending. On the other hand, should the Fed stop tightening or signal the end of tightening, we could see an explosive rally. So the Fed probably goes to 5.25 %, it may go to 5.5% which is what I predicted last fall, and still feel has a strong likelihood. According to the domestic equity strategist for J.P Morgan if the Fed goes past 5.25%, "the market will probably throw up on itself".

Add to this that the second and third quarter of the second year of a presidential term are historically the worst quarters for returns. And this market is getting long in the tooth having risen since October of 2002 almost without interruption, GDP rising since Q2 of 2002; it would seem we are overdue for a correction.

As I have previously pointed out, the Fed has tightened eight times since WW II. And in five of those eight times, the yield curve has inverted. Each time the yield curve has inverted, the economy has suffered a recession one year later. The yield curve has inverted three times this year. All of which leads back to my thesis that we will see a slowdown in the fall in the economy and the markets. The party in power will labor mightily to keep the economy strong because of the mid term elections, but I think they lose that struggle.

Then too Central Banks world wide are attempting to slow the global economy by raising interest rates, so that should have an effect. I do not think they get what they are really after, lower oil prices, because the demand will remain strong, supply constrained, with geopolitical and weather conditions intervening.

So we see real estate under pressure, bonds at risk, and equities fraught with uncertainty. Is it any wonder that gold is doing so well? But we are not gold managers, we are growth managers, and our job is to invest money for the long term. As I have said before, one has to take their "at bats". This means we have to stand in the batter's box and take what the market throws at us. We cannot retire from the game, or choose not to show up, as the market shows up for work each day, and we better be ready. I don't know if the market will throw us a curve, a slider, a knuckle ball, a spitter, or a fast ball down the pipe. We will be trying to tap out some singles and doubles, and maybe a longer ball from time to time. We will continue our process which is finding the best companies in the best sectors, as we navigate through these tough times. Our process was validated when Barron's recently reported that Morningstar had given our flagship separately managed account a 4-star rating for the past three years and a three star rating for the past 10 years. I believe our ratings would have been higher if we had been rated against our peer group of multicap managers, but their risk adjusted ratings show that in spite of the horrible time that growth managers have passed through, we are doing well. We may be in for a rocky ride, but we will try to steer us through.

William D. Rutherford
Rutherford Investment Management, LLC.

Information herein is believed to be reliable and has been obtained from sources believed to be reliable, but its accuracy and completeness cannot be guaranteed. Opinions, estimates, and projections constitute our judgment and are subject to change without notice. Not every investment decision or recommendation made by Advisor will be profitable. Investment involves risk and may result in losses.