

BB Quarterly Update



As I am writing this letter, I am sitting at my desk in a hotel in Midtown Manhattan, and marveling at how small the world has become. Just yesterday, I was called by our president, Megan Clubb, in Walla Walla and asked to attend to a matter for her regarding a meeting. After hanging up with her I promptly dialed another vice president in Walla Walla to confirm details and then called an assistant, also in Walla Walla, to help set up the meeting. While doing this I was shopping for a pair of pajamas, since I forgot mine in Walla Walla, and had ridden in a taxi back to my hotel. After taking care of the meeting, I prepared for a guest appearance on CNBC and Bloomberg which was shown live all over the world. Oh what a wonderful world we live in... and I mean that with all sincerity!

In writing this column I marvel at the complexities that have taken place. How intertwined the entire world has become and how investment managers must have the ability to see the forest for the trees. I hope I have been able to do that, but this quarter's newsletter will be dedicated to pushing that agenda even further.

So what have we seen in the world this quarter? The US economy continues to push forward, due partly to lower interest rates and rising housing prices. Many people wonder if this housing bubble will burst and who will be the big winners and losers. In actuality, I think the US consumer has been relatively smart. The latest studies show that of all residential real estate loans, a full 65% of these are considered to be fixed rate 15 to 30 year loans with relatively low interest rates attached. The rest are either adjustable rate products or interest only loans. Low interest rates have been partially explained by an overabundance of global cash due to instantaneous wire transfer technologies.

Another factor that is working in the economy's favor is that loan to value ratios on average are about 75%, meaning on average consumers have loans on their homes for 75% of their value. That is why Alan Greenspan has been cautious on the housing bubble but not overly pessimistic. There are some areas of the country which have larger bubbles—areas such as Los Angeles, San Francisco, and New York—but in general, the equity built up in houses has given a cushion to these areas in case of a downturn in the markets. Along with the majority of homes being fixed rate with fixed payment schedules and 25% home

equity attached, factors are in place that should give the housing sector a less violent decline in the face of a housing bubble pop.

In addition, homeowners have also taken out home equity loans to either remodel their current homes or pay down higher interest rate borrowing lines such as credit cards. This has continued the economy chugging along at 3.5%, but the consumer cycle has been coming to an end and we see the business cycle helping to boost GDP growth rate in the future.

How will this happen? There are a couple of areas in the US economy that are being stretched. One area is now labor, as unit labor costs have increased at a higher rate than anticipated, and productivity has been falling as a result of it. In words many people will understand, the low fruit has been picked and now the hard work of increasing revenues will be reliant on getting to the higher fruit... in other words, hiring new employees and investing in new property, plant, and equipment.

This new invigoration in business investment coincides with the time that cash is coming to the market due to the Jobs Creation Act that I have mentioned in my newsletters going back to last year. As you will remember, US corporations are allowed to bring offshore corporate profits back to the US with little tax consequence if they use this cash to primarily hire employees or invest in property, plant, and equipment. This cash as you remember could total up to

continued on page two

Investment Management

& Trust Services

Guiding you to a brighter financial future.

Advisors • Managers • Trustees • Founded 1869

Inside this Issue

Mark Kajita's Letter page one

Michael Pettyjohn's Letter page three

John Mathwich Awarded AFM page three

continued from page one

\$750 billion dollars, and the cash is only allowed favorable tax treatment in 2005.

We are seeing this cash start to hit the books of major corporations like Pepsi, which recently brought back \$7.5 billion in cash from its offshore subsidiaries. Cash used for job growth should lower unemployment and spur on another round of consumer spending that will push the economy forward again.

This cash repatriation is also coinciding with one of the most horrible natural disasters in the nation's history. Katrina not only devastated the Gulf Coast, it

rebuilding by corporate America, should have a lasting impact in the area.

Although nothing can console those who have lost everything in this disaster of Homeric proportion, one thing can come out of this that might be a tiny silver lining. The Mississippi Delta area is arguably the poorest area in our nation, with fully 25% of the population earning \$15,000 or less per household. With the investment that is pledged, we have the opportunity to make this a showcase economic zone for the US. If we are rebuilding the area anyway, we may as well rebuild it to compete in the ever more competitive global market.

And what do I mean by global market? For instance, many in the US scoff at the idea that oil can stay above \$45, \$50, \$55 per barrel; the supply issue is only temporary in their minds and in a few months or within the year oil prices might drop back down to \$25 or \$30 per barrel. The same is said of the commodities market for tin, iron ore, copper, and other metals and energy by-products. This view is correct if we were only talking about the US market, but we are increasingly talking about the planet.

In this global view, the US is an important player, but only one player. The other players which are becoming even more important are China and India. Not only because they are fast industrializing, but the way they are doing it is very inefficient. Inefficient energy plants have made it three times less efficient than the US and other industrialized countries in terms of energy costs. They make up for it by having cheap labor to offset the higher energy costs, but the fact is they are soaking up all the oil they can, leaving the world in a very strong demand position relative to the supply of oil. There is no quick solution for getting more oil out of the ground as most countries are pumping oil at capacity—a problem only exacerbated by Katrina and Rita half a world away.

In addition, Chinese inventories of commodities have also started to run down, leading Chinese companies to once again stockpile commodities for their industries which will directly lead to higher commodity prices.

This entire world economic symphony is moving at a time when Japan is finally showing growth in its economy now that the Japanese government is put-

continued on page four

Savor the Moment

We're thinking about your investments so you don't have to. We listen to you and tailor our services to fit your needs—now and in the years to come. Savor the moment and let us guide you to a brighter financial future.

BB Baker Boyer Bank
Guiding you to a brighter financial future.™

(509) 525-2000
www.bakerboyer.com
Member FDIC

also disrupted shipments up and down the Mississippi River. The destruction of the New Orleans core area along with the Mississippi Delta including the states of Mississippi and Alabama was horrifying to see. However, the Federal government's pledge of \$200 billion to the area, along with insurance proceeds and



Estate planning is a subject I touch on often with the clients I work with. As a financial advisor, I try to

communicate how critical this type of planning is to a successful financial future. However, many clients put off planning, assuming they can always do it later, they aren't old enough for estate planning, or things will somehow work out in the future. Ignoring the estate planning process can only cause more difficulties down the road with family, business partners, and others, not to mention that settling an estate without a good road map is a confusing journey.

Estate planning is one of the best things we can do in the stewardship of wealth. If during our lifetimes we endeavor to make the dollars we have do as much as possible—to help those we love, to encourage those who need encouragement, to participate in charitable work—then in death we should consider measures so that the same focus is continued. A long-term financial plan addresses many steps and issues and Baker Boyer can help you with the process. One of the first steps we recommend is making a will. While the actual drafting of the will is done by your legal professional, our discussions will help you determine some of the important issues you should include to carry out your personal plan.

I am constantly amazed at the number of sophisticated people of means who have never articulated where they want their wealth to go, who it will support, or how it will do the most good for their family and/or community. And what truly is the nature of a will? Face-tiously, it could be said that it is a “dead giveaway!” When viewing the legal history of wills, it is apparent that a will can be a way of expressing a bit of creativity. Here are a couple of examples: Britain's Samuel Bratt was never able to enjoy his favorite smokes while married, so at his death he left his wife 330,000 English pounds (about \$500,000) on the condition that she smoke 5 cigars per day!; and poet Heinrich Heine, a wealthy aristocrat, left his sizeable estate to his wife on the condition that she remarry, so “there will be at least one man to regret my death.” Funny yes, but the issue of taking control of how your wealth is distributed is very serious. A will allows *you* to make these important decisions, not the State of Washington or other jurisdiction. If you don't have an estate plan, the laws of the state in which you reside already have an estate plan for you, but typically those laws may not follow your wishes very well. So our message is to simply take the time to have a will drafted if you haven't done so. With so much to lose, I see this as a “no brainer” with tremendous benefits to your family and other beneficiaries of your estate.

continued on page four

John Mathwich, trust officer and farm manager, has recently been awarded the Accredited Farm Manager (A.F.M.) designation from the American Society of Farm Managers and Rural Appraisers (ASFMRA). The A.F.M. designation demonstrates that he meets stringent education and experience requirements, has passed rigorous oral and written examinations, and maintains the highest standards of integrity, professionalism, competence, and ethics.

Accredited Farm Managers have specialized expertise in production, business, environmental issues, and government activities. John's focus in obtaining the designation was to continue providing expert guidance and assistance to people who own and/or operate agricultural lands and rural resource properties.

Baker Boyer Bank has provided Trust and Farm Management services since 1916, and continues to be the predominant provider in our region. Maintaining quality service and experts on staff is a commitment to our clients in guiding you to a brighter financial future.

For more information contact:
John Mathwich
Vice President and Trust Officer, Farm Manager
mathwicj@bakerboyer.com



continued from page three

Once an estate plan has been designed within your will, then a critical look at the family makeup becomes the next step. Ask the question, "Who is able to manage things should something happen to the current primary decision maker?" A family member, friend, or corporate partner? There is no right or wrong answer, but the decision must be based on who possesses the necessary skills to carry out your wishes and directions over a long period of time. One of the best tools that can bring continuity to the long-term management of assets is the use of a trust and a qualified trustee.

A trust is a marvelously flexible tool that allows you to create a management plan that meets your family's specific needs. You select the assets that will be placed in the trust, who the trustee of those assets will be, and who the successor trustees will be should the initial trustee fail for any reason. Further, you establish when the trust will end as well as who and how much the trust assets will benefit. Additionally, the ability to maximize tax savings strategies can be achieved by using trusts, a definite advantage to larger estates. Specialized trusts can also be created to meet even more specific needs. These include Life Insurance Trusts, Charitable Trusts, Special Needs Trusts for disabled or dependent persons, Land Trusts, and so on. These and

other more sophisticated planning tools are discussed with our clients when appropriate.

Should a trust be deemed to be best suited for the client, selecting the partners to help carry out the plan is possibly the most important step in completing the planning process. Many look to a bank relationship for guidance in this area. At Baker Boyer, our fiduciary experience and objective decision making has stood the test of time for over 135 years. Many families have had long standing relationships with Baker Boyer Investment Management & Trust Services because of our knowledge base, continuity, objectivity and careful approach to managing wealth. We will not die, move to Florida, or become ill, and we are held to the highest standards governing corporate trustees. Simply put, we are here today and we'll be here tomorrow.

Please consider utilizing this comprehensive planning service. There is no cost for the consultative services we provide; it is just another benefit of doing business with Baker Boyer Bank. Please contact me to learn more about how our planning services can help you.

Michael Pettyjohn
VP and Trust Business Development Officer
pettyjom@bakerboyer.com

continued from page two

ting financial reform into place a full decade after their stock market crash. Japanese estimates show an increase in machinery orders of 11% year over year, which is tremendous growth from an economy that has languished at 0% growth for over 10 years.

We believe that we will see slightly less robust third and fourth quarters of 2005, due mainly to hurricanes Katrina and Rita, and their impact on the American psyche as well as their effect on higher energy costs. However, we believe a strong 2006 is in the making with the rebuilding of the Gulf Coast region along with the funds from the Jobs Creation Act seeping into the system.

See how intertwined we are? From nation to nation, culture to culture, all play their part in the world economy now, and all impact the other players. I have

only touched on maybe 10% of the interconnections of the markets, but I will touch on more in future newsletters. Have a wonderful fall season!

Mark H. Kajita, CPA
Vice President and Senior Portfolio Manager
kajitam@bakerboyer.com

Contact Us

Walla Walla Home Office
7 W. Main
P.O. Box 1796
Walla Walla, WA 99362
509-525-2000
800-234-7923

Tri-Cities Trust Office
7601 W. Clearwater
Suite 404
Kennewick, WA 99336
509-783-6800
800-234-7923

Yakima Trust Office
3703 River Road
Suite 3
Yakima, WA 98902
509-576-9000
866-525-2262