



Quarterly Update

OCTOBER 2006

NEWSLETTER OF BAKER BOYER INVESTMENT MANAGEMENT & TRUST SERVICES

The third quarter of 2006 had to be one of the most volatile markets in recent memory; but the question is, why? Many of the answers revolve around the Fed's decision to raise interest rates one last time in June and then put any further interest rate moves on hold for the next two meetings. In addition, the housing market slowed, which added to worries that consumer spending would slow as well. But real volatility came when those quasi-investments such as hedge funds, started to falter. In this edition of our newsletter, I want to delve into the alternative investment (hedge fund) markets and why they can be good for a very select group of people and a millstone around the necks of others.

Right after the 9/11 tragedy, alternative investments started to receive a lot of attention. If you remember, interest rates started to fall with bank overnight rates hitting just 1%! At the same time equity investments were losing money through 2003. In this arena, the idea of hitting it big with an alternative investment play seemed like the way to go, and to be fair, if you were wealthy enough and could take the risk, it looked to be a good way to protect your assets by hedging the markets. It's kind of like taking out



insurance on your investments; you have a small portion of your investments making money if the market goes down.

There is one thing that is basic in human nature; a factor that turns things upside down, right things to left and positive things to negative, and that is greed. When people feel that the boat is leaving without them they are fast to react and to get money invested now with someone, anyone, before they are shut out. And when it's all over the news like hedge funds were in the recent past, then they feel even more pressure to invest lest the opportunity be lost.

The problem is this, everyone cannot get into the game and make money, and this is especially true of alternative investments, which

Inside this Issue

- 1 Economic Update
by Mark Kajita
- 4 Welcome Peter Allen

Keep up to date with what is happening in Investment Management & Trust Services. Join our email list by contacting Janet Manuel at (509) 526-1282 or manuelj@bakerboyer.com.



include hedge funds (think of playing odds at a local race track), private equity (think of owning a privately held company), and long/short funds (think of putting bets on whether the economy will either expand or falter).

As interest grew, ordinary individuals were not only investing in alternative investments, but starting to make it their primary investment. This is when greed took over. So many people wanted high double digit returns that they were willing to “shoot the moon”... and “doubling down” meant getting twice as much profit in what appeared to be a secure investment.

In this type of investment arena, the sharks came out of the dark and circled investors like they were baby seals. The fear to not miss a “great deal” overshoot logic in many cases, much like it does when you are buying a car and you hear those immortal words, “Hey, I have a buyer lined up. But I like you so I’ll sell this car to you right now, but don’t tell anyone.”

Money poured into alternative investments, as the newly

minted alternative investment fund managers placed bets on markets. One of the biggest commodities hedged was oil. Many people placed bets that the hurricane season in 2006 would be as bad as or worse than that of 2005. Because of this, they hedged that the price of oil would go up to \$90. As we all know the hurricane season was relatively mild. Oil prices stayed in the \$60 - \$70 range. Then we heard the ever present “KATHUD” when people were told to settle up. Amaranth, a hedge fund with natural gas interests, lost 60% of its assets in one week! Amaranth went from \$10 billion to \$4 billion, as it was ordered to settle its hedges.

My belief is that Amaranth is just the start of an unwinding period that will take place over the next few months with many alternative investment funds. This unwinding has led oil prices lower, which I believe is a temporary issue until oil finds its way to a trading range of \$65 to \$75/barrel. In addition, some of the best companies with excellent track records were sold in some funds in order to capture gains to cover other losses.

These actions led many of the best investment managers in the country to scratch their heads as they watched stock prices of excellent companies slide. What we are seeing now is sanity getting back into the markets as people start to realize that there are some grossly undervalued stocks in the markets right now.

Like I said, greed is a heady intoxicant, but can also lead to massive losses; just think back to the tech boom and bust of the last 10 years. One of the things you hire Baker Boyer to do is step out of the way of a rampaging bull as it leads the herd to an uncertain plunge over the precipice of speculation.

The next troubling fad I see is the need to invest in Mainland China at any cost, especially in the banking arena. With the massive bad loan situation in Native Chinese Banks, it confounds me that huge companies want to invest in them to gain access to the Chinese Market. For the Chinese, I can see the allure... deep pockets coming in with the ability to bail them out if things go bad. For the financial institutions going in, it is a

gamble that they can make more money in China before they have to bail out the bad loans.

Again, exuberance and the need to not be left behind are moving even large corporations into making big bets on high risk ventures. At Baker Boyer we are watching these international mergers and being selective with the companies we believe are making the smart Chinese expansion plays without taking on excess risk.

It is true that being able to keep your eye on the horizon and assess risk relative to return will lead to a better investment strategy. Did you ever wonder why successful investment managers seem to have an understanding of the world that is better than 75 - 90% of the people around them? What sets them apart is their ability to take in new information for

whatever asset class they are working with and see how it will impact the entire economy.

For instance, take a sector like international emerging markets; the best person to manage those funds is a person who is intricately familiar with the world economy. They understand how their world economic view will translate into the emerging markets and which companies and industries will do best.

But you can't be the best at everything. If you are a star pitcher in the National League, no one expects you to be the best hitter or outfielder at the same time. You do what you are the best at and get paid for that expertise. The same is true with investment firms. I don't care who you are and how much money you invest, there is not an all encompassing financial

company out there that does **EVERYTHING** better than everyone else. I hear this so often, that a person invests with a large company like JP Morgan because they are so good at everything, and that is usually a misconception.

Most firms have one or two very good fund managers whose funds do very well and then a cadre of mediocre to poor performing funds. They never tell you about the mediocre funds. They want you to see the shining stars. It's kind of like the investment version of "Loss Leading..." putting out one or two funds that do well, but sell you seven or eight as a package.

This is the main differentiator of Baker Boyer Investment Management. We invest funds directly in areas we have expertise in. But just like your

DUSTY FINANCIAL MYTH #2

Money in the bank is all you need

It takes knowledge to make your money grow. Our skilled investment managers are here with new perspectives to help balance risk and return.

Their insight can help you to develop a custom plan and make the right financial decisions to achieve your goals.

Look to our team for straight answers, creative solutions, and solid performance. We understand your goal of turning dollars into dreams.

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





Peter J. Allen
Trust Officer
allenp@bakerboyer.com

Baker Boyer Bank Investment Management and Trust Services Department is both happy and sad to announce the retirement of Assistant Vice President and Trust Officer Sandra Bradley as of the end of September. Sandra has provided Baker Boyer and her clients with exemplary service for 5 years. While we are sad to see her go, we are happy for her and her family and we wish her the very best and hope that she enjoys her retirement filled with travel, volunteering and grandchildren.

In anticipation of Sandra's retirement, on September 1st, Baker Boyer hired Peter Allen to

assume Sandra's job as Trust Officer. Peter recently moved to Walla Walla from Tacoma, where for the previous 5 years he was an attorney specializing in real estate, business law and estate planning. Peter is a graduate of Whitman College and the George Washington University Law School. Peter moves to Walla Walla with his wife Carol, also a Whitman graduate, their 8-month old daughter, Catie, and their black lab, Maggie. They are all thrilled to be back in Walla Walla. Peter looks forward to providing the same excellent service to Baker Boyer and its clients that Sandra did. Feel free to stop in any time to meet Peter and visit. ♦

continued from page three
favorite baseball team, we surround ourselves with the best team players to assure our success. Our team players are the fund managers who share our investment philosophy in asset categories we don't specialize in. This plan for success has been very profitable to our clients since the beginning of my tenure, and we continue to believe in its future success.

So, as baseball season closes out, the fall colors will start to shine. We will put a close to 2006 and the volatility of the summer months. I hope you have a wonderful holiday season and Happy New Year. ♦

Mark H. Kajita, CPA
VP & Senior Portfolio Manager
kajitam@bakerboyer.com

Investment Management & Trust Services

Guiding you to a brighter financial future.

Advisors • Managers • Trustees • Founded 1869

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
509-735-5163 • 800-234-7923

Yakima Trust Office
909 Triple Crown Way, Suite 101 • Yakima, WA 98908
509-576-9000 • 866-525-2262