



WINTER 2007

Quarterly Update

NEWSLETTER OF BAKER BOYER WEALTH MANAGEMENT SERVICES

The year 2006 was probably more robust than even we could have dreamed. At the end of the year, the S&P 500 was up a staggering 13.8%, and that is an especially high number considering the enormous drop off the market saw in May and June of 2006. At that time the Dow Jones actually fell to 10,653, only to close on December 31, 2006, almost 2,000 points up from that low.

This surge in the market was a faster turnaround in a slowing economy than we had predicted at the end of 2005. Last year we were predicting that the economy would slow after the first quarter of 2006 and that equity markets would gain only 8 – 10%; happily we were incorrect. The overall strength in the World economy has led economic zones to raise interest rates, and all of a sudden the U.S. is looking like a better bet for equity growth.

The question is how long can this growth survive? How long can the World economy continue to expand? We believe that the World economy can expand for quite some time. There are many reasons why, but there is one that is the simplest and easiest to explain, and at the same time the most crass and basest of human instincts. Many people will hate to hear this, but simply put, “greed,” is



the reason why we feel so positive about the future of the World.

Greed is often vilified by many as being only a negative trait. If you are greedy, you are looked at as being someone who only wants more money, someone who wants to profit at the expense of others, someone who is the quintessential “Gekko,” of the movie “Wall Street.” In this movie Michael Douglas plays a Wall Street financier named Gordon Gekko who declares, “Greed is good... Greed works...” Although the person was despicable and did prey on others’ weaknesses, the overall philosophy was probably correct.

Greed in the positive sense is as old as mankind. The need to achieve more than someone else, to excel and to find out something that no one else knows or no one else has

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yet discovered is also greed. It is this positive aspect of the base instinct of greed that I believe will power the World economy for the next half century.

The key is to expand the World economy for the betterment of the masses, while at the same time avoiding excessive air pollution, water contamination, ground contamination and excessive wear on the environment we live in. Ted will discuss our look towards alternative energy sources to combat some of the environmental issues we now face.

But just picture it, the amount of wealth that the United States, Europe and Japan created over the last 100 years was staggering, but it came at an environmental cost. Now imagine a population three times that large just starting their journey of economic expansion within the last 5 years; I speak of the population of China and India. China alone is growing at approximately 10% a year, and has just recently surpassed Japan for having the second largest population of affluent individuals on the face of the planet, second only to the United States.

As that population continues to grow, there will continue to be pressure on oil prices, raw material prices and food prices. Any temporary adjustment in those costs are just that, temporary... and I base this on that simple human instinct of greed. As long as there are people, there will be a need for those people to strive to be more prosperous. Deng Xiaoping set the entire Chinese population of 1.3 billion towards this path when he confidently stated, "To be rich is GLORIOUS!" Quite a comment from a lifelong Communist, but Deng Xiaoping was also a pragmatist; he realized that to leave his country behind would subjugate them to a life of servitude to the West.

With the words of Deng in mind, imagine the mass of Chinese now trying to be rich and at the same time buy the goods of the affluent. So now you know why we believe that the World economy will continue to expand over the long term. True, there may be ups and downs in the market, as there always are, but the general trend for the market will be pushed by ever increasing profits from selling to the newly affluent Chinese and Indians. Is it a negative that these

populations now want to have what we in the West take for granted? Or is it just human nature, and a natural occurrence that will happen when societies achieve a higher level of income? In the future our quest should be to "Be Gloriously Rich and live in Harmony with our Environment!"

For 2007, we predict that large multinational corporations that can sell to the Chinese and Indian upwardly mobile population will do well. It is a matter of the Goliaths having easier and more stable access to those markets and being able to bring economies of scale to the problem of mass marketing.

In the meantime, small businesses will be increasingly stressed if they compete on a global scale. The time of a small computer maker starting her company in the garage of her house is probably over. That entrepreneur will not have the ability to access the mass markets of the Far East in a way that will prove profitable for the long term. To be sure, there will be hits from time to time in the small cap market, but they will be long shots and the vast majority will not be able to survive. Because
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ALTERNATIVE ENERGY



As the appetite for energy in any form has increased due to the industrialization emerging market countries, stress will be placed on all countries both industrialized and emerging, now and in the future. This appetite for energy in all forms is the basis for many of the investment decisions we make and the focus of our special report for the next two newsletters.

Energy is the ability to do work. While energy surrounds us in all aspects of life, the ability to harness and use it as efficiently as possible is the challenge. Currently, the world burns fossil fuels such as oil, natural gas, or coal to produce both the electricity it needs as well as to power cars and other forms of transportation.

Alternative energy refers to energy sources which are not based on the burning of fossil fuels or the splitting of atoms. Due to the undesirable effects of pollution from the burning of fossil fuels, alternative energy has taken center stage in the world economy.

In 2006, the United States will have imported over \$200 billion dollars of crude oil, which is roughly 1/3 of the trade deficit.

While some of the imported oil comes from stable countries such as Canada, the majority comes from unstable countries like Venezuela or entire regions in the Middle East.

While there are several types of alternative energy solutions, each one would need several pages to properly cover, so I will summarize some of the types currently being used today. Although any of these alternative energy solutions may not solve all problems, a combination of solutions is very feasible.

We will start by discussing in this issue ethanol and wind power.

Ethanol is a clean burning, high octane fuel that is produced from renewable sources, such as corn. The most commonly used ethanol is E85, which is a mixture of 85% ethanol and 15% gasoline, and is used in flexible fuel vehicles sold today. Currently there are over 6 million flexible fuel vehicles in America and 111 ethanol production facilities in the US, with 72 more under construction. Ethanol lowers carbon monoxide emissions by 30% and reduces carbon dioxide emissions by 27%

and is expected to biodegrade in all environments. One common misconception is that by using corn for ethanol we reduce human and animal food supplies, when in fact the production of ethanol from corn uses only the starch of the corn kernel and all of the valuable protein, minerals, and nutrients remain. One acre of corn can produce 300 gallons of ethanol.

Wind power is the conversion of wind energy into more useful electric energy by using wind turbines. In 2005 worldwide capacity of wind powered generators was less than 1% of world wide electricity use. Wind power has the potential to generate over five times the amount of current world energy use and 40 times the world's current electricity use.

Wind power has a large upfront cost for wind turbines, but low ongoing costs once set up. Wind power also takes large spaces of land or sea for the wind turbines and is not consistent in power generation, due to much of the average power generated coming in short bursts. Wind power consumes no fuel for continuing operation, and has no

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of the long shot nature of this asset category, we have pulled back our investment in that area, and leave it only to fund managers with huge research capabilities to cull the weak from the herd.

As for the growth rate of 2007, we anticipate a slight increase in the markets of 3 – 5% for the first two quarters of 2007. Then we believe that the Federal Reserve will have kept a lid on growth for too long and we will probably see a stagnation in the equity markets for the remainder of 2007. This does not mean all equities will stagnate, we believe that diversified financials will probably strengthen as well as high dividend stocks in more stable arenas like health care.

We have already taken a more defensive posture in the selection of our equity fund managers and individual stock picks.

We do not see a collapse of the equity market, but rather a stagnation in the arena of US equities, which will push us to invest in more international equity for 2007. Our choices should protect our client balances and give them the best chance for additional growth in 2007.

From Baker Boyer Bank, we wish you a Happy and Prosperous 2007!

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emissions directly related to the electricity produced.

Ethanol and wind power are only the beginning of the alternative energy options. In the next newsletter we will continue the article and discuss solar

power, geothermal power, and hydro-electricity. ♦

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