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### Relevant Market Update

Well, as they say on the radio, you heard it here first! In our June 15 e-newsletter we stated that we thought the Federal Reserve would finally halt rate hikes at 5.25%, and by golly they did, calling a halt earlier this week after two years and 17 straight rate hikes! I think this is good news. There is a real risk of “overshooting” by hiking rates too much; a pause to evaluate the still building impacts from the last five hikes reflects an appropriately careful approach. We think the new Federal Reserve Chairman, Ben Bernanke, should be commended for ignoring the clamor to continue to tighten.

The second quarter company earnings season is drawing to a close. At this point, with about 420 of the S&P 500 companies having reported, we are happy to say that it appears to have been a big quarter. The latest S&P estimate puts operating earnings per share up 13.5% from the second quarter of last year and up 9.2% for the first two quarters. So, we are on track to meet or exceed my guesstimate of 15% earnings growth for the full year.

Meanwhile, stock prices have continued to meander, with the S&P 500 stock price index up 1.5% year-to-date. The P/E ratio, therefore, has fallen one full point so far this year. We view the falling P/E as stripping significant risk out of the equity market and that the level of the forward P/E, at 14.5, to be low.

Let's look at the score: While complete data for Q2 is not yet available, total U.S. pretax profits (annualized) hit \$1569 billion in Q1 — a record high. Corporate tax payments were \$457 billion — a record high. Corporate dividends, at \$616 billion, were second to the record high (the record came in 2004 Q4 with the special Microsoft dividend). And, retained profits were \$496 billion — a record high.

But, as they say on TV, that's not all — companies took most of the retained earnings and bought back stock. The net buyback was a record high \$100 billion (\$400 billion annualized) in the first quarter, and the rest went on the balance sheet. There, financial assets now exceed liabilities by — you guessed it — a record high \$642 billion. Q2 results will likely push most of these numbers on to new record highs.

So, with what we consider to be very good financial and economic developments, we remain optimistic on equities. We just wish we could find a way to get some stability in the Middle East and get energy prices back down again. As always, please do not hesitate to call me with any questions or concerns.



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