



June Swoon

US STOCKS ENDED JUNE AND THE SECOND QUARTER with sharp losses. Surging oil prices and

ailing financial firms continued to fuel concerns about profits and the economy. The Dow lost 10% in June, 7% in the second quarter and 14% year-to-date. The broader market S&P 500 fared better than the Dow, but only slightly. The Nasdaq, heavily weighted with tech stocks has outperformed the broad indices this year. Small cap stocks held up slightly better than large, with growth weathering the storm somewhat better than value.

After eight brutal months on Wall Street, the Dow's slide came close to 20% from its October peak - the technical definition of a bear market.

Closer to the Bottom than the Top?

Market declines are normal. Over the long-term, stocks have provided excellent returns. Equities have managed to keep pace with inflation over time, whereas bonds, for all their ability to buffer a portfolio, have not offered protection against eroding purchasing power. But the price we pay for strong long-term performance is market volatility. Stock prices simply do not move up in a straight line.

Based on historical stock market action, investors should expect to see declines of 5% - 10% quite regularly and more severe declines every few years. The S&P 500 index has suffered falls of at least 20% on nine separate occasions in the last 50 years. Since 1900 the Dow has declined 20%, entering "bear" territory 31 times or once every three years on average. Is it pleasant? No, but smart investors stay put and maintain a long-term focus.

Equity investors typically get paid high investment returns after periods of sharp losses. The sellers of stocks feel anxious and that is how prices get depressed. The worst time to abandon investment discipline is often just when sentiment is lowest and media reports most pessimistic.

As Upgraders we know that our strategy will help us adapt to changing market conditions. Ultimately, Upgrading will lead us to those areas of the market bringing in the best relative returns. Since the picture is only clear in hindsight and no trend is announced as it occurs, the best we can do is follow closely and make continual adjustments to align our portfolios with winning funds.

New funds are now rising in the ranks and we're seeing much greater diversity among the highly ranked funds, with many more domestic funds represented. Internationals dominated for the last few years, but now we see a mix of domestic and international funds as well as both growth and value funds.

Energy prices continued their long move up. As a result, this month's winners are clustered around energy and natural resources. Among sector funds, financials and real estate were the hardest hit, as the credit crisis continued to claim casualties. Many banks took write-downs and reported poor earnings, leading to financial services funds as a group dropping another 15% for the month, down 24% year-to-date. Emerging markets funds slid last month as well, though no worse than their mature-markets counterparts.

If you have any questions about our strategy, please do not hesitate to give me a call!

Thank you for your business and continued trust,

P. Michael Valley II

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