BILLS ASSET MANAGEMENT

BAM MARKET NOTE

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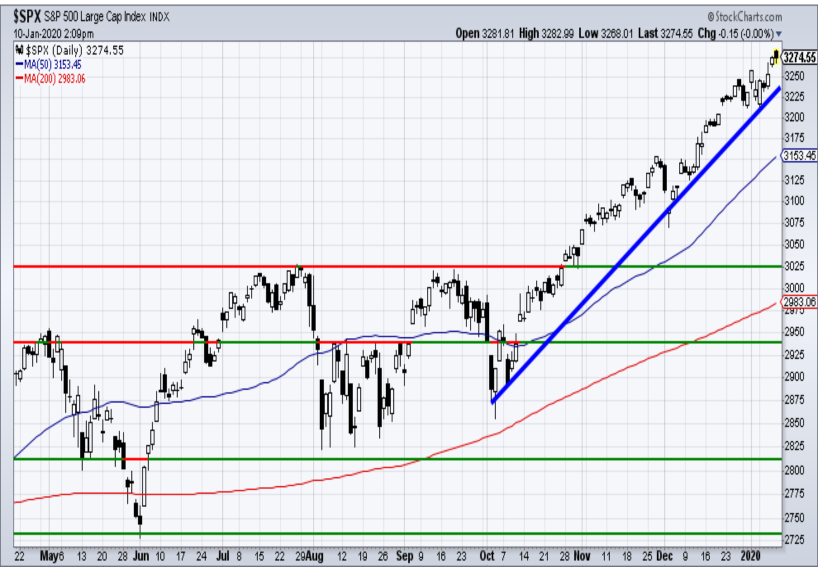
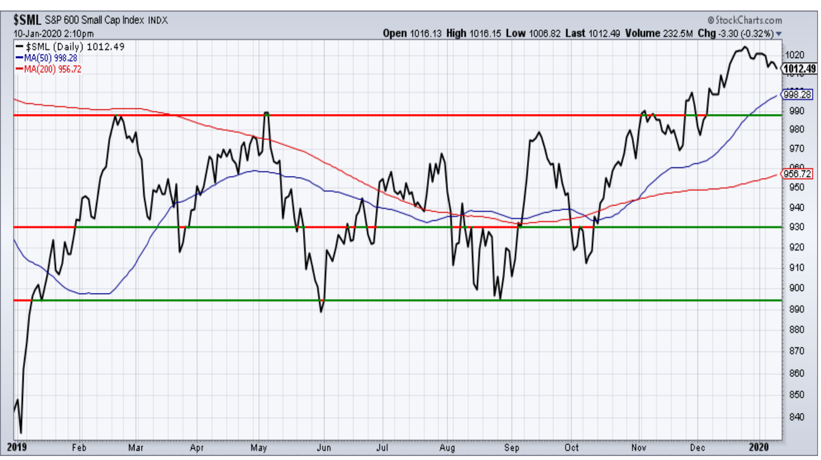


Despite increased tensions in the Middle East and the subsequent retaliatory strike by Iran earlier this week, the S&P keeps on climbing. As of now, it appears that both sides are measuring their responses. Meanwhile, the market shrugged. Tensions in the Middle East is nothing new and unless there is a full-blown conflict, we suspect that the market will take things in stride. As seen in the chart, the S&P is in a steep uptrend. The steepness of the trend is unlikely to continue much longer without interruption. The first logical correction would be to return to the trendline somewhere around the 3240 mark (just a 1% decline). It is likely, though, that the next correction is deeper than that and would be somewhere in the 3-5% range. Until proven otherwise, investors should continue to use pullbacks to buy into the market or upgrade their holdings.



After showing some initial relative strength in early December, small caps failed to maintain that strength. While small caps enjoyed an excellent December, they did not surge to the upside as we had hoped. In fact, over the last week they have begun to weaken as the S&P keeps moving higher. The recent change may be a warning sign that a correction is nearing. It would be unusual for small caps to trend down while the rest of the market moves up. Relative underperformance can persist but moving in opposite directions would not last long.

Our Point

The market's continued strength, durability and ambivalence to negative headlines is impressive. Despite the media reports of an impending World War III and a reinstatement of the draft, Wall Street looked through the over-reaction and took things as they came. That is not to say that things can't heat back up in the Middle East, but, for now, cooler heads have prevailed. Today's employment report came in a little below expectation which is leading to a little profit taking today. We will have to see if this is a start to something more significant or just another blip before the markets turns back up. The US economy remains on solid footing. We will get a good idea of how solid in the next week or two as earnings begin rolling in. While historical earnings are important, investors would be better served by looking at what company forecasts are for the coming year. As the new year begins, we are starting to see some rotation into new leading sectors. One sector that is not seeing any rotation yet is technology as it continues to lead this market higher. While the S&P is up 1% for the year, the Nasdaq 100 is up almost 3 times that at a little less than 3%. As long as the big techs are performing well, it will be difficult for the bears to gain any momentum to the downside. We made a few changes to our portfolios this week as we liquidated our small cap holdings. The positions yielded good returns but have weakened this week. We decided to take our profits in these holdings and look for better opportunities. For now, we will keep the resulting proceeds in money markets while we see if the recent weakness continues or is just a pause. We are already looking at a few intriguing opportunities. Continued evaluation of your portfolio is a key to successful investing. Despite the recent gains, investors should not get too complacent. With a Vols bowl win and the Titans in the 2nd round of the playoffs, it was a great sports week. Hoping I can report more positive news next Friday! Enjoy your weekend.