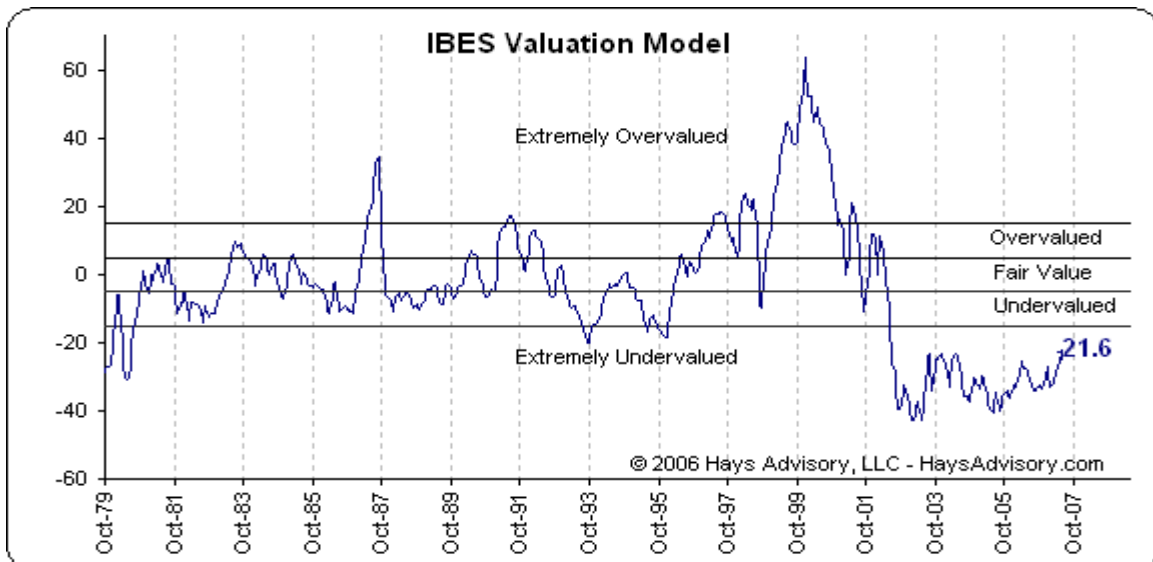


Growth is Back!

Summary: Portfolio reports are essentially already out of date and don't reflect recent events. Our cutoff was June 30 but in the first 10 days of July there was a dramatic surge in "Growth" stocks, the long awaited return after 7 years in exile is now a reality.

Growth stocks remain amazingly resilient for reasons better expressed below. In the meantime, any weakness should be used for further buying as it would appear that my '07 prediction for +17% returns could be conservative as we're over half way there. Bonds have become a bit more interesting but not significantly compelling yet. Despite the run up in share prices, Growth stocks remain attractive as the "reversion to the mean" that I've spoken so often about over the years appears to be in play and the leader is Growth.

As I mentioned last quarter one of the worst things an investor can do is "chase returns", buying what was hot last year in the hope its repeated the coming year. Very few times does it ever work, but the pressure to do so can be madly inviting. "Growth" stocks, which have been out of vogue (and the cheapest relative to Value since Disco and bell bottoms) since early 2000 are coming back fast, this makes investing actually fun. Growth is capable of moving in great leaps and bounds but if you were one of those who gave up on Growth last year and swapped into the trendy Value you're about as content as Paris in the Hotel Lynwood. The last time Growth came into vogue surpassing Value was in 1995 and that run lasted till the first quarter of 2000, so we have a ways to go.



As the chart above shows, stocks are finally lifting off trough levels that stem back to the nuclear winter of 2002 and *still have another 21.6% to rise* before they move into their historical valuation with bonds. That could take another year or two to happen assuming no growth in earnings (very unrealistic), so we're still a very long way from reaching "Overvalued".

So what's driving this market higher? In my opinion, there are factors present now that are unique that are making this ramp higher relentless. There has been a huge proliferation of Hedge Funds of which most of these fund managers cut their teeth during the great bear market in Growth stocks from 2000-2003. During that 4 year period these fund managers shorted Growth companies indiscriminately (selling a stock first, hoping to buy it back later at a cheaper price). Their view was that every move higher in the market was just another great opportunity to Short at higher prices, every move down regardless of how small was another start to a massive bear market. But they got it all wrong as Growth dropped to its lowest relative valuation in 30 years in 2006. In spite of the market's remarkable advance the open short positions on the NYSE are hitting record levels – keep in mind as markets go higher, those short positions lose more money and for the hedge managers who're squirming, angsty to cut their losses. To stop the pain they must **buy** back those shares to close out the positions, thus further fueling the market's advance.

As further evidence of the bubble in pessimism: (remember high negativity is a contrary indicator)

1. Greenwich Associates recently said hedge funds managers were the most bearish since 2004.
2. Investors Intelligence reported today that more financial advisors are expecting a correction than at any time in the last 10 years.
3. The Yale School of Management Crash Confidence Index is showing the individual is currently the most concerned about a stock market crash since November 2002, right near the trough of one of the worst bear markets in U.S. history and the record-setting low for the index going back to 1989.

It's my opinion that a very large percentage of investors, both professional and amateurs remain short or negative on this market. This negativity fuels the advance higher as market tops tend to occur not when negativism is popular but the markets are filled with unbridled optimism. It's my suspicion that there has never been a time in market history when negativism was this popular in spite of the markets making continual new highs.

A hedge fund manager that I have great respect for has propositioned that we might see the "mother of all short covering rallies" later this year. And indeed, early July had a whiff of panic to those short the markets. How else do you explain First Solar leaping \$25 in a single day? Or Research In Motion jumping \$60 in a few days?

This extreme pessimism corresponds with the recent parabolic rise in short interest (the amount of shares short on the NYSE) and is symptomatic of the current U.S. "negativity bubble," which is laying the groundwork for the beginning of the "mother of all short-covering rallies."

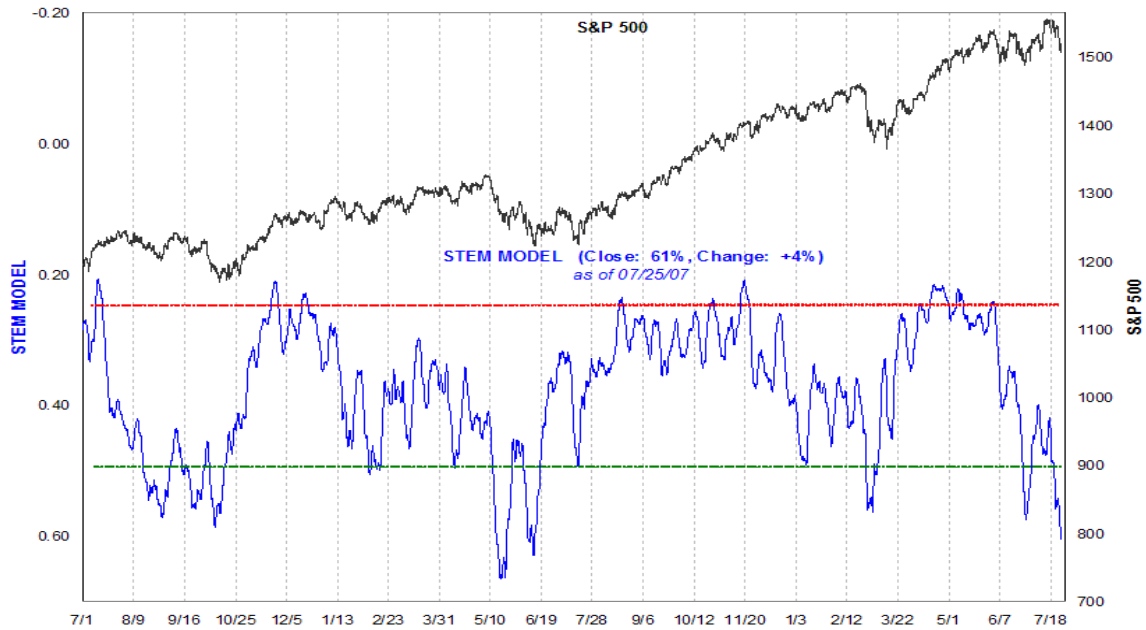


Chart courtesy of Sentimentrader

In the short term

The chart above shows that once again sentiment is getting pretty negative and that should set us up for a rally sometime in the next 30 days.

If we follow the last year that Growth took over leadership, which was 1995; Growth had a stellar year with many managers and funds at or better than 20%. Impossible to say if that will happen again, but it looks quite possible.

For individual stock selection and rationale see the RMHI stock list accompanying this report.

Warmest Regards,
 Brad Pappas
 July 25, 2007

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