Client Bulletin
January 2006

Investment / Economic Review – Despite numerous challenges last year, our accounts managed to post modest gains for 2005. Stock prices ended marginally higher, while bonds finished flat to down. Money market or cash yields more than doubled and are approaching 4%, as they respond quickly to Fed rate increases. Holding 5-10% in cash is not a bad thing. Our managed accounts average return was below our 6-8% target for balanced accounts, but we are confident in the viability of our holdings for 2006 and the future.

Our biggest winners for 2005 were international stock funds **Dodge & Cox International** (DODFX)**, First Eagle Overseas** (SGOVX)**, American Funds - New World** (NWFFX)**,** and **Capital World Growth & Income** (CWGFX) that own a mix of foreign companies from developed markets in Europe and Japan, with some emerging markets added in for spice. The **Matthews Asian Growth & Income Fund** (MACSX) is a terrific balanced conservative play targeting South East Asia, which has produced consistent returns and low risk. Given the big runs these funds have had, we're going easy on new investments.

Despite a fourth quarter correction, most of our energy and natural resource holdings posted double digit returns for the twelve month period and still represent good value. We have been hesitant to take a direct gold play due to the high volatility. Utilities and financials have done well for us. Health care holdings, with the exception of the large pharmaceutical companies, had a good year.

Long-term interest rates barely budged over the past twelve months, measured by the 10-year U.S. Treasury bond yield moving from 4.28% to 4.37%, as inflation expectations remained muted in spite of higher energy costs. We now have an inverted yield curve, where short-term Treasury yields (2 yr. @ 4.38%) slightly exceed long-term rates. Could a recession be on the horizon? Not in the near term, and not if our new Federal Reserve chairman can help it. On January 31, Alan Greenspan will preside over his last FOMC meeting on interest rate policy, before turning the reins over to Ben Bernanke.

The massive transfer of production from high-cost regions to low-cost regions of the world is keeping pricing power controlled, and new technologies are contributing to productivity gains that are driving down labor costs. Foreigners are recycling dollars back into our U.S. Treasury market keeping longer-term interest rates artificially low.

Equities / Stock Funds – Judging by the stock market action in the 4th quarter, and what's happened since the 1st of the New Year, stock investors have reason to cheer. Many large growth companies like **Cisco Systems** (CSCO), **Microsoft** (MSFT), **General Electric** (GE), and **Disney** (DIS) that have been disappointing in recent years, are now starting to stir. Valuations are reasonable, so we are cautiously optimistic. We have established positions to gain exposure to large growth stocks via no-load funds with **Transamerica Premier Equity** (TEQUX), and the more conservative **Vanguard Primecap Core Fund** (VPCCX). The latter fund is managed by the same team that runs **Vanguard Capital Opportunity** (VHCOX) and **Vanguard Primecap** (VPMCX), which are closed to new investors. These can be volatile stock funds, so prudence is dictated.

Individual issues like **Qualcomm** (QCOM) and **Yahoo** (YHOO) carry high P/E's and pay little in the way of dividends, but own valuable franchises that produce high earnings growth that will continue to benefit and grow from wireless technology and the internet.

We are comfortable holding 10-30% of a portfolio, or ½ your equity allocation in international funds. The twin deficits in the U.S. make the dollar vulnerable to downside surprises. The strongest economic growth in the world is in China, India, and other emerging markets. We own actively managed no-load funds to tap into extensive research to prosper from this mega trend. We are holding extra cash in many client accounts following year-end sales. We trimmed off and sold partial positions in some of our big winners from the past few years, like **Oakmark Select** (OAKLX), to free up capital to purchase the new **Wintergreen Fund** (WGRNX). The approval of this fund on the Schwab platform has been delayed, but we expect it to be available before the end of this month. We have a long buy list ready to go. The fund is off to a good start and will follow what they refer to as the "ABCs of global value investing which combines the following key elements: Activism and arbitrage, bankruptcy, cash and convertibles, distressed companies, equities that are undervalued, financings, hedging, and integrity of management." Lead manager, David Winters produced outstanding results at the Mutual Discovery Fund using the same strategies.

Fixed Income Securities – Our bond funds from **Metropolitan West** struggled, but managed to post positive year-end results. The management team from the firm was honored last week by *Morningstar* and named domestic bond managers of the year for superior long-term results. The fund rating firm stated "Met West will adjust its funds' interest-rate sensitivity, shift into different sectors of the bond market, or bulk up on individual bond issues when opportunities present themselves. Met West also gets an A for stewardship because management invests in the funds and the firm keeps expenses low."

Our various preferred stock holdings held up well while continuing to pump out above average quarterly dividends. **Maytag** (MPY) has risen to a premium above its $25 par value as the merger with Whirlpool moves closer to approval. One exception was **Truststreet** preferred (TSY+A), which saw a price decline of over $2/share. This company is the largest restaurant real estate investment trust (REIT) in the U.S. They manage financial interests in approximately 2,900 restaurants with 450 tenants in 49 states. Burger King, Golden Corral, and Jack In the Box represent 23% of the portfolio. Truststreet was formed earlier this year when CNL properties merged a large part of their operation with U.S. Restaurant Properties. Truststreet owns the land and building and has long-term triple net leases with the operators. The company is profitable and our preferred stock dividend of $1.92/yr. is safe. At the current price, we are earning a 9% yield.

Our closed-end bond funds ended the year with mixed results. The non-leveraged tax-free funds from **Nuveen** (NCA, NXC and NXP) held up well. The story was not the same with the leveraged **Nuveen Preferred and Convertible Fund** (JPC). This fund was hit with year end tax-related selling, but we held on and believe the recent rebound in the share price will stick as the market begins to anticipate the completion of the Fed tightening cycle. The current yield of the fund is 8.2%.

In case we're wrong, and rates continue moving higher, we are hedging our fixed-rate bond holdings with the **Pimco Floating Rate Income Fund** (PFL). The market price of this fund traded down briefly to below $18/sh. in the fourth quarter after being as high as $22/sh. earlier in the year. The net asset value, or NAV, which is the true worth of each share, has remained above $19 since inception. We like to buy when the market price is trading at a discount to the NAV. We noticed insider buying in December, and discovered that Bill Gross, the bond guru at Pimco was buying shares for his own account, so we're in good company. We're getting an 8%+ annual yield paid monthly.

Global High Income (GHI) is a recent addition back into client accounts. We sold this emerging markets bond fund in January 2005 when it was overvalued. We repurchased shares in December at a significantly lower price and will again enjoy the generous monthly payout of approximately 9%. We're back in at a good price and will be well compensated for owning bonds from Argentina, Russia, Qatar, and Brazil.

Domestically, we took advantage of price weakness last year to buy short-term notes from **GMAC**, the giant financing arm of General Motors (GM). While the prices of these have traded down by a couple of points, the GMAC division continues to be profitable, with the parent attempting to sell off a majority stake to an outside buyer. The concern is that the parent company, GM may declare bankruptcy in 2006 or 2007 to address its cost disadvantage to Japanese rivals and to reduce its onerous health-care and pension obligations. But unlike the typical distressed company, GM isn't running out of money. It finished the third quarter with $19 billion of cash and marketable securities. According to *Barron's*, GMAC is likely worth $20 billion or more and will report estimated net income of $2.7 billion for 2005. We admit the long-term situation for GM is not looking good, but we do not believe the struggles at the parent will bring down GMAC and impair our principal and interest payment at maturity.

Schwab eStatements – For clients who are receiving Schwab eConfirms over the internet, you will no longer receive hard copy monthly statements from Schwab after the first quarter of this year. Clients now have the ability to log on to www.schwaballiance.com to view their current statement plus a three year archive. If you would like to discontinue paper statements immediately, you may do so through the statements preferences page on schwaballiance.com. The convenience of electronic delivery helps the environment, reduces paperwork for you, and qualifies you for lower commissions from Schwab. For those who prefer to review a hard copy, you may simply print out the electronic information. If you are not yet enrolled in edelivery and would like to sign up, please notify us and we will forward the necessary paperwork. Technical questions may be directed to the Schwab Alliance Service Team at 800-515-2157.

Income Taxes – For clients with taxable brokerage accounts, we will be mailing your realized gain/loss report prior to January 31. Our report will provide original trade date and cost basis information to be used with the Schwab 1099. These two documents will give you everything necessary to report sales that occurred in your account during 2005. As always, we suggest you defer filing your income taxes until early March to avoid having to amend your return, as Schwab may be required to issue a corrected 1099.

Retirement Planning – Outliving one's resources is a fear many have in the latter stages of life. There are many variables and assumptions that go into a retirement planning analysis: Projecting expenses and income flows, inflation and investment return rates, income from part-time work, which accounts or assets to deplete first, and planning for a long-term care contingency. We are now providing a retirement income analysis for a flat fee of $1,500. A 20% discount is available for existing asset management clients. After a data gathering process, initial spreadsheet projections are prepared on a year-by-year basis over the client's estimated life expectancy. These projections can provide peace of mind by assuring clients that they will not outlive their money.

We value each client relationship and take our fiduciary duty very seriously. Please let us know if there is anything we can do to improve your experience.

Scott Walker
January 10, 2006