February 2006

Dear Client,

Enclosed are the 2005 returns for your account(s). Where applicable three and five-year results are included as well.

Last year the stock market, as measured by the S&P 500, returned 4.88% with dividends. Since the new millennium began, the S&P 500 has generated a compound annual return of -1.10% including dividends. That's not a lot to get excited about. Even money market funds, whose yields hovered around one percent from late in 2001 until late 2004, performed better.

As detailed in last year's letter, our performance over the same period has been very good both on a relative and absolute basis. An account composite covering the same period has returned 59.45% or 8.09% compounded annually (individual results may vary). Also detailed in last year's results was an explanation of our out-performance which largely had to do with avoiding the carnage in the internet stocks and investing in the inexpensive valuations of the then so-called "old economy" stocks (it's been so long ago that the phrase "old economy" itself seems dated).

Our performance last year was mediocre. On average, we were up about 2.34%. We fully expect to do better than the market over extended periods of time, however in the short-term, results are often random. One thing else to keep in mind; our results, like those of the market will not be- despite the fervent wishes of many investors- linear. Stock prices fluctuate, sometimes dramatically.

One interesting feature of the present investment landscape is the reasonably attractive valuations being accorded many of America's leading businesses. Companies such as Coca-Cola, Anheuser-Busch and Johnson & Johnson to name but a few, are trading at levels quite attractive relative to their prospects. These companies and others like them were once the darlings of the investment world. They had good growth records and commanded a premium stock price. Now however, due to a combination of factors mostly centering on the perception of lower growth prospects, the combination of low stock prices and relatively high dividends ought to provide for successful results.

A quick word here about valuations. All of the aforementioned companies were great businesses but poor investments over the past five years. Of the three, only J&J produced a positive return. As Bill Miller of Legg Mason Funds recently pointed out to investors in his fund: “A company that is doing terrifically well, that has great management and high returns on capital, and great products and prospects, may be a terrible investment if the expectations embedded in the current valuation are in excess of those fundamentals.” The flip-side of this is often true as well; while no rational investor seeks out companies with awful products and poor prospects, many factors can lead to a poor short-term results, which in turn, can have big impact on the stock price as investors project these short-term results into the future.

Of course reflexively buying any company’s stock just because it has dropped in price isn’t an effective strategy. Often times the markets’ assessment is correct and the stock price drop is warranted. For example, it would have been a big mistake to purchase the shares of most steel or textile manufactures at any time during the last 40 years believing that a return to earlier profitability lay just around the corner. The real trick to identifying good stock market investments is, again to borrow from Bill Miller, figuring out when “… the market is wrong about how important something is, or wrong about when something occurs, or both.” We feel we can do a pretty job at figuring those things out, but very often that means owning companies who shares are out of favor, mentioned in the business news in an unflattering way, or somehow “controversial”.

One final item to note about the present investment landscape; as mentioned earlier, short-term interest rates which had essentially been stuck at around one percent for the better part of four years have increased dramatically. Risk-free rates of almost five percent can be found on the short end of the yield curve and in the absence of many alternatives, represent pretty good value.

Please feel free to contact us with any questions or comments. As always, thank you for you trust and patience.

Very truly yours,

Eckart A. Weeck
Managing Director