

Market Review and Outlook—March 10, 2006

In our June report we predicted that the Fed would end the steady hikes in overnight interest rates later in 2005. Almost a year later, and we still await the last hike; we are hopeful that the last increase will come very soon. A jobless recovery strengthened in 2005—who cared that it was largely financed by consumers spending the equity in their inflated home prices? Fortunately for the economy, while Americans were trading their savings for more consumption, US corporations were strengthening their balance sheets, sitting on growing piles of cash rather than spending on plants and equipment to add capacity and enhance productivity. This could enable corporations to take the baton from consumers and help carry the economy in 2006 and 2007. Core inflation, which seemed tame this time last year, has increased, significantly when energy is included. Foreigners have been willing to fund the Federal debt (they hold more than half of treasuries maturing from one to ten years), and we do not yet see signs of their appetite weakening. This is one reason that the record deficits and debt has not caused spiraling inflation.

So how have things changed since June? We've seen higher gasoline prices, as hurricanes put further pressures on the shaky energy situation, and the war in Iraq deteriorated with no end in sight. Consumer confidence dropped sharply due to Katrina, but has largely recovered. Housing prices are cooling without collapsing. Incomes and spending by consumers have both seen solid gains. Payrolls have been expanding slowly despite Detroit's woes. Factory expansions have continued to rise, as growing factory orders are leading companies to increase their capacity.

Greenspan's successor, Ben Bernanke, has recently said that the Fed hikes that began in 2002 may have to continue. We will continue to monitor the situation and make timely recommendations, as conditions warrant. For the future, the portfolio strategies outlined in our last Market Review and Outlook are largely reinforced: invest globally, use general bond funds, balance growth and value, adopt a global strategy for large-cap stocks, and be wary of the real estate and energy sectors, where downside risk could be high.

In the past quarter, only pessimistic bear-market funds as a group lost money. Leaders included precious metals funds, Latin American and other emerging market stock funds, and most foreign stock funds. Growth has extended its rebound, leading value investing for the past year, and closing the gap for the past three

The data in the following table comes from Morningstar Principia Pro, and is based on data through 2/28/2006.

Category	3 Months	Past Year	3-Yr Avg	5-Yr Avg	10-Yr Avg
Money Market—Taxable	+0.88%	+2.77%	+1.40%	+1.74%	+3.43%
Intermediate Term Bond	+1.20%	+2.13%	+3.21%	+4.83%	+5.56%
Intermediate Muni Bond	+1.34%	+2.42%	+2.82%	+4.28%	+4.66%
Large-Cap Core Stock	+3.48%	+9.06%	+16.80%	+2.18%	+7.94%
Mid-Cap Core	+5.55%	+13.85%	+23.97%	+9.51%	+11.85%
Small-Cap Core	+7.47%	+15.34%	+27.31%	+11.73%	+11.64%
International Stock	+11.41%	+18.52%	+26.59%	+5.70%	+6.73%
Real Estate	+9.47%	+27.58%	+30.14%	+20.81%	+15.51%
Natural Resources	+6.43%	+24.29%	+33.52%	+17.50%	+14.65%
Science/Technology	+5.28%	+18.17%	+21.78%	-4.24%	+6.62%
Multi-Cap Growth	+5.66%	+15.25%	+21.19%	+2.95%	+8.00%
Multi-Cap Value	+5.29%	+11.29%	+23.55%	+9.83%	+12.88%
Balanced	+2.87%	+6.73%	+11.94%	+3.86%	+7.09%

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