

July 5, 2006



## INVESTMENT STRATEGY OVERVIEW

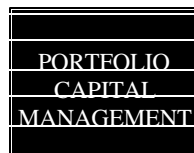
The stock market has been in a correction for most of the second quarter, with the worst declines occurring in the month of May. The correction has eliminated most of the advance experienced in the first quarter.

	<u>Value</u>	<u>June</u>	<u>3 Months</u>	<u>2006 YTD</u>
DJIA	11150.20	-0.2%	0.4%	4.0%
S&P 500	1270.20	0.0%	-1.9%	1.8%
NASDAQ Comp.	2172.09	-0.3%	-7.2%	-1.5%
Value Line 1700	423.11	-1.0%	-5.3%	2.6%
Russell 2000	724.67	0.5%	-5.3%	7.6%

Investors expressed much enthusiasm for stocks in the first quarter seemingly to ignore the risks of higher inflation and slower growth. The attitude of investors changed sharply in the second quarter as concerns about inflation and economic growth surfaced and triggered selling by investors. In a matter of weeks the outlook has become more clouded and uncertain. Part of this nervousness by investors was fueled by hawkish comments made by Federal Reserve Chairman Bernanke. In public comments he indicated inflation may be higher than the Fed would prefer, and the market concluded higher interest rates would follow as additional Fed tightening was likely. During the remaining weeks of the quarter Bernanke and other Fed Board members tried to calm the markets, however, the direction of interest rates and economic growth remain in question.

In our last strategy report we discussed the mixed economic reports concerning the future direction of the economy. The past quarter has put into clearer focus the direction of the economy and inflation. Leading indicators are clearly pointing to a slow down in growth, while the inflation indicators point to both the CPI and PPI above levels desired by the Federal Reserve and the markets. Consumer spending will slow and higher interest rates will cool the housing market. Recent reports have showed housing remains positive, but definitely slowing. A recent report in Barron's and other publications have documented the weakness in resort and second home sales. We anticipate the weakness in home sales will depend more on the local economic conditions, rather than the national trends.

The drivers for economic growth are switching from housing and consumer spending to business fixed investment. The former have started to slow, while non-defense capital goods remain robust. Aircraft orders have been strong and spending on plant and equipment should grow at a 10% rate in the second quarter. These indicators point to continued economic growth well into next year. This should help support employment and productivity improvements.



## Stock Market Outlook/Strategy

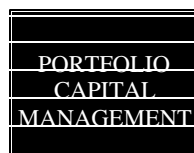
The market returns in the second quarter were negative; as the S&P 500 declined 1.9%, while the Russell 2000, a small capitalization index fell 5.3%. The decline was worldwide as the foreign markets fell in the second quarter with the emerging markets suffering the largest declines. We have felt that a 7-8% level of appreciation was probable for 2006, with large capitalization higher quality stocks leading the way. We are confident the market will return to quality, however, the improvement in share prices will likely be delayed until late in the year. The magnitude of the correction will limit the potential for the market over the summer months. While we may see a brief rally in July, the market is more likely to remain in a narrow trading range over the summer. Until market participants become more confident in the economic and interest rate outlook, more investors will remain on the sidelines.

We continue to believe valuation levels for large companies are the most compelling when compared to other sectors of the market. The S&P 500 index is selling at 15.5 price/earnings ratio (P/E) on trailing earnings. In contrast the Russell 2000 is selling at 26.2 P/E on trailing earnings. We believe there is more risk than reward in many smaller stocks at this time and discipline and patience is required when choosing stocks or mutual funds that invest in this sector. In the current environment larger stocks offer significantly higher rewards with far less risk.

Investors are well served by buying quality stocks and holding them for a long period. However, there are times when the lowest quality stocks have their day in the sun. So far this year and for the past 12 months, the sun has been shining in the land of the low-quality stocks. Please note that high quality stocks have significantly lagged in returns compared to lower quality stocks. Through May 31, 2006, "A" rated stocks in the S&P 500 increased 0.3%, "B" rated stocks increased 2.5%, and "C" and "D" rated stocks increased 8.5%. Our investment portfolios have an average quality rating of "A-". It is important to remember that during the March 15, 2000 to March 15, 2003 bear market, the reverse occurred. Stocks rated "A" for quality *rose* an average of 16.1%, while those rated "C" or "D" *declined* an average of 64.0%. We believe we may have had an inflection point in late May and early June as investors sought safety during the volatile markets.

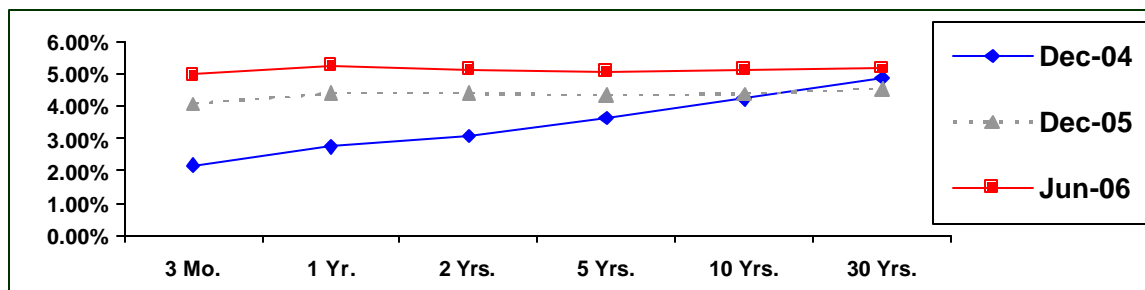
During the second quarter we made several changes to the portfolios. The stocks that were sold from the portfolios were AT&T, Dell Computer, L-3 Communications, Synovus Financial and United Health Group. We added to existing positions in Chesapeake Energy, and added new positions in Florida Rock, Genworth Financial and Wyeth. Our purchases were concentrated in economic sectors we view constructively such as energy, materials, financial services and healthcare. With our view of a narrow trading range market we anticipate the cash levels may be moderately higher than normal. The strategy will enable us to take advantage of attractive new opportunities in the coming months. We feel our portfolios are better positioned today than they were at the end of 2005 to take advantage of the investment opportunities we perceive for the remainder of 2006 and beyond.

We have been very pleased with our relative performance on a long term basis, although our performance this year and over the last one year basis is currently lagging the benchmark. We believe our focus on high quality, well managed companies, with competitive products, and growing revenues will translate into superior investment returns going forward. We remain committed to our investment style of value investing in growing companies. This strategy has proven itself over the last 20+ years and we feel as strongly as ever that it will continue to do so in the future.



## Fixed Income Outlook

The Federal Reserve has increased short term interest rates seventeen consecutive times and the Federal Funds rate is currently at 5.25%. Reading into the statement release from the Fed, we believe the future direction of interest rates is more dependent on future economic indicators, In fact, the initial reaction to the last increase on June 29<sup>th</sup>, was the perception the Fed will pause at their August meeting.



	<u>12/31/04</u>	<u>12/31/05</u>	<u>06/30/06</u>	<u>2006 Change</u>
3 Mos.	2.18%	4.08%	4.98%	+0.90%
1 Yr.	2.74%	4.40%	5.28%	+0.88%
2 Yrs.	3.08%	4.40%	5.15%	+0.75%
5 Yrs.	3.63%	4.35%	5.09%	+0.74%
10 Yrs.	4.25%	4.39%	5.14%	+0.75%
30 Yrs.	4.87%	4.54%	5.19%	+0.65%

The yield curve shown above has remained practically flat although yields across the board have continued to rise as they have increased approximately 70-90bps this year. For the first time rates across the curve moved higher as bond investors became more nervous concerning inflation and the dollar. The change in the yield curve also reflects investors' reaction to public statements by the Federal Reserve Chairman. We had forecast in our last report the yield on the 10 year Treasury could reach 5.25% by the end of 2006. We are close to that level and believe any further increase in rates will be modest.

In our last report we indicated the five to seven year maturity range was the most attractive and we selectively made fixed income purchases in this range. The current structure of the yield curve and our interest rate outlook has once again made the two to three year maturity range the most attractive. If interest rates rise sufficiently from current levels we will selectively add to longer maturities..

