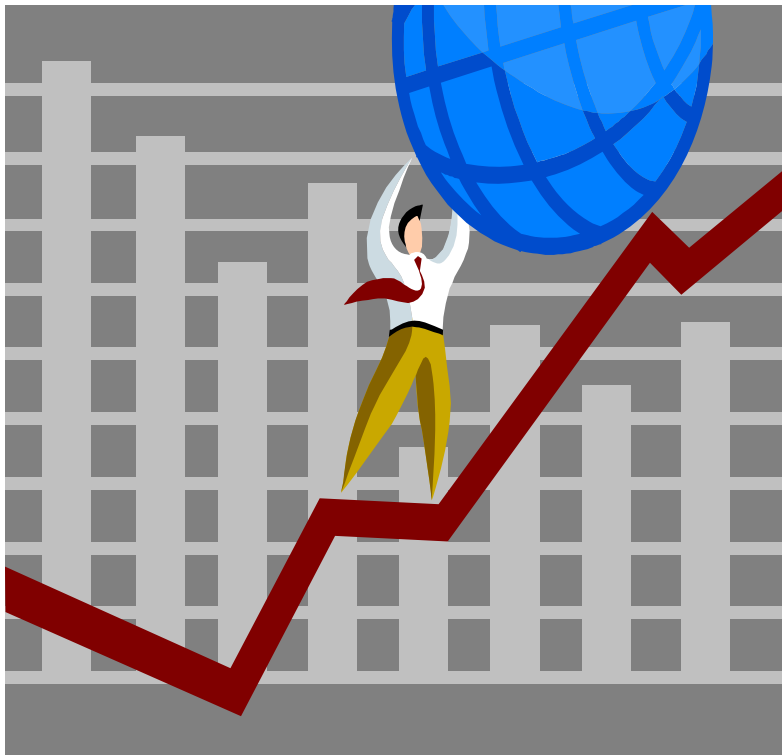


Fast Out of the Gates 2005 Review & 2006 Forecast

2005 Q4 Quarterly Commentary



Robert W. Henkel
Chief Investment Officer
bhenkel@weyland.com

Fast Out of the Gates

2006 commenced with an electrifying start, with global markets reacting to the Federal Open Market Committee's December minutes. In the minutes, the Fed was the least "hawkish" it had been since the tightening phase began back in June 2004. In the meeting Fed staff economists forecasted slowing, yet solid growth for the United States in 2006 while committee members' concern of inflation eased. Going forward, the Fed committee members noted that further tightenings would not be automatic, but "would depend to an increased extent on the implications of incoming economic data for future growth and inflation." Translation: they'll call it as they see it, but they're not as worried as they used to be.

Markets took off, with the S&P 500 gaining 3.5%, other markets even more, in just the first eight trading days. And that's because the combination of slowing, yet solid growth, and benign inflationary pressures is the recipe for Goldilocks' porridge. The last time a Goldilocks economic cycle began in the US was in 1995, the first great year of the last bull market, and a year when the S&P 500 rose 37.5%. No surprise investors were suddenly bullish. A note aside: Had these minutes been announced in December, 2005 would have gone down in US stock market history as a solid year rather than a tepid one. Anyway, 2005's loss is 2006's gain, at least for most of January.

So with the Fed seemingly a bit more relaxed, what could go wrong?

Tehran-osaurus Rex

Tehran seems to be on the warpath. The reports we have received indicate that Iran's strategy is likely to gain prestige in the Islamic world through bellicose words and actions, with breaking the UN seals on their nuclear facilities being a key example. The unfortunate bit is that from the Iranian leadership perspective it is likely that there is little downside to their strategy. If they acquire a nuclear device they win militarily. If the US or, less likely, Israel mounts an attack to take out the production facilities, Iran, it is argued, wins politically among the Muslim people.

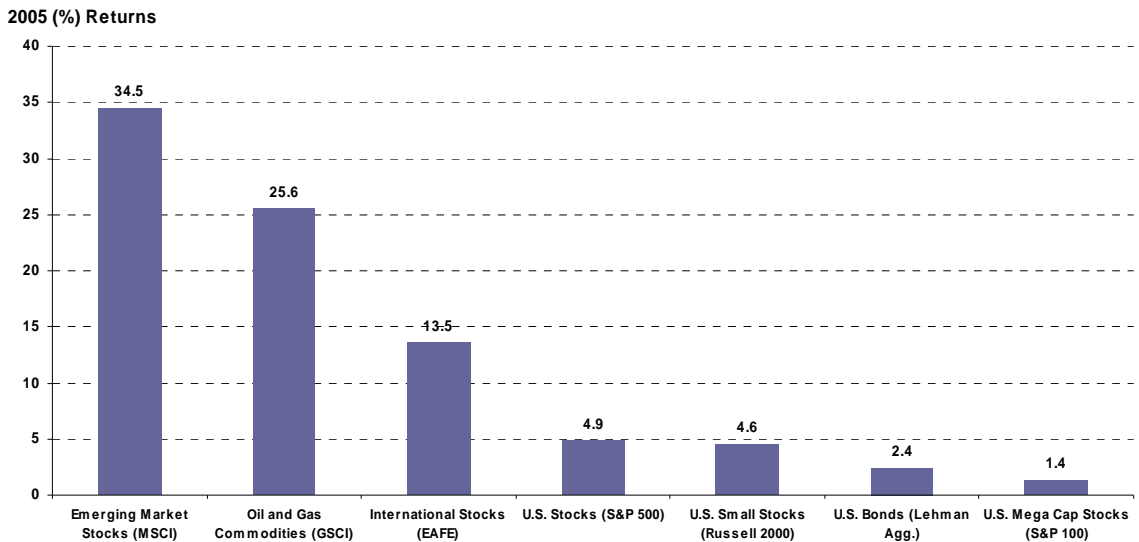
From a markets perspective, the good news is that US markets valuation is 30% less (on a forward earnings basis) than it was before September 11, 2001. This gives us some cushion. Another bit of news which we would classify as of the "not too bad" variety is that there is a big difference between developing a nuclear "device" and a nuclear "weapon". What this means is that Iran is likely still years away from becoming a true nuclear threat. That buys the world some time.

The Iran drama could play out in many ways: some bad, some not so bad. As it does, we will be watching it very closely.

Review of 2005

What follows is our end of year research note that reviewed the results of 2005 and our outlook on 2006. It is important to understand that these are our going-in strategies and, as events unfold, any of these may be tweaked.

2005 Asset Class Returns



Key Investment Themes of 2005

- Emerging markets and commodities were the clear winners in 2005.
- International stocks beat domestic stocks, despite significant double digit currency losses of approximately 14%.
- Small cap stocks underperformed large cap stocks – the first time in five years that small stocks have not been the winner.
- The clear laggards of the year were the largest stocks in the U.S. market, the mega caps, which barely managed to stay in positive territory.
- Fixed Income was a dead asset class, with returns just above the flat line.

2005 Market Return Detail

U.S. Sector	% Return
Oil & Gas Index	34.1
Utilities Index	15.4
Transportation	11.7
Real Estate Index	9.6
Health Care Index	8.3
Financials Index	6.5
Basic Materials	5.0
Total U.S. Market - S&P 500	4.9
Industrials Index	4.8
Financial Services Index	4.1
Technology Index	3.3
Consumer Goods	2.0
Consumer Services	-1.9
Telecommunications Index	-4.0

The energy sector was again the big winner in 2005, with stocks outperforming physical oil and gas commodities by about 10%. Despite the headlines confronting the healthcare sector, the segment outperformed the broad market.

U.S. Style: Growth vs Value	% Return
Mid Cap Growth	13.6
Mid Cap Value	11.5
Large Cap Value	7.1
Large Cap Growth	5.3
Small Cap Value	4.7
Small Cap Growth	4.2

Style was a non-factor in 2005, with value maintaining a slight edge.

U.S. Size	% Return
Mid Cap	12.6
Large Cap	4.9
Small Cap	4.6
Mega Cap	1.4

The market continued to dislike the largest 100 companies in the U.S., and instead favored smaller mid-cap companies.

Fixed Income	% Return
20+ Year Treasury	8.6
U.S. Treasury Inflation Notes	2.8
7-10 Year Treasury	2.4
U.S. Aggregate	2.4
1-3 Year Treasury	1.6
Corporate Bonds	0.8

Fixed income was essentially a dead asset class in 2005 with the narrow exception of long-term treasuries. Investors were better off investing their assets in money market accounts than investing in the broader asset class.

Major Global Markets	% Return
Emerging Markets	34.5
Japan	25.5
International Total (EAFE)	13.5
Germany	9.9
France	9.9
United Kingdom	7.4
Total U.S. Market - S&P 500	4.9

International stocks outperformed US stocks by approximately 800bp. The US dollar strengthened considerably against all major currencies and was a major detractor from international stock returns in 2005. EAFE International Index returns were reduced a full 15% as a result of currency effects.

Global Markets	% Return
South Korea	57.0
Brazil	56.5
Mexico	49.1
South Africa	28.3
Canada	28.3
Austria	24.6
Switzerland	16.3
Australia	16.0
Singapore	14.4
Taiwan	6.4
Spain	4.4
Malaysia	2.3
Italy	1.9

The country leaders in 2005 were those that had significant exposure to commodities.

2006 Forecast

- US stocks should enjoy strong returns and outperform bonds for the fourth straight year. Positives include a pause in the interest rate cycle, increased corporate share buy-backs and dividends, and a lower expected dollar (which will promote export/manufacturing activity).
- The secular bull story for energy and energy stocks will continue as a result of continued global economic strength and tight supply. Energy stocks should continue to outperform the S&P 500, as their share of S&P 500 profits will again exceed their relative market cap.
- Fixed income will deliver tepid absolute and relative performance. The short end of the curve will outperform the long end of the market. The yield curve will steepen, though it will continue to be relatively flat.
- Large stocks should outperform small stocks, as quality stocks at reasonable valuations take center stage. Large multinationals will be in a position to take advantage of a cheaper dollar abroad.
- The U.S. dollar will weaken against the major world currencies. We believe the secular bear case against the dollar is intact as a result of the substantial current and trade account deficits the U.S. is running. International currencies will look increasingly attractive as the U.S. slows its interest rate increase campaign, while countries abroad tighten.
- International stocks will continue to outperform US stocks, but mostly as a result of currency translation.
- Japanese equities will outperform the international EAFE index, as structural changes in consumer and corporate behavior continue.
- Gold and gold shares should continue their bull run as the dollar-weakness story gains traction again and as hedge funds continue to build positions on momentum.
- As in any year, surprises are bound to occur. Who would have predicted Katrina last year? It is our opinion that 2006 could provide markets significant volatility with a resurgence in geopolitical concerns.

Bob Henkel
Chief Investment Officer

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