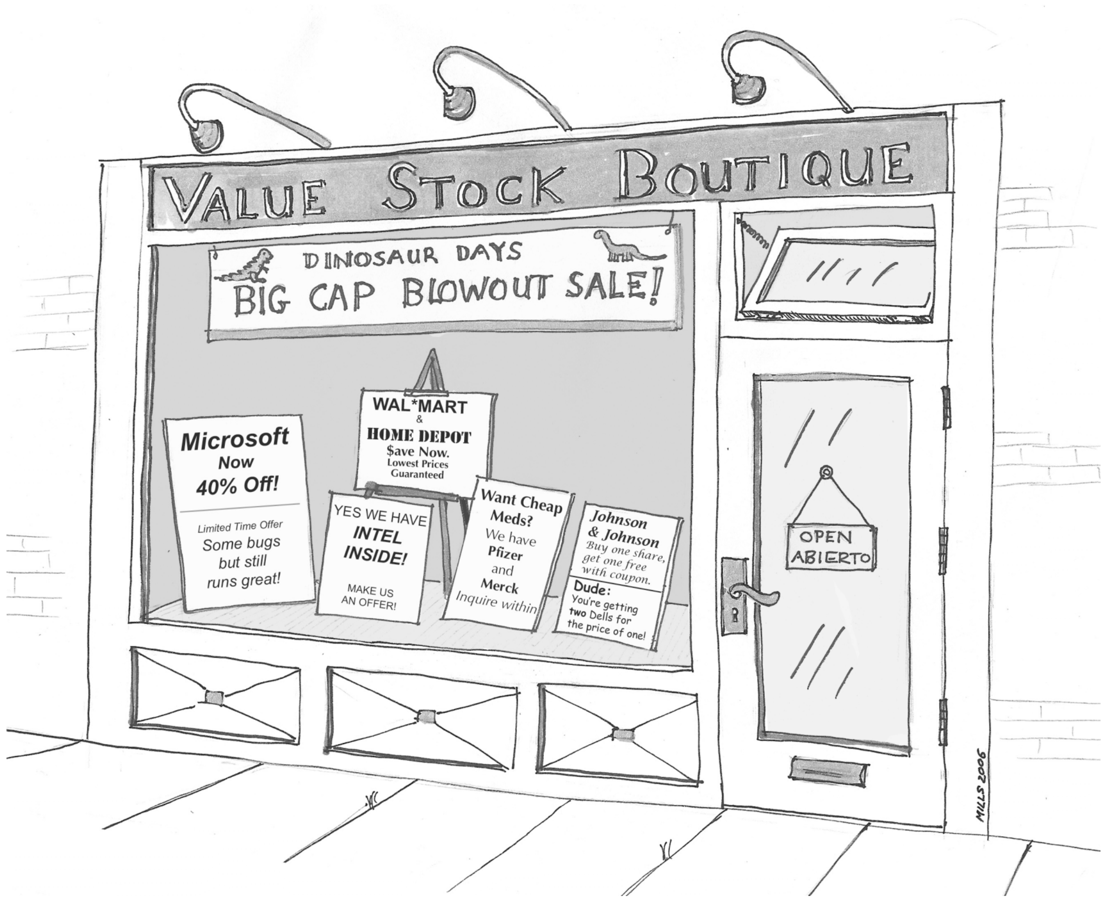

Commentary

Second Quarter, 2006

Sleeping Giants

After a robust start to the year the broad market gave back most of its earlier gains ending the first half of the year up 1.8%. The technology heavy NASDAQ faired worse, declining 1.5% year-to-date, while the small-cap driven Russell 2000 finished the first half up 7.6%.

Many of the things that worked best earlier in the year such as energy, commodity and emerging markets funds turned ugly in the second quarter sending investors running for the exits.

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One area that has had a particularly tough time gaining respect of late and which to us is very interesting is in the realm of the very largest capitalization stocks, which, despite their fortress-like balance sheets and competitive positioning, are perceived as dead money. We think that a number of them are sleeping giants and offer compelling value and opportunity.

Wait and Flee?

Against an all-too-familiar backdrop of geopolitical concerns, investors seem focused on two primary economic concerns: inflation and interest rates.

Watching the Federal Reserve and divining the regular pronouncements of new Fed Chairman Ben Bernanke has become national obsession, almost eclipsing World Cup soccer as a spectator sport. The major question that most people have on their mind is what to do now? Where should they be investing?

Without a clear sense that the inflationary beast has been tamed, the economy is slowing, and the Fed is nearly done raising short-term interest rates, investors are taking a wait and see, if not a wait and flee attitude towards stocks.

Our near-term view remains that U.S. economic growth is moderating, inflation is fairly tame, and that the Federal Reserve is nearly done raising rates for the time being.

Our longer term view remains that inflationary forces and long-term interest rates are on the rise as a result of forces beyond the Federal Reserve's control: global growth and competition for raw materials as well as U.S. indebtedness and competition for capital.

Slowing growth and higher interest rates are not in and of themselves fatal. Inflation and interest rates are still relatively low on an absolute and historical basis and serve as a brake rather than a barrier to new investment. Even against a secular backdrop of greater competition for raw materials and capital the U.S. economy is well positioned to participate in global growth, the scale of which will be enormous over the coming decade.

These forces do make for a more challenging investment environment as investors look for opportunity in the face of slowing domestic growth and declining valuation multiples on earnings. These conditions make more highly valued stocks especially vulnerable to correction on any disappointment. Valuation relative to growth should become a critical factor for success going forward.

Which brings us back to the sleeping giants.

Although small and mid-capitalization stocks have enjoyed several years of strong performance, some of the very largest of the large stocks, including a number of former growth glamour stocks of the late1990s have fallen out-of-favor and are selling at historically cheap valuations.

Today, companies like Microsoft, Cisco, Dell, Intel, Wal*Mart, Home Depot, Pfizer, and Merck, are considered to be slow-growing behemoths, fraught with problems and challenges and too big to get out of their own way. They lack clear and present exposure to the oil patch, commodities or emerging markets, and a perceived ability to grow rapidly unlike their smaller brethren.

Some of these concerns are well founded, but are also more than fully reflected in the valuations of the companies. And some of these concerns reflect the normal cycle of investor sentiment as it shifts between large and small. This cycle has repeated itself many times over the decades.

Often, what are seen as character flaws today may be perceived as virtues tomorrow.

We find at least three virtues in a number of these companies. First, they are cash-rich competitive powerhouses with well-established market positions in growing markets. Second, despite slow top and bottom line growth, they stand to benefit handsomely from global growth. New consumers in developing economies will buy computers and software, use the Internet, require healthcare and pharmaceuticals, and shop for branded consumer products. It isn't every decade that a few hundred million new customers move in next door. Third, they offer compelling value, selling at historically low multiples to earnings and sales. In our view, they have less downside even as the market multiple contracts and are a safe harbor in stormy seas, offer potential for improvement and future appreciation, and represent one of the cheapest ways to invest in the emerging markets.

We therefore favor overweighting client portfolios towards very large-capitalization multi-national companies, especially in the realm of technology, healthcare and consumer products. We would also continue to overweight non-U.S. exposure. We would underweight small and mid-capitalization exposure, especially to growth stocks, which we think are most vulnerable to a contraction in market valuation levels.

Jurika, Mills & Keifer
June 30, 2006

Opinions expressed are those of the adviser and are subject to change, are not guaranteed and are not recommendations to buy or sell any security.