

## Financial & Investment Management Advisors, Inc.

Registered Investment Advisor

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*1 out of every 13 households in the USA has a net worth (including real estate) of at least \$1 million (source: Census Bureau, Barron's).*

*10% of American families control 70% of the nation's total net worth. To be ranked in the top 10% requires at least \$832,000 of net worth. To be ranked in the top 10% of family income requires annual earnings of at least \$129,400 (source: Federal Reserve).*

*The NASDAQ Composite index is a cap-weighted index, allowing the largest capitalized stocks to have the greatest influence on its return. Even though over 3,000 stocks make up the NASDAQ, just 3 stocks drive 20% of the return of the 35-year old index (source: NASDAQ).*

*OPEC's anticipated revenues during 2006 from the oil it exports to the rest of the world are \$522 billion or \$1 million a minute for the entire year (source: DOE, Financial Times).*

*The cost of living in the USA increased +25% in the decade of the 50s, +28% in the 60s, +103% in the 70s, +64% in the 80s and +33% in the 90s (source: Department of Labor).*

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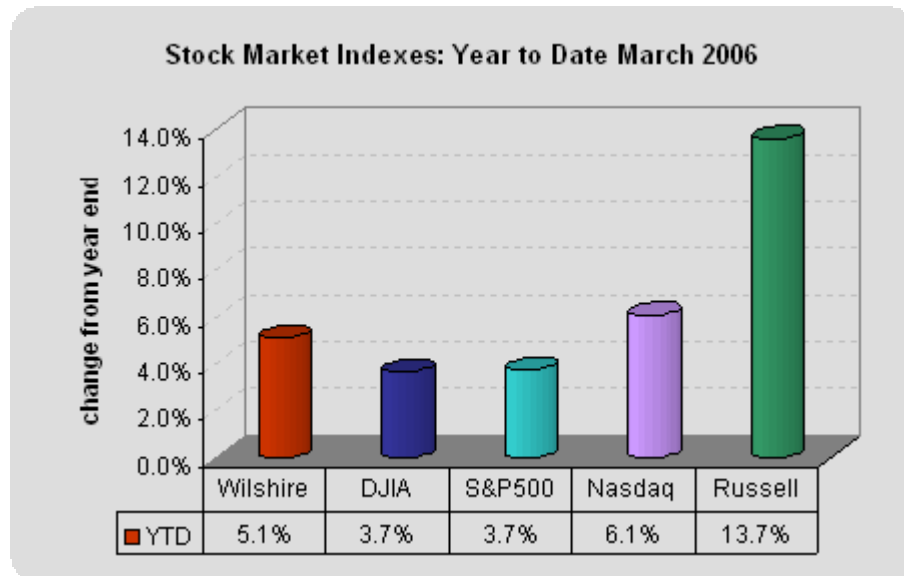
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## 1st QUARTER 2006 INVESTMENT PERFORMANCE REPORTING

Dear Clients and Friends;

I'm very happy to enclose your 1st quarter 2006 investment performance for the period beginning January 1, 2006 and ending on March 31, 2006.

Despite seemingly daily new highs in the price of oil, the recently completed 1<sup>st</sup> quarter of 2006 was generally a very good one for U.S. stocks as our economy continued to grow at a measured pace. A quick



glance at the major market barometers reveal that both the 30 Dow Industrials and S&P 500 made substantial advances of about 3.7%, while the NASDAQ Composite pushed ahead 6.1%, its largest quarterly gain since 2000. The small cap sector is outperforming the rest of the market by a wide margin with the Russell 2000 up 13.7% from year-end levels<sup>1</sup>.

Small caps and mid-caps outperformed large caps, while international stocks outpaced their domestic counterparts. Both of these are familiar patterns. Bonds were weak, as they continued to feel the effects of the Federal Reserve's multiple rate increases for the second straight quarter, though high-yield and emerging-markets bonds continued their multiyear runs.

The smaller the market cap, the better the performance for the first quarter of 2006. Interestingly, growth outperformed value in both mid and small-cap ranges, perhaps signaling a rotation toward growth and away from value. Small-growth and mid-growth have outperformed their value counterparts for the past year now. Large caps brought up the rear, and in their case, there has been no rotation from value to growth<sup>2</sup>.

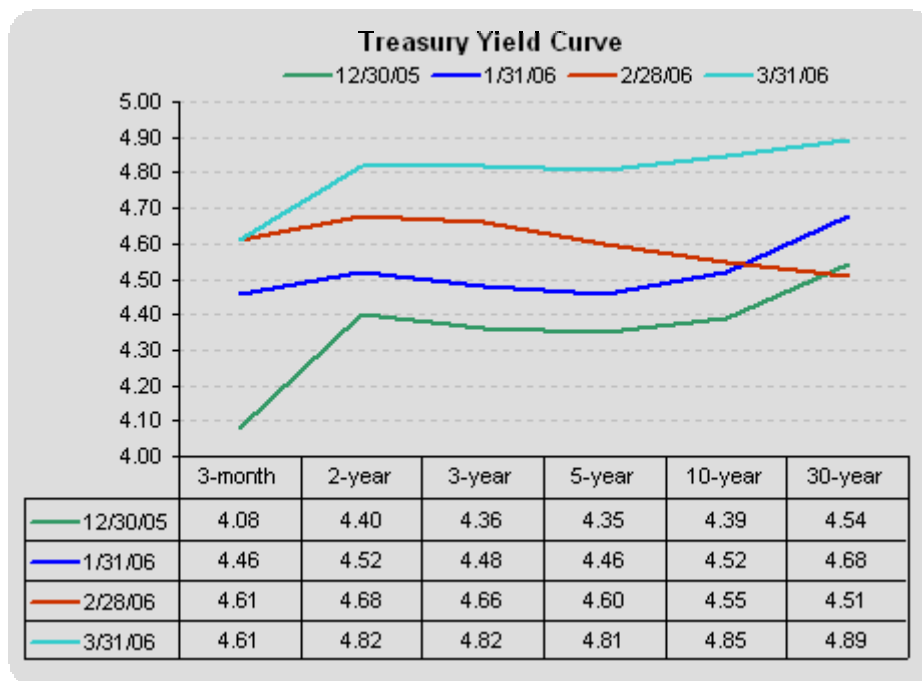
International funds generally outpaced domestic funds again this quarter, continuing another seemingly familiar trend. Fund inflows dramatically increased into international funds during the quarter according to the Investment Company Institute. Other continuing positive performance trends were in the specialized areas of real estate and natural resources, predominately influenced by the price of oil and gas.

MorningStar analysts view the money flow into international funds with mixed feelings. On the one hand, they are happy to see U.S. investors gaining exposure to international markets and adding another element of diversification to their portfolios. On the other hand, they are worried that short-term "performance-chasing" represents a significant portion of assets moving into international funds now. According to MorningStar, they encourage investors to maintain international exposure as part of their long-term asset-allocation plans, as a means to increase returns and damp the volatility of their portfolios over the longer haul.

## Bonds

As widely anticipated, the Federal Reserve increased the fed funds rate target by 25 basis points on March 28 to 4.75%. The post-FOMC meeting statement seemed to disappoint bond investors, not because it was so different from the January 31 statement, but because it was so similar. In both cases, the statement ended with the following paragraph:

"The Committee judges that some further policy firming may be needed to keep the risks to the attainment of both sustainable economic growth and price stability roughly in balance. In any event, the Committee will respond to changes in economic prospects as needed to foster these objectives."



Since "some further policy firming may be needed" was kept in the statement, it suggests that the Fed has not ended its rate raising cycle. In reality, anything can happen between now and May 10 that could cause the Fed to change its mind - and stop raising rates.

One can certainly still call the yield curve flat - notice the closing yields for the 2-year, 3-year and 5-year notes. But at least the long end has picked up a bit, and the shape of the curve is slightly sloping

upwards. Indeed, the biggest change in yields between February and March were at the long end of the curve<sup>3</sup>.

Generally speaking our managed portfolios did well during the quarter, with returns comparing very favorably with the major domestic indexes with generally. Exceptions might be due to timing of investment cash flows during the quarter. Our portfolios, while generally being broadly diversified, have had investment exposure to small caps, mid caps, international, natural resources and real estate.

Some of the same worries of last year spilled over and continued on in the 1<sup>st</sup> quarter. Fear of rising interest rates, cooling housing market, the War in Iraq, threat of a terror attack, threat of nuclear Iran, rapidly increasing energy prices, and worry about rising inflation all plagued investors, as the mainstream news media continued its habitual negative news reporting. Meanwhile, I consistently advised that you not to listen to the mainstream media noise and stay the course, as economic conditions were good and market valuations were historically favorable.

There will always be something missing in the one-way dissemination of information as practiced by newspapers, magazines, books, television, radio, and even newsletters and public financial seminars. Educating the public—especially if there's an agenda beyond pure truth telling—is very different from counseling clients. With the former, you are simply putting the information out there. With the latter, you are

sharing the client's interest in the outcome, as we do with you. It's one thing for a magazine to report back a year later and say, "Oops, some of our stock picks were dogs—and don't you admire us for admitting it?" It's quite another to face a client whose portfolio has gone south and who must now pick up the pieces.

Here are four reasons why you should be skeptical of the media's financial advice.

**1. The media succumbs to the siren song of statistics.** Journalists are generally looking for statistical averages; they're just trying to give an overview of the big picture. If some study shows that 70% of actively managed mutual funds fail to beat their benchmark, to them the implication is clear: you'd have to be an idiot to buy an actively managed mutual fund.

But thinking in such generalities overlooks the fact that investing is always an individual endeavor. Just because most fund managers fail to beat the averages doesn't mean that it's not worthwhile to seek out those truly talented managers who are in the minority, as we do. Journalists have to deal in generalities because they are writing for a large audience. The mistake readers make is assuming those generalities apply to them.

**2. The media encourages flawed extrapolation.** Everyone knows or should know past performance is not indicative or a guarantee of future success. But extrapolation comes so naturally. If it's reported that XYZ fund averaged 15% for the past five years, that number sticks in readers' heads; they naturally go on to assume the fund will continue to earn 15% in the future, even when they know better. Extrapolation is often done unconsciously; we all do it at times, assuming a top-performing manager will keep doing well or a company with a good dividend-paying record will keep raising dividends. Some extrapolations are valid; others are not.

The financial media encourages extrapolation. The tech bubble was an extreme example of this as people assumed stock prices would keep going up just because they had in the past. Because extrapolation is so easy—just look at what's happening and assume it will continue—it prevents people from doing the hard work of examining fundamentals to see if changes are on the horizon. As advisors, we have difficulty reeducating clients whose assumptions are based on extrapolation, whether conscious or not.

**3. The media oversimplifies.** In order to hold people's attention, financial articles can't be too complicated. So they rarely delve deep enough to cover all the issues a client must consider when deciding on a course of action. Clients who believe they can choose the right type of retirement plan or design a complete investment portfolio after reading a few articles on the subject will be tackling a complicated task without sufficient information.

Peter Bernstein, author of *Against the Gods: The Remarkable Story of Risk*, has said that the public has gotten the impression that investing is easy, even if they're not quite sure how to do it. He himself, at age 85 and with decades of investing experience behind him, says he still hasn't figured it all out. But the difference is that he knows there's more to it.

Clients who read simplified articles in the financial press or the do it yourself advertisements of online trading firms are led to believe anyone can become a successful investor by merely following "these six easy steps." What they don't understand is it's really not that easy, even the most experienced professionals can sometimes get it wrong.

**4. The media doesn't give follow-up advice.** Perhaps the biggest cause of trouble for clients who follow media recommendations is that there's no follow-up other than the obligatory "Oops, we blew it!" admissions a year or more later. Clients need to understand that investments require ongoing management. If they're going to rely on magazines to tell them what to buy, they must realize they'll be on

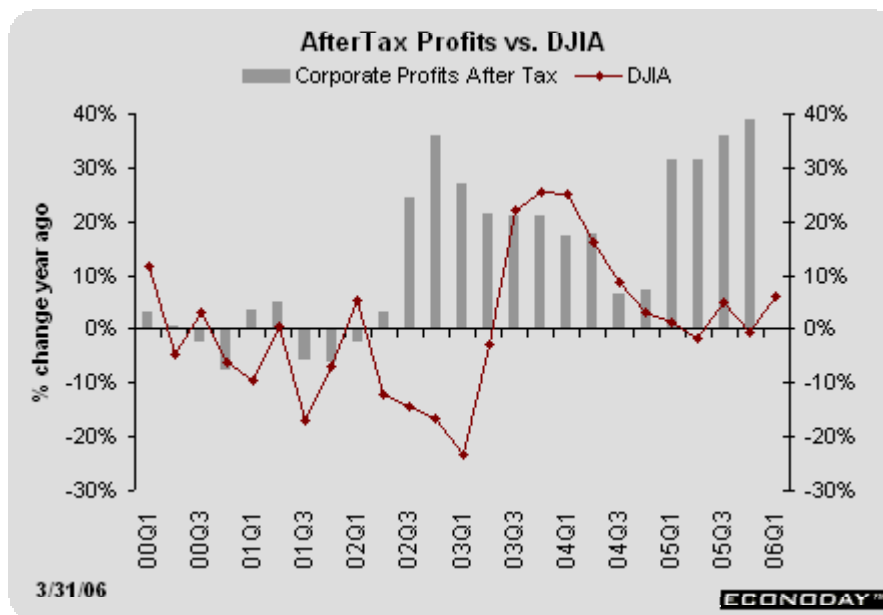
their own when it comes to deciding when to sell. You ever notice how the covers of some of those magazine publications always seem to have those bold eye-catching headlines like, "The Top Ten Funds to Own Today!" Doesn't seem peculiar to you when the following month there's an entirely new headline and list of funds contains only two of the ten funds from the previous month and the rest are all new.

Everyone assumes journalists are objective because they are trained to present both sides of a story. But people who rely on the media for financial advice could be making a big mistake.

While many people believe they can act on general advice, we always recommend that we give you specific recommendations tailored to your individual circumstances. As an asset management client, we are in a position to make changes for you in situations requiring a change in strategy.

## Peering Into the Future

Regardless of what you may be hearing or reading in the media, the future of the economy looks bright at this point and time. While it's true there are still many significant worries and concerns, the economy now appears to be healthy and resilient. A good economy generally indicates a good environment for businesses and corporations to make money. Strong corporate profits and earnings ultimately drive the direction of the markets. I don't need to discuss further the worries and concerns as the media has most likely made you intensely aware of them. However, I will mention what's going well, as the pundits rarely mention this.



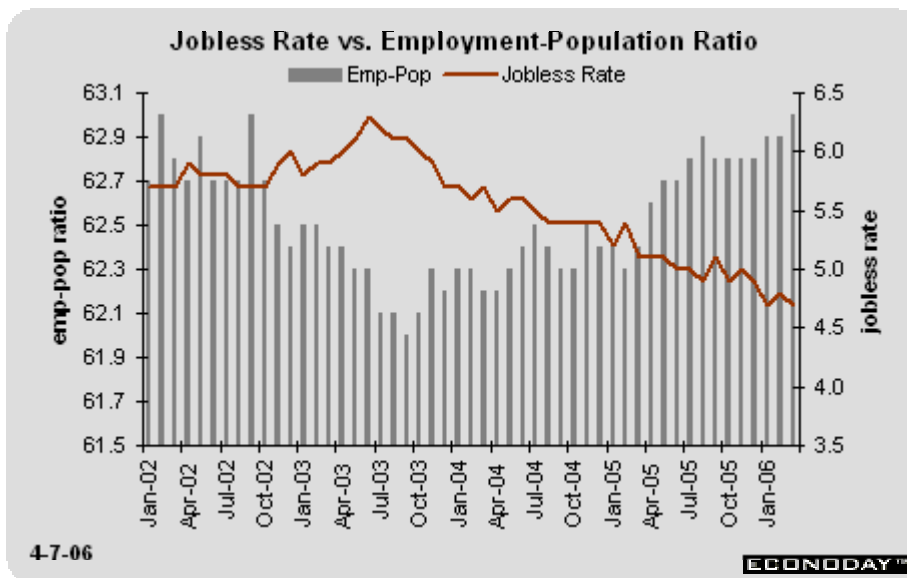
According to the U. S. Commerce Department, after tax corporate profits increased 11.7% from the third quarter and are up a whopping 38.7% from year ago levels. Over the past year, profit gains have been healthy, particularly after a slower growth period in 2004. Interesting to note, stock prices have not increased commensurately with profit growth. Profits have posted year-over-year gains for 15 straight quarters, but the same cannot be said for

the equity market, although 2006 is beginning on a relatively healthy note since stock prices are up on the year - and the quarter.



The economy is growing at a healthy pace. Gross Domestic Product (GDP), a measure of goods and services produced in our country, rose in line with expectations with a 4.8% boost the first quarter. The 4.8% rate is the fastest since the 7.2% jump in the third quarter of 2003 and reflects in part a rebound in motor vehicle sales. Excluding motor vehicle production, GDP rose a robust 5.2% versus 2.4% in the prior quarter<sup>4</sup>. The Commerce

Department's final estimate showed that real GDP expanded at a sluggish 1.7% rate in the fourth quarter of 2005 with weakness in consumption expenditures and investment spending.



More people are working. Since employment hit its low point in August 2003, the economy has added almost 5 million new jobs. Nonfarm payrolls increased 211,000 in March after downward revised gains of 225,000 in February and 154,000 in January<sup>5</sup>. Even with the downward revision to previous months' figures, the overall trend in payroll growth is decent these days running at roughly 200,000 over the past three months. The civilian

unemployment rate edged down to 4.7% in March from 4.8% in February.

In his annual economic report presented to Congress on 2/13/06, President Bush projected that the nation will create +2.1 million new jobs in 2006 or +176,000 new jobs each month. American employers hired +1.9 million new workers in 2005<sup>6</sup>. Contrary to popular opinion (and the media), the jobs added have been good jobs with the strongest gains being seen in medical care, education, financial services, and various technical services. Retail has actually added jobs a little slower than average, while manufacturing has actually lost jobs. What's interesting is that the industries that have seen the strongest wage gains in the past two and a half years also pay slightly above average wages. Measured by pay, the quality of jobs has actually been rising.

## *The End of Fed Rate Increases May Be Near*

The new Fed Chairman, Ben Bernanke said that the Fed might need to pause, even if inflation remains a threat, to allow more time to get a true picture of the economy. "There is ... the possibility that if there is sufficient uncertainty, that we may chose to pause, simply to gain more information to learn better what the true risks are and how the economy is actually evolving," Bernanke told the congressional Joint Economic Committee in his recent testimony. Nonetheless, Bernanke stressed that a pause might not signal the end of rate hikes. "Of course, a decision to take no action at a particular meeting does not preclude action at subsequent meetings," Bernanke stated.

The Fed has been hiking rates for almost two years, bringing the Fed funds rate back up to 4.75% from a 40-year low of 1% in 2004 with rate hikes at 15 straight meetings, by far the longest consecutive streak in Fed history.

The incessant hikes in interest rates by the Fed has caused many, including some Federal Open Market Committee (FOMC) members, to be concerned that raising rates too much could throw a monkey wrench into the economic growth and potentially cause an unintended recession.

The yield on the 2-year Treasury note has exceeded the yield on the 10-year Treasury note for 23 consecutive trading days this year. The last time the yield curve was inverted for at least 23 straight trading days was December 2000. An inverted yield curve existed during 91% of the trading days in 2000. This was during the Fed's last rate hiking stint to combat the tech bubble and we all know what happened then. Although some economists worry that such an event is a precursor to an economic downturn, Fed Chairman Bernanke believes "this time is different" and he is not concerned a slowdown is imminent<sup>7</sup>.

The good news is that FOMC members are keenly aware of the consequences of too many rates hikes. According to a summary of the March 27-28 Fed FOMC meeting released recently. "Most members thought that the end of the tightening process was likely to be near and some expressed concerns about the dangers of tightening too much, given the lags in the effects of policy," the summary said. Typically, the impacts of interest rate increases are felt with full force some 12 to 18 months later.

Janet Yellen, president of the San Francisco Federal Reserve Bank and voting FOMC member, said the impact of past rate increases have been delayed and could hit consumers harder than expected. "I am increasingly concerned about the well-known long and variable lags in monetary policy -- specifically, that the delayed effects of our past policy actions might impact spending with greater force than expected," she said. This lagged effect could show up especially in the housing market, where a slowdown in price appreciation could dent consumer spending, she added. "While I expect the housing sector to slow somewhat, I will be highly alert to the possibility of the policy tightening going too far," Yellen said. Inflation risks are currently tilted "slightly" to the upside, but inflation should remain well contained in the future, she said.

Many economists and analyst believe that based on Fed member statements, we'll see another quarter point increase in May and then possibly a breather in June. Hopefully, they're right.

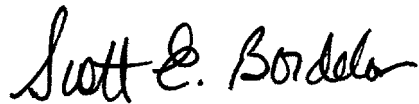
With the end of interest rate increases or at least a pause likely in sight, we will be making some changes during the next quarter to our portfolio models and your accounts to reflect changes in the expected economic environment.

We appreciate the confidence and trust you have placed in us to manage your investments. We take this charge very seriously. We sincerely appreciate your business.

Please feel free to call us if you have any questions regarding this report, your investment portfolio or its performance. Please do not hesitate to call your advisor if you would like to schedule an appointment or telephone appointment. Regular consultations with you are an important part of the service your advisor provides.


I hope you are doing well and have enjoyed the spring. Summer will soon be here. Your 2<sup>nd</sup> quarter investment performance report should be sent to you around the middle of August 2006 or sooner if possible.

Sincerely,



Scott E. Bordelon, CFP<sup>®</sup>, AAMS

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- ◆ *The S&P 500 is made up of 500 common stocks representing major US industry sectors*
- ◆ *The Dow Jones Industrial Average is an index of 30 blue chip US Stocks*
- ◆ *The Russell 2000 is a small cap index which tracks the returns of the smallest 2000 firms in the Russell 3000 Index, which is composed of the 3000 largest companies in the United States, as measured by Market Capitalization*
- ◆ *The NASDAQ Index is a measure of the combined value of roughly 5000 stocks traded on the National Association of Securities Dealers Exchange*
- ◆ *Lehman Brothers Aggregate Bond Index is abroad based bond index composed of U.S. investment-grade fixed-rate bond market, including government and credit securities, agency mortgage pass-through securities, asset-backed securities, and commercial mortgage-based securities.*
- ◆ *NAREIT Equity Index. NAREIT share price equity index measures the performance of all tax-qualified REITs listed on the New York Stock Exchange, American Stock Exchange, and the NASDAQ National Market system.*
- ◆ *Lehman Brothers High Yield Index is an index comprised of the universe of fixed-rate, non-investment-grade debt.*
- ◆ *One cannot invest directly in an index.*
- ◆ *Investments are not guaranteed and may lose value.*
- ◆ *Past performance in no way guarantees future results.*
- ◆ *Diversification does not assure against market loss.*
- ◆ *Russell1000<sup>®</sup> Index – measures the performance of the 1,000 largest companies in the Russell 3000 Index, which represents approximately 92% of the total market capitalization of the Russell 3000 Index. As of the*

latest reconstitution, the average market capitalization was approximately \$13 billion; the median market capitalization was approximately \$3.8 billion. The smallest company in the index had an approximate market capitalization of \$1.4 billion.

- ◆ *The Wilshire 5000 is an index of approximately 5000 stocks designed to be a measure of the entire U.S. market.*
- ◆ *Data Source for charts: Haver Analytics.*
- ◆ *S&P Mid-Cap Index is a diverse basket of medium-sized U.S. firms. A mid-cap stock is broadly defined as a company with a market capitalization ranging from about \$2 billion to \$10 billion.*
- ◆ *The S&P Small Cap 600 Index consists of 600 small-cap stocks. A small-cap company is generally defined as a stock with a market capitalization between \$300 million and \$2 billion.*
- ◆ *PSE 100 Index - The ArcaEx Tech100 Index is a price-weighted index comprised of common stocks and ADRs of technology-related companies listed on US exchanges.*
- ◆ *The Dow Jones Utility Average is a price-weighted average of 15 utility stocks traded in the United States.*
- ◆ *The Dow Jones Transportation Average is a price-weighted index composed of 20 stocks that are chosen to represent the transportation industry.*

## Endnotes:

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<sup>1</sup> Econoday, Halver Analytics

<sup>2</sup> According toMorningStar.

<sup>3</sup> Econoday, Halver Analytics

<sup>4</sup> U.S. Commerce Dept.

<sup>5</sup> U.S. Dept. of Labor

<sup>6</sup> Council of Economic Advisers, Dept. of Labor

<sup>7</sup> Treasury Department, Wall Street Journal