Trusted Advisor

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The Year of Suspended Animation

The three major US equity indexes barely moved the needle last year, with the Dow being saved from a loss only by virtue of dividend income paid to shareholders of its 30 component companies. As the table indicates, unaided index investing proved a tough way to make money in 2005. Yet diligent analysis of companies and major trends along with careful balancing of assets within client portfolios allowed us to produce superior results for most discretionary clients.

For the year, client accounts generally outperformed all major indexes except international. We do not seek to beat any particular index, and each client account is created and managed individually, but it is nice to be able to demonstrate our value to clients with these figures.

Our investment approach is not enslaved to some preconceived notion of what the economy will look like over the next twelve months. We do however, allow some "Secular" (super long term) trends to point us toward successful investments. For example, after reading Ken Dychtwald's *Age Wave* in 1989, I was receptive when economist Edward Yardeni promulgated his view that Baby Boomers would drive financial markets for decades to come. In recent years, as Boomer's entered their '50's, an age when health care usage begins to rise significantly, I looked for opportunities in a number of medically related companies, including Caremark, Teva Pharmaceuticals and Vanguard Healthcare fund. Currently, we are invested in a Real Estate Investment (REIT) trust that holds a portfolio of medical office buildings and assisted living facilities.

Last year, our international investments were a significant reason for the superior performance enjoyed by most discretionary accounts. Long before fashionable (1987)[1], I was investing client assets in international mutual funds and placing them with international money managers. Non-US investments have been a meaningful portion of client portfolios ever since. With the United States a mature economy, offshore stocks present exciting profit opportunities. To date we've kept client funds in large, developed economies, but may tiptoe into emerging markets which performed magnificently in 2005.

As with most readers, I lived through gasoline

2005 Index Performance

INDEX	12 31 05	12 31 04	% CHANGE	Est Dividend %	Total % Gain (loss)
S&P 500	1248.29	1213.55	2.86%	1.95%	*4.91%*
DOW JONES INDUSTRI	10717.5	10800.3	-0.77%	2.26%	*1.49%*
NASDAQ COMPOSITE	2200.51	2178.34	1.02%	0.38%	*1.40%*
DOW JONES WORLD	n/a	n/a	17.11%	n/a	*17.11%*
Lehman Aggregate Bond	100.21	102.16	-1.91%	4.34%	*2.43%*

Certified Financial Planner™

Gary Miller is in his 32nd year of providing financial guidance to individuals and pension plans. He is a Registered Investment Advisor and a Certified Financial Planner ™ Practitioner. Gary holds a Certificate in Personal Financial Planning from the University of California, Irvine and has served as a Board member of the Financial Planning Association, Orange County Chapter.

lines and brown outs in the 1970's. Study of the world's projected energy needs and supplies convinced me that shortages would occur and re-occur in the future. Research and a class in tertiary oil recovery techniques also proved useful. I was directing clients into energy investments in the early to mid 1980's. This included traditional oil and gas exploration and wind power. These undertakings were not always successful, as oil prices plunged in the late '80's and remained depressed for nearly fifteen years. The experience, however, kept me attuned to events in the energy markets and so I suspected we were witnessing the return of a secular energy shortage about four years ago, and began sniffing around for opportunities.

Our first venture was Valero, an oil refining and distribution company, purchased for many clients in early 2002. Refiners being volatile, we shifted to a more conservative approach with the purchase of gas pipeline company Kinder Morgan, LLC in early 2003. Clients who were placed in this company three years ago have enjoyed a total return of about 70%. Occidental Petroleum was bought later that same year , sold at a profit in 2004 and with little delay, was replaced by Exxon Mobil, where corporate governance is better. Recently, for clients able to take a some what greater degree of risk, we purchased a small interest in Apache Corporation, one of the best run exploration and production companies in the business, in my opinion. When individual holdings within mutual funds are included, energy constitutes our clients' largest industry holding. I believe the secular bull market that began about three years ago has a long way to run. Still, many energy companies appear to be trading at reasonable if not bargain prices: consider that Apache trades at a price/earnings ratio of about 10, and Exxon Mobil at a PE ratio of 11, while Cisco has a 20 PE, Microsoft about 23, and Intel 19[2].

Underlying all of our equity selections is an effort to purchase especially well run businesses that have some sort of economic "moat" (difficult for competition to hurt the company) and are under valued. By not over paying for stocks, we've protected clients from panic such as the bursting of the Tech Bubble. I'm at least as proud of my record of protecting client assets during the last bear market as I am of beating the indexes over the nearly five years I've managed funds as an independent, fee only investment advisor.

We subdue portfolio volatility, by placing diverse asset classes into client portfolios. US stocks, International stocks, US bonds, foreign bonds, commodity backed equities, real estate securities and money market funds have all been used. By including non - correlating assets into client portfolios (i.e. real estate and gold don't usually move in the same direction as US stocks), we've been able to achieve growth that exceeds US equity indexes but with only about half as much risk.

Trusted Financial's Long Term Performance Record

As reported to attendees of our annual client holiday luncheon last month, using 4 and ½ years of composite client data (through September 30 2005), Trusted Financial Advisors clients significantly out performed US equities with less than one half the volatility of US stock ownership.[3] The year 2005 appears to be consistent with the long term track record.

Considering the alternatives available to investors at this time, a well thought out portfolio of liquid investments in highly profitable, growing companies, and some of the best run mutual funds in the world, continues to be an attractive way to build and protect wealth.

I'm grateful to our clients for the opportunity to guide your investments. Thank you for referring your family members and friends to us.

Best wishes for a happy, prosperous, and most of all a healthy New Year!

2006 Financial Markets Outlook

As stated at the opening of this issue of Trusted Advisor, I do not engage in prognostication of the economy as a whole. This does not mean I ignore financial trends and developing events that may be supportive to our stock and mutual fund selections. The table below seeks to outline some major themes that may have a profound effect on financial markets in the coming year.

Cross Currents in the US Economic Picture, 2006

POSITIVES	NEGATIVES
Moderating Energy Prices. Likely only temporary, but a positive while it lasts.	High energy prices hurt consumer spending Retail sales will likely suffer.
Moderating Interest Rates – it appears unlikely that rates will rise a lot from current le Competition for work from China, India and Mexico should keep a lid on wages, and continue to provide in expensive imports.	Higher short term interest rates imposed by Federal Reserve Board policy will, many economists believe, trigger a recession. Home refinancing has plummeted, meaning consumers are no longer tapping this source of savings for current spending - hurts retail sales.
Corporate Cash High – Expect businesses to maximize shareholder value – increasing dividends and share buybacks. *Is a capital spending boom about to occur?*	70% GDP growth funded by consumer spending - US economy depends on the "kindness of strangers" - JAPAN, CHINA buy US Bonds = low interest rates enabling US consumer borrowing
Iraq Exit talk	Continued loss of jobs to foreign nations hobbles consumer confidence, may lead to the disappearance of America's middle class
Market has adjusted to "normal" terrorist risk	US employment growth slipping, and may reverse
Fiscal conservatives ascendant in Republican party. Rate of Federal deficit spending may be slowed by more disciplined legislation.	Weight of history: market is in older middle age (3.4 yrs av.) Measured from Oct '02 or March'03 (*graph*)
NEW Federal Reserve Chairman has confidence of most institutional investors.	Real possibility of power shift in Washington - 2006 Congressional elections (Scooter Libby, Tom DeLay, Jack Abramoff, Iraq hurt Republicans)

Class and Workshop Schedule

Title	Location	Date/Time	To register call or visit...
Tax Saving Retirement Plans for Small Business and the Self Employed	Saddleback Community College	Saturday February 18, 2005 9:00 AM to Noon	949 582 4646 www.saddleback-ce.com
Financial Independence for Women	Saddleback Community College	Thursday evenings (3 evenings) Feb.23 - March 9	www.saddleback-ce.com 949-582-4646

(Footnotes)

[1] The author, a Registered Investment Advisor, was employed as a Registered Representative of broker dealer firms from 1983 to early 2000.

[2] SourceBigCharts.com, WallStreetJournal.com, author estimates

[3] Composite of all discretionary management clients, 3-31-01 through 9-30-05, unweighted, and net of management fees and brokerage commissions. Raw data for this time period is available for review at our office. I expect to provide you updated composite performance information in February, once 12/31/05 data on major indexes is published.