

# THE LONG AND SHORT OF IT

QUARTERLY NEWSLETTER FROM  
**ROBINSON & WILKES, LTD.**  
THIRD QUARTER, 2005

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Equity markets showed considerable resilience during the third quarter, despite numerous obstacles such as the Federal Reserve's continued increases in interest rates, multiple hurricanes, rising commodity prices (especially energy), bankruptcy declarations in the airline industry, and significant credit rating downgrades in the auto industry. Sector returns were generally modest (low single-digit amounts) with the exceptions of the utility and energy sectors. These two sectors extended their gains, though they were already over-priced relative to their long-term fundamentals at the beginning of the quarter. The energy sector rose about 17% during the quarter. We had begun to move away from energy last quarter, and now firmly believe that valuation levels reached by the energy sector in the third quarter will continue to be unsustainable. Interestingly, in the first nine trading days of the fourth quarter, the energy sector had already given up 77% of the third quarter gain (if interested, see the CBOE Oil Index, symbol \$OIX.X).

Small-cap and mid-cap stocks outperformed large-cap once again. Growth style holdings began to assert themselves a bit, outperforming value in small-cap and mid-cap stocks, but continuing to lag value in large-cap stocks.

At this point, through our research (which is performed stock-by-stock as opposed to using sector or style studies) we are finding many attractive opportunities in the large-cap to mega-cap stocks. Many of these names continue to be from among those traditionally considered to be part of growth portfolios. In fact, our "Top 10 Holdings" looks a bit more like a core portfolio than a value portfolio. This is not because we have changed our approach to investing - something we would never do. The appearance of growth-oriented names is due to a change in where the opportunities exist. For these "traditional growth" stocks, the price multiples required to own them today are lower than typically found throughout history. Indeed, the multiples (i.e. price-to-earnings ratio, price-to-book value ratio) are currently lower than for many cyclical companies, as well as most small-cap and mid-cap stocks.

## Portfolio Top 10 Holdings as of 9-30-05

Company Name	Percent of Portfolio
McDonald's Corporation	5.8%
Electronic Data Systems Corporation	5.3
American International Group, Inc.	5.0
BB & T Corporation	4.9
Marsh & McLennan Companies, Inc.	4.6
ConocoPhillips Oil Company	4.5
JPMorgan Chase & Company	4.4
Cendant Corporation	4.2
Gannett Company	4.2
Bristol-Myers Squibb Company	3.8

## Equity Composite Portfolio Fundamentals as of 9-30-05

	R&W Equity Composite	BARRA Value	S&P 500
Number of holdings	30	323	500
Wtd. Avg. Mkt. Cap. (\$B)	64.8	58.0	90.4
Trailing P/E Ratio	16.6	17.6	19.3
Price/Book Ratio	2.4	2.1	2.9
Price/Cash Flow	7.6	8.9	11.5
Dividend Yield	2.2%	2.3%	2.0%
Return on Equity	14.9%	14.2%	19.6%

Interestingly, over the last two weeks, we have seen a large number of stock pickers in the media begin to pound the table quite loudly about the opportunities they see in the large-cap and traditional growth stocks. Since the winter of 1998, the S&P 400 (mid-cap) and S&P 600 (small-cap) indices have returned approximately 100%, while the S&P 500 (large-cap) has returned only 11%. As an aside, during this time period, the Robinson & Wilkes Equity Composite has returned just over 49%.

Fundamentals are improving nicely for most stocks in the large-cap group, while the prices of the stocks remain stable. As a result, we are seeing a decline in P/E ratios (stocks are becoming more attractively priced). Through September, the earnings on the S&P 500 had grown 12.5%, while the P/E multiple had declined 9.5%. Anytime certain areas for investment become as popular as energy and small-cap/mid-cap are today, there are always other areas for investment that are abandoned in order to over-participate in the hot area. The current disinterest in large-cap and traditional growth companies is not due to their lack of fundamental performance, but rather due to the extended period of price performance delivered by cyclicals (energy, basic materials) and small-cap and mid-cap companies over the last several years. This is where investors have been moving their money, and large-cap has been the source of funds. In particular, areas such as media, retail, telecom, and technology are now considered by most to be "passé."

We are finding many companies in those areas of investment to be very attractively priced, that is where we will continue to invest, as we are less concerned about what is hot or not, and more concerned about pricing and valuation. There has been so much frightening news this year, and so many reasons not to invest. Even a cessation of bad news, i.e. oil prices begin to decline, cessation of interest rate increases, even simply the absence of new hurricanes, could be enough to send the market higher. Yet, as investors, we are always aware that new bad news can come at any time.

Again, we continue to be able to find stocks of great companies that are priced very attractively. In the long run, owning these types of names has paid off handsomely for investors, even though there are lengthy periods of time that seem to be somewhat unrewarding. The relative performance of our approach has never been stronger than in 2000 and 2001 - an extremely difficult environment for most investors. The performance of our approach over the last three years has been in line with the S&P 500 and the Dow Jones Industrial Average, but somewhat below what we expect over the long run. It was also somewhat below the value indices, as we were never over-weighted in energy. Throughout the early 2000's, companies in the energy sector never became under-priced enough relative to long-term fundamentals to be considered a value play (which would have been cause for us to over-weight the sector). Stocks in the energy sector simply responded to the rise in crude oil. As a result, the sector has moved from fairly priced to somewhat over-priced.

The emotionally gratifying thing to do at moments like these might be to abandon our approach and go buy some recent winners. Historically, moments such as these have proven to be the best times to dig deeper into our process and to further embrace our approach. Our clients trust us to adhere to our disciplines, especially when the pressure to do something different becomes greatest. This approach has been rewarded over numerous similar, and difficult, cycles over the past 30 years.

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Established in 1997, Robinson & Wilkes, Ltd. is an independent investment management firm that uses a value-oriented, somewhat contrarian approach to investing client assets primarily in domestic, large capitalization companies, U. S. Treasury obligations and high-grade domestic bonds.

The Equity Composite is described as all fee-paying, fully discretionary accounts with a client objective of allocating at least 85% to equity. Non-fee paying portfolios are excluded from the composites but are included in the definition of total firm assets. As of September 30, 2005, the value of the 16 accounts in the Equity Composite was \$12.0 million, which represented 23% of the firm's total assets. Neither leverage nor derivatives are used in the Equity Composite portfolios. Returns reflect reinvested dividends and are expressed in U.S. dollars.

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