The Long and Short of It

Quarterly Newsletter from

Robinson & Wilkes, Ltd.

Second Quarter, 2005

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Beginning this quarter, we are pleased to provide our clients with a new separate publication called "The Model Portfolio." It describes each trade that took place in the Equity Model during the prior quarter, as well as the reasons for the action. While a discussion of the economy, as found in "The Long and Short of It," may be interesting to some, it has little to do with our approach to finding attractively priced companies in which to invest. We believe "The Model Portfolio" will be an excellent tool for sharing and explaining the investment approach applied to our clients' portfolios. We hope our clients will enjoy the addition of "The Model Portfolio" and look forward to any feedback it may generate. "The Long and Short of It" will continue to focus on the economy and, where appropriate, a general description of our approach to investing and current portfolio characteristics.

During the Second Quarter of 2005, the S&P 500 gained 1.4%, leaving its return at -0.8% year-to-date. Small-cap stocks outperformed large-cap stocks by about 3%. Within the large-cap indices, value outperformed growth by 2.7%, primarily due to value's greater exposure to the utility and energy sectors, which were up 8.7% and 7.6%, respectively during the quarter. According to our research, these two sectors are clearly over-priced relative to their long-term fundamentals. Although it may be heresy to say this in South Texas, we believe investors should now be underweighted in energy. While we do not see a reason for any significant decline in the price of energy, the stock prices of most energy companies already take into account very positive – perhaps excessively positive - expectations. In addition, during the Second Quarter, companies in the health care sector generally performed well, while those in the media and industrial materials sectors dropped significantly. International stocks also performed poorly. High quality bonds performed well due to falling intermediate-term and long-term interest rates.

The economy continued its moderate, yet resilient recovery, with solid monthly gains in retail sales, durable goods orders, and manufacturing activity, along with an improvement in the unemployment rate. Continued increases in short-term interest rates by the Federal Reserve are beginning to appear very well founded, as capacity utilization has increased to around 80% and inventories remain generally low. The only item that has peaked our interest in the economic news has been the recent decline in Total Consumer Credit Outstanding, a broad measure of consumer debt that historically correlates well with consumer spending. At this point, a modest decline seems healthy, as credit has perhaps been accessed to excess. It also seems logical, as money supply growth is slowing, and since short-term borrowing rates have increased enough to make the "carry trade" (the spread between the lender's cost of funds and the rate at which they lend) less profitable for banks. Yet, this is the first time since April 1992 that consumer credit has declined by –0.14% or more in one month. It is also the lowest annual rate of growth since the year ending in June of 1993. If consumer credit continues at these low levels, it could raise concerns about American consumers finally pulling back on their spending. It is an item worth watching.

Stock investors continued to be comfortable taking on risk during the quarter. Morningstar's "Aggressive Growth" and "Distressed" stocks rose by 9.2% and 5.3%, respectively, while "High Yield" and "Cyclical" stocks returned 0.8% and –1.2%, respectively. Viewing the market differently, bond investors began to move away from risk as evidenced by a widening of the yield spreads of corporate bonds over treasuries. Perhaps bond investors know something stock investors do not, which is usually the case. As the Fed continues to raise interest rates and the yield curve flattens, the environment becomes one in which stocks have had trouble performing well. This scenario is consistent with the fact that, except for utilities and energy, most of the companies we are finding to be attractively priced happen to be high quality companies with very strong balance sheets, and in industries traditionally thought to be defensive in nature.

Equity Composite Portfolio Fundamentals
as of 6-30-05

	R&W Equity Composite	BARRA Value	S&P 500
Number of holdings	30	324	500
Wtd. Avg. Mkt. Cap. ($B)	65.1	58.9	88.6
Trailing P/E Ratio	16.5	17.5	19.5
Price/Book Ratio	2.3	2.0	2.8
Price/Cash Flow	7.5	8.6	11.2
Dividend Yield	2.5%	2.3%	2.1%
Return on Equity	14.6%	14.2%	19.5%

As investors have moved toward riskier investments, including small-cap and lower quality stocks, they have sold and/or ignored some traditionally lucrative places for fund placement, such as pharmaceuticals, telecoms and, most recently, paper and media companies. As a result, companies in these generally more stable, defensive industries have performed quite poorly, creating buying opportunities. In addition, technology appears somewhat interesting, as several technology names have drifted toward the front of our stock valuation ranking. Microsoft Corporation (MSFT) is one example. Microsoft will introduce its next generation of operating system software (named "Longhorn") late this year. Typically, the upgrade cycle generates a considerable amount of spending for the whole PC industry. With a name like Longhorn, many Texans are sure to become enthusiastic about the upgrade.

We are pleased with the composition of the portfolios in this environment. Concentrations in the pharmaceutical sector and the telecommunication sector appear timely as investor optimism currently is quite firm. Late in the Second Quarter, our clients' portfolios were not rewarded for maintaining this posture; but the valuations are compelling and, in the long run, valuation matters. We continue to find numerous solid companies selling at attractive prices, but the present environment may mean we will have to wait until late 2005 before being rewarded with a significant rise in stock prices.

Portfolio Top 10 Holdings
as of 6-30-05

Company Name	**Percent of Portfolio**
BB & T Corporation	5.4%
Merck & Company	5.2
Electronic Data Systems Corporation	5.0
JPMorgan Chase & Company	5.0
Cendant Corporation	5.0
St. Paul Travelers Companies, Inc.	4.8
Gannett Company	4.7
Marsh & McLennan Companies, Inc.	4.6
Bristol-Myers Squibb Company	4.4
ConocoPhillips Oil Company	4.0

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.

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