

THE LONG AND SHORT OF IT

QUARTERLY NEWSLETTER FROM
ROBINSON & WILKES, LTD.
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In the fourth quarter of 2005, stocks rose slightly as energy price pressures subsided somewhat and investors began to anticipate an end to monetary tightening by the Federal Reserve. Numerous concerns faced by investors kept a lid on performance, such as the ongoing turmoil in the Middle East, a flattening yield curve, several airline and auto parts bankruptcies, along with growing concerns about the creditworthiness of General Motors and Ford.

2005 will likely be remembered as the year to own energy. Stocks in the energy sector returned, on average, about 33% for the year. The overall market (as gauged by the S&P 500 Index) rose only 4.8%. Without the energy sector, the broader market return would have been below 2%. Clearly, not much was working besides energy.

Mid-cap stocks maintained their outperformance for the year, although they are showing signs of weariness after six years of outperforming their large capitalization brethren. Growth style holdings, for the second quarter in a row, outperformed value. It seems that we are beginning to see the shift from small/value toward large/growth, which has been developing for over a year. Typically, these cycles last about four years, but it seems logical for the cycle to be extended this time around, allowing a greater period of digestion after the large imbalances of the bubble years.

At any rate, something has taken historically successful large cap value managers by surprise according to a Wall Street Journal article ("Fund Stars Don't Like This Ride" - 1/13/06. hereafter WSJ). The article, subtitled "Managers With Top 10-Year Runs Fall Short for 12-Month Period; A Tricky Time for Large-Caps," states that:

"In an unusual development, several top managers in the large-company "value" category posted lousy returns last year, despite their impressive long-term track records. The managers were experienced, well respected and in some cases quite famous in investing circles for their ability to deliver consistently impressive results. Yet last year the only thing consistent about them was their inability to do so."

The article points out several funds ranked highly among large-cap value funds for ten-year returns, each of which turned in 2005 returns near the bottom of the percentile rankings. For example, the Weitz Value Fund, ranks in the first percentile in the large value peer group for its return over the last ten years, but in 2005 ranked in the 98th percentile with a -2.77% total return for the year. In confirming WSJ's research in Morningstar, we found numerous others with a similar profile (many more than can be listed here). We also found that most had also underperformed in 2004, and several in 2003 as well. Yet they all have exceptional 10-year records. The accompanying chart gives examples of some of the best ten-year performers.

Portfolio Top 10 Holdings as of 12-31-05

Company Name	Percent of Portfolio
Electronic Data Systems Corporation	5.7%
American International Group, Inc.	5.5
BB & T Corporation	5.2
JPMorgan Chase & Company	5.1
Marsh & McLennan Companies, Inc.	4.8
Walt Disney Company	4.4
Abbott Labs	4.1
ConocoPhillips Oil Company	3.7
Bristol-Myers Squibb Company	3.7
Gannett Company	3.7

Fund Name	2005	10-Year
Weitz Value Fund	98%	1%
American Century Equity Income	87	2
The Yachtman Fund	97	19
The Clipper Fund	96	3
American Funds Washington Mutual	76	26
Longleaf Partners	78	4
Thompson Plumb	98	2

Again, many had difficult periods in 2004 and 2003 as well. The Clipper Fund (ranked in the 3rd percentile for the 10-year period ending 12/31/05) had ranked in the 98th percentile for its returns in both 2003 and 2004. American Century ranked 57th and 85th percentile for the same two years. In 2004, The Yachtman Fund ranked in the

82nd percentile, American Funds Washington Mutual, 83rd, Longleaf Partners, 84th, and Thompson Plumb, 96th.

One thing these managers have in common is that they “seek out undervalued gems among large companies through in-depth financial analysis, rather than trying to predict macroeconomic trends such as rising oil prices (WSJ).” This helps to explain why these funds missed out on the booming energy sector, which over the last three years never traded at the low multiples required for attracting value managers.

While it is painful when a style's performance lags, history demonstrates that long-term performance is maximized when the style is embraced during the difficult times.

As for 2006, seasonal tendencies dictate that we not expect much from stocks until after September. Seasonal tendencies are, however, based on averages, with considerable differences from one cycle to the next. Topics we expect to see more of during the year ahead are:

- 1) Credit problems with General Motors and Ford, as GM will likely need an infusion of cash (from where?) before year-end. Remember the old saying, “Where GM goes, so goes the country?” That is not as true now as it used to be. Nevertheless, if bankruptcy is required, there will be some ripple effects.
- 2) Significant uncertainty about monetary policy due to the transition of leadership from Alan Greenspan to Ben Bernanke. It is possible that the Fed is raising rates too aggressively, as we have now encountered a flat yield curve. People who say, “This time it is different,” in the world of finance are usually wrong. If so, and rates begin to decline in anticipation of a slowing economy, there could be renewed weakness in the dollar. The potential for a falling dollar could be a separate item number three – but for its close relationship with this item number two.
- 3) Renewed ad spending for the mid-term elections and the Olympics should revive the over-sold and out-of-favor media companies that have been declared DOA by the proponents of Google. Many such proponents believe Google will take over the media world this year. “Not so fast,” we say.
- 4) An encouraging finish to stocks in 2006, as investors realize that the world is not as bad off as the politicians will make it out to be during the first three quarters of the year. In other words, the investing world remains, to some extent, protected from the ongoing bazaar in Washington, DC.

Equity Composite Portfolio Fundamentals as of 12-31-05

	R&W Equity Composite	S&P 500
Number of holdings	32	500
Wtd. Avg. Mkt. Cap. (\$B)	67.0	84.1
Trailing P/E Ratio	17.1	18.7
Price/Book Ratio	3.1	2.9
Price/Cash Flow	8.0	11.5
Dividend Yield	2.3%	1.9%
Return on Equity	17.6%	20.0%

We will continue to embrace our approach, and be in the good company of the other managers listed above who maintain their disciplines for records of long-term success, despite languishing these last few years. With a sufficient time horizon, it is the long-term that counts! We wish you success in 2006.

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