



## Quarterly Commentary: April 5, 2006

Greetings from a rainy but very green San Mateo! As Spring unfolds, we hope you and your families are able to take advantage of the season. Springtime is usually a time of optimism, but it seems these days that pessimism pervades much of the national and international media. We constantly read and hear stories about avian flu, Iran's nuclear capability, or global political unrest, to name just a few examples. Meanwhile, the business press highlights such troubles as General Motors' restructuring or the ongoing Enron trial. This media bombardment fosters a natural concern about the future, and several clients have asked us to comment on our outlook in the context of the current environment.

We remain quite optimistic about the prospects for the domestic and global economies and therefore the markets representing investment in those economies. Whether we are considering the prospects for a specific business or the broader markets, we always analyze current mass expectations. High expectations create the potential for disappointment, while low expectations create opportunity. In the Spring of 2000, we had something akin to a perfect storm, where expectations and therefore valuations were absurdly high. Today, the opposite is true. Pessimism runs high, creating low expectations, low valuations, and great opportunity.

Today the S&P 500, taking into consideration interest rates and corporate profits, is at its lowest valuation in 25 years. Interest rates have moved up, but they remain reasonable from an historical perspective. Global competition and strong productivity growth have kept a lid on inflation. This environment bodes well for stocks over the next several years.

Soaring corporate profits are also contributing to the S&P 500's remarkably cheap valuation. Earnings from Corporate America accounted for 11.6% of our Gross Domestic Product in the fourth quarter of 2005, the highest percentage since 1966. And while earnings may slow somewhat this year after a stellar 2005, we believe 2006 profit growth will be about 12% – an impressive number in its own right.

There are several factors contributing to this impressive profitability. Strong productivity is a major contributor, as companies are getting more out of the capital (both physical and human assets) they employ. As a result, profit margins at U.S. corporations are exceptionally strong. Increased globalization has forced businesses across the planet into a state of hyper-competitiveness, but American businesses – long subjected to vigorous competition – are thriving in this setting. German and Japanese companies built reputations for highly efficient manufacturing, but American companies are now winning praise for their equally efficient management of service employees and “knowledge workers” in our increasingly global economy.

We see signs such as these, and we wonder why pessimism continues to prevail, at least with respect to the markets. Dire predictions are nothing new, from decades of frightening Cold War scenarios to Y2K scares more recently. We of course cannot predict whether any of the current ominous predictions will come to pass. Yet when we analyze the fundamentals underpinning our investments, we see the great opportunity presented to us when the market is preoccupied with a rainy forecast – and not the bright future evident in the data.



Our focus is always on finding attractively priced businesses for your portfolios and allowing the markets to recognize that value over time. Today, we are pleased to see so much value in the shares of large-capitalization, high-quality companies, such as the ones in your portfolios. When viewed as a group, blue-chip stocks (represented by the Russell 200) have:

- Generated higher returns on equity;
- Produced comparable growth in earnings; and
- Increased their dividends at a faster rate as compared to their smaller company counterparts.

Notwithstanding these superior attributes, large company shares also trade at a lower earnings multiple than more speculative issues.

<i>(period ended 12/31/05)</i>	<b>Return on Equity</b> (5 Yr. Avg.)	<b>Earnings Growth</b> (5 Yr. Avg.)	<b>Dividend Growth</b> (5 Yr. Avg.)	<b>P/E Ratio</b> (Trailing 12 Months)
<b>Russell 200</b>	19.6%	13.4%	11.9%	17.1x
<b>Russell 1000</b>	18.2%	13.4%	10.6%	17.9x
<b>Russell Midcap</b>	14.6%	14.0%	5.7%	20.3x
<b>Russell 2000</b>	9.5%	11.4%	6.8%	24.9x

Capital seeks value over time, and the greatest value is clearly available among large-capitalization stocks. Further, these factors give us comfort that we continue to operate from a posture of limited risk while providing for upside in your portfolios.

Included with this letter are your account performance figures, management fee invoice(s), and a copy of your portfolio allocation as of 3/31/06. Please note that below your aggregate performance, we have included two benchmarks for your comparison. The first is the S&P 500, which is a pure stock index, and the second is a blended benchmark, which reflects the weighted returns for the various asset classes represented in your account(s). In the future, we will include both relative measures for your review. If you have questions about this report or any of the enclosed information, please feel free to give us a call; we always enjoy hearing from you. Also, we welcome you to access your accounts online at [www.golubgroup.com](http://www.golubgroup.com). If you haven't done so already, just contact Claire Silverman to arrange access. We have updated our website to include our individual photos and a Community Outreach link which includes a few pictures from our most recent activity with Habitat for Humanity.

With Spring officially underway, we wish you and your families a warm and optimistic season!

Best Wishes,

The Golub Group

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