THE GOLUB GROUP
Investment Counsel

Quarterly Commentary: July 5, 2006

Hello and happy Summer! We hope your summer is focused on spending time with friends and family, even as we remain focused on managing your portfolios. Regarding your investments, volatility returned to the markets in the second quarter, as negative sentiment grew sharply. For the quarter, the Dow Jones Industrial Average managed a 0.4% gain, the NASDAQ Composite dropped 7.2%, and the S&P 500, our primary benchmark, slipped 1.9%. Several factors contributed to the broad decline, but many market-watchers attributed it to concerns about rising inflation and slowing economic growth. We believe global competition will continue to limit inflationary pressures, but we do recognize that the economy has slowed somewhat. It is in this environment, however, that the benefits of investing in well-capitalized, world-class companies become apparent.

The recent market environment – wherein investor sentiment has dropped to its lowest level in almost four years – has afforded us the opportunity to add to positions in the high quality investments you already own. The market also has discounted many other securities, providing us with several new investment opportunities. Investors may have given up on these stocks, but the businesses underlying them are still strong. When we measure our own portfolio companies in the aggregate, they have recently enjoyed a 10% annual increase in revenues and an 11% annual increase in both operating income and net income. They have also raised their dividends 9% over the past year, with a full 75% of our companies declaring an increase. The superior performance of many of your portfolios in a "down" quarter such as this one comes as the result of our steadfast focus on these business fundamentals and an acute attention to valuation.

The booming economy of the past few years covered up much of the weakness hiding within marginal businesses. Weaker companies may perform well when a rising economy lifts all companies, but that performance tends to be fleeting. Meanwhile, we are confident that the companies we purchase for you will continue to earn high returns for many years to come. These companies have a long-term focus, just like our own. More importantly, they have developed great competitive advantages, allowing them to earn large returns on their invested capital. Those returns are ultimately what drive stock prices over the long run.

We should elaborate on the point above regarding valuation. In a sense, we are purchasing these companies at a "double discount" – they are undervalued names within an undervalued asset class. As a group, large capitalization equities remain at historically low valuations. This portion of the capital markets has been shunned for a number of years, while excitement and enthusiasm have surrounded small-cap stocks, commodities, and the emerging markets. It was not surprising to hear so many people clamor for these asset classes as they were hitting all-time highs in May – it is natural human behavior to extrapolate recent performance trends into the future. Unfortunately, such high expectations can make for lousy returns. Investors chasing performance often fail to appreciate that fundamentals and valuation drive returns. Buyers of the recent "hot" investments almost always fail to give an appropriate consideration of the risk involved. Put simply, these folks are not investors; they are speculators.

Indeed, the other shoe dropped this quarter for the speculators. The Russell 2000, a well-followed index of small-cap stocks, lost 14% between early May and mid-June. A widely-watched index of emerging markets stocks was at one point down 26% from its May high, while a similar index of commodity-related stocks was down 18% from its high. This is the kind of volatility that develops as weaker companies trading at inflated valuations face the prospect of tighter credit and a slowing economy. Meanwhile, the large, well-financed companies we own on your behalf are well-positioned to withstand most weaknesses in the economy, becoming stronger at the expense of their smaller competitors. We are just fortunate that we can bet against the prevailing negative sentiment and pick up these superb assets for a song.

The volatility we've all seen may make it tempting to increase our own activity in your accounts. However, we do not trade frequently by design. We are careful to avoid the cardinal mistake made by most investors, which is to allow emotion to guide decision-making. More to the point, most individuals become more aggressive when stocks are high and rising (as in early May), and become more fearful when stocks are down (as in the present). You have hired us in part to remove emotion from the process. And as most of your accounts have performed better than the broader market this quarter, we believe our discipline is working. Protection against loss in down periods is one of the key means to build wealth over the long run. If you agree, please tell your friends and loved ones that we can help them, as well – your referrals tell us we are indeed doing a good job for you.

As you head out on your summer adventures, please remember a few key points:

- Corporate balance sheets are loaded with the most cash they've had in 40 years.
- Large-cap, blue chip stocks are the cheapest they've been in 10 years.
- Long-term interest rates remain at historically low levels.

And finally, consider this hypothetical scenario: if earnings for the S&P 500 companies grow at a 7% rate over the next five years, and if the S&P 500 index trades at a 16x P/E multiple at that time, the index will be 50% higher than it is today. We think this is an entirely achievable objective.

Notwithstanding our own confidence, we do understand that investing can cause apprehension and confusion. We are here to help you. If you would like to discuss anything related to our outlook or your specific situation, please don't hesitate to contact us. We always welcome the opportunity to meet with you in person, or alternatively, to talk with you by phone. If nothing else, we hope you will pay us a visit during our annual Open House. Please save the date: this year's Open House will be October 13.

As always, included with this commentary are your quarterly performance figures, management fee invoice(s), and a copy of your portfolio allocation as of 6/30/06. You are welcome to visit us online and access your account(s) at www.golubgroup.com. Please contact us to establish a login and password if you do not already have one. We wish you and your families a warm and relaxing summer.

Our best regards,

The Golub Group

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