



Quarterly Commentary: October 3, 2006

As your investment advisor, we spend a significant amount of time focusing on how we can build a lasting and meaningful relationship with you and how we can help you achieve your financial goals. Over the years we have built an organization which, we believe, does an excellent job on both of these fronts. It starts with our people, who share a common set of values and have a clear understanding that our mission is to be of uncommon value to you. Internally, we talk about our “Main Thing,” which is to build long-term relationships through high quality investment management. This long-term mission underlines everything we do, it guides our decision-making and our actions, and we believe it distinguishes us from many other firms.

We mention our Main Thing at the outset this quarter because of its particular relevance to the current investment environment. Conflicting forecasts over the direction of the economy, interest rates and corporate earnings have created considerable uncertainty in today’s markets. We are also beset almost daily by headlines about terrorism, war in the Middle East and nuclear saber-rattling from the likes of Iran and North Korea. Through all these near-term unknowns, it is our focus on the long-term that gives us clarity of thought when making decisions about your investments.

These days, too many investors consider “long-term” to be one year, one quarter, or even less. We consider a long-term investment to be at least three-to-five years in length, and we are thrilled if we discover an opportunity where we can invest for 10 years or longer. One way we are able to focus on the long-term is by investing in high-quality, sustainable businesses. The large-cap, blue-chip equities that comprise your portfolios are those which demonstrate strong cash flows, a solid balance sheet, a history of consistent profitability, high returns on equity, a proven management team and honest accounting. They also have a history of returning cash to their shareholders through share repurchases and healthy dividends. In fact, an impressive 77% of the companies in our current core portfolio increased their dividends over the past year by an average of 15%.

Allow us to elaborate on dividends. We believe the markets are undergoing a long-term transformation, and our emphasis on dividend-paying securities helps position your accounts for that transformation. Global competition and deep international capital markets are creating a world where lower returns are commonplace. In short, it’s getting harder to find investments which will provide a “good” return. We take comfort in the current income that dividends provide, but we like them even more because dividends (as opposed to capital appreciation) promise to become a greater component of total return in the future. Since the 1940s, dividends have accounted for roughly half of the S&P 500’s total return. And during that time, S&P 500 companies have paid out 54% of their earnings in the form of dividends. Presently, however, S&P 500 companies pay out just 33% of their earnings through dividends. We believe this “payout ratio” is currently too low, since the S&P 500 companies are presently very profitable, are sitting on growing cash hoards, and are immersed in a slow-growth world while their investors clamor for higher real returns. Given this state of affairs, we think it’s eminently wise to be invested in large-cap stocks which pay good dividends.



The potential return from large-cap common stocks looks even more appealing given where they are trading these days. Even after a nice quarter like this one, where the S&P 500 gained 5.2%, we still believe stocks are the most attractive asset class. The current 15.5x earnings multiple on the S&P 500 is below similar measures for bonds (21.7x), residential housing (18.7x) and even cash (19.1x). Further, it's said stocks "climb a wall of worry," and we see more worry than legitimate concern. The economy is slowing down, but as it does, inflation subsides – and we're still quite far from heading into a recession. The Federal Reserve will eventually confront the slowing economy by cutting interest rates, something which has been historically very positive for stocks. During the two prior Fed cycles (1984-85 and 1994-95), the S&P 500 has posted strong rallies as the Fed made its final rate increase. With the Fed taking no action at its last two meetings, we believe we are in the midst of the same bullish scenario today.

At the Golub Group, we understand that our success depends on the strength of our relationship with you, our clients. This relationship works best when we clearly understand your financial goals and objectives and when you clearly understand the steps we can take to achieve them. We are the experts in investing, but you are the experts in knowing and communicating your own situation. Because we want to achieve our Main Thing – in part, to build a long-term relationship with you – we need your help to ensure we are aware of your situation and financial goals, both current and as they evolve over time. We have rigorous procedures to make certain we are actively monitoring your accounts and communicating with you regularly. But we also understand that you experience many changes throughout your lifetimes (marriages, births, property sales, retirement, *etc.*), so we hope and invite you to share these with us as they occur. We want to be a part of your planning so we can be of the greatest possible value to you, just as you are to us.

Included with this commentary are your quarterly performance figures, management fee invoice(s), and a copy of your portfolio allocation as of 9/29/06. 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. In closing, we are looking forward to seeing many friends at our Open House on October 13th; we hope you can join us. If not, please accept our best wishes for a very pleasant fall.

Warm regards,

The Golub Group

Disclaimer: All opinions presented in this commentary are strictly those of the Golub Group. You should not construe any implied or expressed conclusions presented as a promise of future returns.