

Rolling Fives

Economic and Market Commentary

2005 was filled with its share of devastating natural disasters, political tensions, and change:

Overview

2005 was filled with:

- Hurricane Katrina and earthquake in Kashmir
- Global terrorism
- Riots in France
- Elections in Iraq and the Saddam Hussein trial
- Down vote on the European Union constitution, Blair reelection, and first female Chancellor elected in Germany

- Greenspan retiring and two new Supreme Court judges nominated
- North Korea agrees to change in nuclear program.

Economic Highlights

Despite the turmoil, the major global economies continue to grow. The United States is chugging along, Japan is reviving, and Germany is arising from its slumber.

In the United States, capacity utilization is still below its 10 year average (see Figure 1), but it has increased significantly now from its 10 year low of 74% back at the end of 2001 to 80%. Simultaneously, production has been increasing and inventories have been declining (in real terms).

Real corporate profits have stayed strong. Real disposable personal income has been increasing, but real domestic debt is growing even more rapidly

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EXECUTIVE SUMMARY

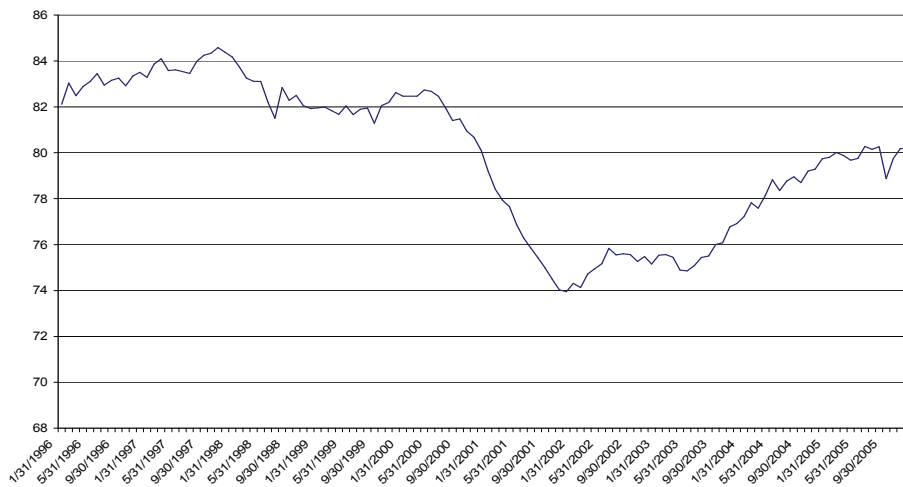
The Past Year

- Environmental and political upheavals
- Muted market volatility
- Appreciating dollar

The Year Ahead

- Continued political change
- Chinese market opens
- The return of volatility
- Increased cross-border mergers

Figure 1 U.S. Capacity Utilization



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(see Figure 2), which is a major concern for the credit markets and future growth.

Consumer and producer prices have been rising very slowly, with the gap between consumer price increases and producer

price increases narrowing. Producers have finally been able to pass-through their cost increases to consumers. The general price level in the economy however has not been rising rapidly. When core-inflation (Consumer Price Index excluding energy and food) is considered

only, then consumer prices have fallen relative to producer prices. Short and long term Treasury bond yields continue to converge reflecting investor belief that inflation is not worrisome for the foreseeable future.

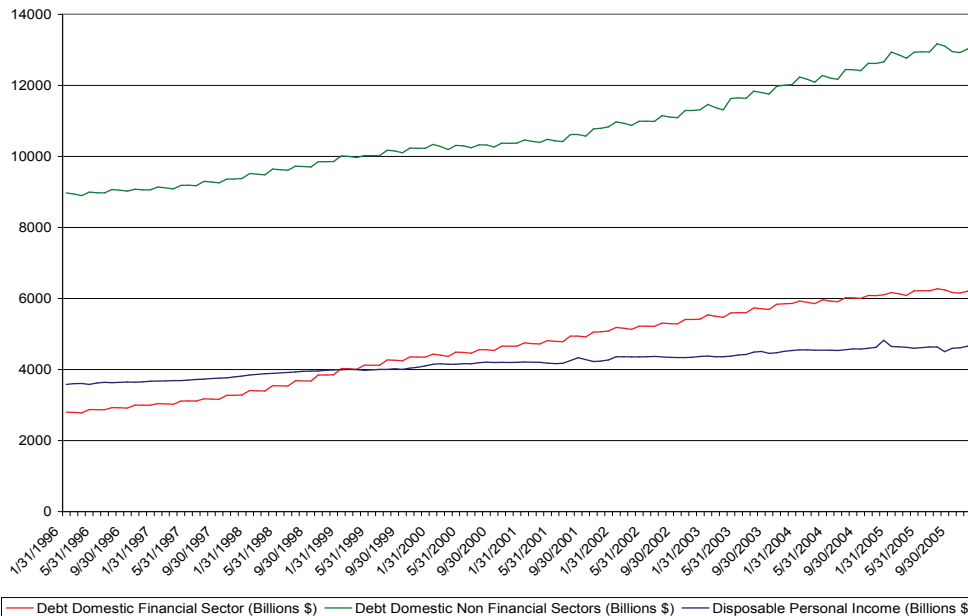
U.S. investors continue to

pump money into residential fixed investments and non-residential fixed investments (like equipment which is approaching its 2000 peak). Despite talk of a residential housing bubble, in real terms, existing home prices have increased only 38% (3.3% per annum) from 10 years ago nationally, while new home prices have increased 34% (2.97% per annum). So, even if housing prices do stray from their fundamental value in certain regions, we do not believe the so-called housing bubble will pop. Rather, there may be a local hissing sound as some local prices deflate (most likely in coastal areas where price increases have been more extreme).

The real trade gap has widened significantly due to the imbalance of trade in consumer goods. U.S. consumers have been able to buy goods at lower prices with our stronger dollar while U.S. productivity has been financed from abroad.

Though the federal deficit has ballooned it has been shrewdly financed at low interest rates. The U.S. Treasury is bringing back the 30 year U.S. Treasury Bond to lock in low rates.

Figure 2 Real Disposable Income and Real Domestic Debt



Financial Markets

The “new economy” has been trampling the “old” as evidenced by the rise of Google and the fall of General Motors; however, the “old” will try to reinvent itself by adopting new technologies for familiar brands. Absent innovation however, the “old economy” may have to rely on economies of scale to maintain their profitability. Case in point is Procter & Gamble’s purchase of Gillette for \$57 billion, which will certainly give them more pricing power to counter large retailers’ push for lower prices.

In other industries, Boeing has reasserted itself as the dominant airplane manufacturer over Airbus despite the European Union’s subsidies for Airbus. Airlines themselves continue to suffer from structural problems such as high labor costs, poor business models, and large

Table 1 Domestic Equity Performance as of 12/31/05

Capital Market Performance - Domestic Equity as of 12/31/05								
Capitalization	Barra/S&P Value		S&P 500 Composite		Barra/S&P Growth		Russell 1000 Growth	
	Return	Risk	Return	Risk	Return	Risk	Return	Risk
↑	Last Quarter	20.4%	Last Quarter	2.08%	Last Quarter	1.87%	Last Quarter	2.98%
	YTD	5.66%	YTD	4.91%	YTD	3.90%	YTD	5.28%
	1 Year	5.66%	1 Year	4.91%	1 Year	3.90%	1 Year	5.28%
	3 Year	17.23%	3 Year	14.39%	3 Year	11.49%	3 Year	13.23%
	5 Year	2.40%	5 Year	0.54%	5 Year	-1.57%	5 Year	-3.53%
↓	Russell 1000 Value		Russell 1000		Russell 1000 Growth		Russell 1000 Growth	
	Last Quarter	1.27%	Last Quarter	2.12%	Last Quarter	2.98%	Last Quarter	2.98%
	YTD	7.05%	YTD	6.27%	YTD	5.28%	YTD	5.28%
	1 Year	7.05%	1 Year	6.27%	1 Year	5.28%	1 Year	5.28%
	3 Year	17.49%	3 Year	15.42%	3 Year	13.23%	3 Year	13.23%
↓	Russell Midcap Value		Russell Midcap		Russell Midcap Growth		Russell Midcap Growth	
	Last Quarter	1.34%	Last Quarter	2.35%	Last Quarter	3.44%	Last Quarter	3.44%
	YTD	12.65%	YTD	12.65%	YTD	12.10%	YTD	12.10%
	1 Year	12.65%	1 Year	12.65%	1 Year	12.10%	1 Year	12.10%
	3 Year	24.38%	3 Year	23.79%	3 Year	22.70%	3 Year	22.70%
↓	Russell 2000 Value		Russell 2000		Russell 2000 Growth		Russell 2000 Growth	
	Last Quarter	0.63%	Last Quarter	1.13%	Last Quarter	1.61%	Last Quarter	1.61%
	YTD	4.71%	YTD	4.55%	YTD	4.15%	YTD	4.15%
	1 Year	4.71%	1 Year	4.55%	1 Year	4.15%	1 Year	4.15%
	3 Year	23.18%	3 Year	22.13%	3 Year	20.93%	3 Year	20.93%
5 Year	13.55%	5 Year	8.22%	5 Year	2.28%	5 Year	2.28%	

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attractive; especially with growing privatization and the withdrawal of government influence in Japanese business. The future of the European Union is uncertain, with its expansion stifled from a lack of consensus on a constitution and rising

social tension. Germany, under new leadership, may emerge from slow times, and battle for European supremacy with England—especially if England sees a new Prime Minister before the year is over. If the U.S. dollar weakens from growing trade imbalances, U.S. investors plac-

ing dollars overseas may benefit doubly from both rising foreign markets and currencies.

If China opens its markets, large, well capitalized, growth-oriented U.S. firms will be the major beneficiaries. These same companies may also be

merger or acquisition targets of foreign companies.

2006 should prove interesting are sure to be filled with events that test assessment of the investment landscape. Let's hope whatever occurs is profitable.

Welcome to Rolling Fives

Thank you for your trust and confidence in us. We are committed to helping you navigate the financial maze of the markets, and we take our responsibility seriously.

We send this newsletter for many reasons. The most important reasons are so you can keep up-to-date on financial topics and become a more knowledgeable investor.

If you know someone who would appreciate this newsletter, please let us know and we will add that person to our mailing list.

Our clients are from all different backgrounds and despite their personal and professional differences, each is seeking a common goal: to achieve financial security.

However, the definition of financial security is different for each person. This is why each client has a different financial plan.

Because there is such diversity among our clients, ClayBorne Group takes the time to get to know each client to determine what is most important to them and what their financial objectives are. We can work together to design a financial plan to help you pursue your goals and objectives in a way in which you are comfortable.

If you have any questions, or if you would like to discuss your financial plan, please call us, 888-227-6781.

Why "Rolling Fives"

You may be wondering why ClayBorne Group decided to call a quarterly newsletter "Rolling Fives."

It is our view that in order to achieve superior investment results, you need to establish and adhere to appropriate investment policies over the long-

term that position the portfolio to benefit from the main long-term forces in the capital markets.

As Charles Ellis said, "Investment policy wisely formulated by realistic well-informed clients with a long-term perspective and clearly defined objec-

tives, is the foundation upon which portfolios should be constructed and managed over time and through market cycles." We believe that rolling five year periods can assist us a great deal when it comes to constructing and managing portfolios. Hence, the name "Rolling Fives".

As always, we thank you for your trust and confidence in us. Always remember, our goal is your success.

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