



## 2005 Year End Commentary

(Aside) I look forward to the day when I can talk into a microphone and generate text on a page, although having looked at "The Matrix" again recently it's hard not to start daydreaming about wireless networks involving a computer and a person's mind. (Puts a spin on the "knowledge on demand" 'Net paradigm, doesn't it?) The bottleneck in **THIS** network is between brain and hands!

**The Year in Numbers: We have a lot to be thankful for in 2005.** The Dare Capital model portfolios had a terrific year: (Note: all performance figures include reinvested dividends and, if applicable, capital gains. Portfolio performance is monitored using Morningstar resources.)

**Gibson-Woodard Modified: 18.01%**

**Gibson-Woodard Pure: 11.74%**

**Challenge: 11.55%**

**Bond Fund: 3.00% ttm yield 4.31%**

**Our main benchmark, the S&P 500 (America's 500 largest companies by market capitalization) returned 4.82% (including reinvested dividends) for 2005.**

Client accounts are facing minimal capital gains exposure, too, as we didn't do a lot of buying and selling. We will be looking at doing some periodic rebalancing in the coming days.

**It is really gratifying** to achieve these types of returns without doing a lot of trading in and out of positions....(As some of you all know, I can be A LITTLE hard-headed about selling a position!)

**Rest assured, we haven't gotten everything right**-we don't own enough gold, we bought some oil and natural gas stocks too high in October, and the "more conservative" portfolios that have bond funds in them have generally underperformed due to rising interest rates. We also own some out of favor and little-known companies that are capable of testing our resolve from time to time.

Reading through Bill Nygren's 2005 letter to shareholders for the Oakmark and Oakmark Select Funds was heartening, though-Oakmark Select returned 4.84% for 2005 and the Oakmark Fund returned -1.31% for 2005. All things considered, we're doing alright.

**A more important issue to me** is that not all clients have the components of the two "core" portfolios (Modified or Pure) in their portfolios. There are several reasons why this may have happened- multiple deposits/purchases leading to multiple account allocations over time, client preference to not own indexes, smaller account size leading to less diversification.

**It is an ongoing priority to me for everyone to get some of this exposure in their portfolios!**

**There were two sharp sell-offs in 2005**-in April and October (both, ironically, column deadlines, so the fear component was perhaps overly stated in my newsletters to you. The half-kidding joke to clients on the phone was "when I'm about to be sick to my stomach it's near a bottom." Ah, the life of a canary in a coalmine.)

**The markets go to extremes** that way-when you're afraid it may be a good time to buy, and when you're giddy it may be a good time to sell. Fear and greed, fear and greed.....

**Thoughts on the market for 2006:** My crystal ball doesn't see any better than any of you all's, but I think that a couple of scenarios are worth considering: 1) The Fed's rate hikes start kicking in and slow down the economy, and 2) The Fed stops tightening and a "Goldilocks economy" continues- i.e. not too hot, not too cold, but just right. Let's consider each outcome and how to position for it.

### 1) The Fed's rate hikes kick in and start slowing the economy:

**-What would tell us that this was happening?** Slower GDP growth, an inverted yield curve in the bond market.

**-What would we want to own in such a scenario?** "Eat drink smoke" companies, other defensive sectors (ie drugs, healthcare), well-run financials.

**-What would we probably not want to own in such a scenario?** Any growth stock with slowing growth, any company tied to discretionary consumer spending (other than high-end retailers).

**What is the downside risk of assuming such an investment posture?** We may miss out on some upside under a "Goldilocks economy" or more robust growth scenario.

### 2) Goldilocks economy scenario:

**-What would tell us this was happening?** GDP figures stay firm, if not continue to rise; inflation figures stay tame.

**-What would we want to own in such a scenario?** Best of breed growth stocks, best of breed financials, strong companies in economically sensitive sectors ie transports/utilities/industrials/retailers.

**-What would we not want to own in such a scenario?** Overpriced companies in classically defensive sectors.

**-What is the downside risk of assuming such an investment posture?** Potentially significant! I do not want to get too far towards growth-oriented portfolios after 13 interest rate hikes. I think one piece of soft GDP data will put the market in a very defensive posture, as if it were beginning to anticipate a recession. The average growth stock loses something like 43% of its value during a recession. No thanks!

**A note on Natural Gas:** Most of the portfolio allocation work that I did this past fall includes exposure to natural gas stocks. They are more volatile than I would like and have underperformed over the last several months due to a warmer than average winter (so far) in much of the country. We will see if that trend continues...meanwhile, I bought them too high, at least in the short run.

My reasoning for owning this sector is that there appears to be a developing shortage of natural gas, but natural gas is a very volatile commodity and has traded in the range of \$5 to \$15 over the last two years. My anticipation that owning these companies would be a hedge against paying high winter utility bills and may make some good returns on investment if natural gas increases in price. Sorry for the gyrations along the way...I think there's still some winter to come!

**Other notes:** I am trying to learn to be a more contrarian investor-to be able to buy when the market is headed south and to sell into the optimism that has appeared fourth quarter of the last two years....but the reality of the situation is that it's hard! It's hard to stick one's neck out too far at market bottoms. It's also hard to sell when things are going well. I promise I will work hard to keep getting better at it.

My gut feeling is that the market (at least) takes a break towards the end of January. The more defensive portfolios (and that's most everyone) are due to outperform relative to the market under any scenario save roaring growth.

Meanwhile, the asset allocation models that we are using have been working nicely. Above market returns with low capital gains exposure and (perhaps most importantly) peace of mind regarding investment direction (including filtering out most if not all of the short term noise)...That sounds like what we want to keep doing!

Thanks for all of the kind words and support, and for allowing my firm the opportunity to add value to your family's financial lives.

Cordially,

Will W. Woodard, III, CFP®