



# Park Piedmont Advisors LLC

Registered Investment Advisor

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## JANUARY 2006 COMMENTS

### ENCLOSURES:

**1) ELDERCARE SURVEY:** We thank all of you who have replied, and would appreciate hearing from those who have not. Another copy of the survey, with a return envelope, is enclosed.

**2) PARK PIEDMONT POSTCARD:** This mailing piece is a convenient way of describing our services on behalf of clients. If you know anyone who you think would benefit from our services, we welcome all new client referrals. We are currently in discussions with more than one accounting firm interested in becoming associated with Park Piedmont.

### TAX MATTERS for 2006:

**1) Cost Basis information for all securities sold during 2005:**

You should have received Form 1099s from National Financial Services (NFS) by now. These forms report taxable dividends and interest, and also the proceeds of securities sold during the year. To the extent the forms do not have cost basis information to go with the proceeds of sales, please contact Lynette, who will provide all necessary information for your tax reporting.

**2) Cost Basis Reports for all unsold security positions in taxable accounts:**

Many clients have already received the reports with cost basis information for all current positions in their accounts. For those who have signed and returned the reports, you will now be able to see this cost basis information on your monthly statements. For those who have received, but not yet signed and returned, the reports, we would appreciate your doing so. For those clients who have not yet received these reports, you should be receiving them soon.

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*Any recommendation contained in these Comments may not be suitable for all investors. Moreover, although the information contained herein has been obtained from sources believed to be reliable, its accuracy and completeness cannot be guaranteed.*

**COMMENTS: INDEX RESULTS for period ending January, 2006**

<u>STOCKS</u>	<u>YEAR</u> <u>1999</u>	<u>YEAR</u> <u>2000</u>	<u>YEAR</u> <u>2001</u>	<u>YEAR</u> <u>2002</u>	<u>YEAR</u> <u>2003</u>	<u>YEAR</u> <u>2004</u>	<u>YEAR</u> <u>2005</u>	<u>YTD</u> <u>2006</u>	<u>CURR.</u> <u>MONTH</u>
Vanguard Total Stock Market Index Fund (1)	23.8%	(10.6%)	(11.0%)	(21.0%)	28.4%	12.5%	6.0%	3.5%	3.5%
Standard & Poors 500 Index (2)	19.6%	(10.1%)	(13.0%)	(23.4%)	26.4%	9.0%	3.0%	2.5%	2.5%
Vanguard S&P 500 Growth Index Fund (1)	28.8%	(22.2%)	(13.0%)	(23.7%)	25.9%	7.2%	5.1%	2.5%	2.5%
Vanguard S&P 500 Value Index Fund (1)	12.6%	6.1%	(12.0%)	(20.9%)	32.2%	15.3%	7.1%	3.2%	3.2%
Dow Jones Industrial Average Index (2)	25.2%	(6.2%)	(7.1%)	(16.8%)	25.3%	3.2%	(0.6)%	1.4%	1.4%
NASDAQ Composite Index (2)	85.6%	(39.3%)	(21.0%)	(31.5%)	50.0%	8.6%	1.4%	4.6%	4.6%
Vanguard Midcap US Index Fund (1)	25.0%	2.6%	(4.8%)	(16.3%)	34.1%	20.4%	13.9%	5.6%	5.6%
Vanguard Smallcap US Index Fund (1)	19.6%	(4.2%)	1.0%	(21.6%)	45.6%	19.9%	7.4%	7.9%	7.9%
Vanguard International Index Fund (EAFE) (1)	25.3%	(15.2%)	(22.6%)	(17.5%)	40.3%	20.8%	15.6%	6.9%	6.9%
Vanguard Real Estate Invest. Trust Fund (1)	(0.4%)	26.4%	12.4%	3.8%	35.7%	30.8%	11.9%	7.5%	7.5%
<b><u>BONDS</u></b>									
Vanguard Total Bond Market Index (1)	(0.8%)	11.3%	8.3%	8.2%	4.0%	4.2%	2.4%	(0.1)%	(0.1)%
Vanguard Intern. Tax-Exempt Index Fund (1)	(2.9%)	9.2%	5.0%	7.9%	4.4%	3.2%	2.4%	0.3%	0.3%
Vanguard Short-term Bond Index (1)	2.1%	8.9%	8.9%	6.1%	3.4%	1.7%	1.3%	0.1%	0.1%
Vanguard Short Tax-Exempt Index Fund (1)	2.6%	4.9%	4.8%	3.5%	1.6%	1.1%	1.8%	0.3%	0.3%
Vanguard High-Yield	NA	NA	NA	1.7%	17.2%	8.5%	2.8%	0.9%	0.9%

1) Results for Vanguard funds include dividends and fund expenses but do not reflect PPA's advisory fee.  
 2) Results for S&P 500, Dow Jones, and NASDAQ indexes do not reflect dividends or PPA's advisory fee.

%	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q
		<u>1999</u>				<u>2000</u>				<u>2001</u>		
<b>S&amp;P 500</b>	4.1	7.6	(7.7)	15.6	2.0	(3.0)	(1.3)	(7.8)	(12.1)	4.8	(13.8)	8.1
<b>NASDAQ</b>	14.6	10.0	0.0	61.0	12.4	(14.8)	(7.2)	(29.6)	(25.5)	12.9	(26.7)	18.3
<b>BONDS</b>	0.0	(0.5)	0.4	(0.7)	2.4	1.5	3.1	4.3	3.2	0.8	4.3	0.0
Interm. Tax.												
		<u>2002</u>				<u>2003</u>				<u>2004</u>		
<b>S&amp;P 500</b>	0.0	(13.8)	(14.1)	4.5	(1.8)	12.8	2.2	13.2	1.3	1.3	(2.4)	8.8
<b>NASDAQ</b>	(5.5)	(19.5)	(13.5)	7.0	2.5	19.2	12.1	16.2	(0.5)	2.7	(7.5)	13.9
<b>BONDS</b>	0.0	2.8	3.6	1.8	0.9	2.7	0.2	0.2	2.7	(2.6)	3.1	1.0
Interm. Tax.												
		<u>2005</u>				<u>2006</u>				<u>2007</u>		
<b>S&amp;P 500</b>	(2.6)	0.9%	3.1%	1.6%								
<b>NASDAQ</b>	(8.1)	2.6%	4.4%	2.5%								
<b>BONDS</b>	(0.5)	3.0%	(0.7%)	0.6%								
Interm. Tax.												

## JANUARY 2006 COMMENTS

**STOCK** index prices for US large cap stocks rose in January. The S&P 500, Dow Industrials, and NASDAQ gained 2.5%, 1.4%, and 4.6%, respectively. Continuing a trend that has occurred since the end of the bear market in early 2003, the Total Stock Market (TSM), Midcap, Smallcap, REIT, and International indexes outperformed the Largecap indexes, posting gains ranging from 3.5% to 7.9%. TSM benefits from the relative outperformance of Midcap and Smallcap stocks. Also notable is the near-convergence of Large Cap Growth and Value results, after five consecutive years of outperformance on the Value side. See page 2 for the monthly and YTD figures.

**BOND** returns (price change plus interest) were essentially flat in January, as the interest earned was equal to the modest price declines resulting from higher interest rates. The Federal Reserve, as expected, raised the short-term interest rate it controls to 4.5%, the fourteenth consecutive quarter point rise since the low point of 1% reached in mid-2004. The benchmark 10-year US Treasury yield closed the month at 4.52%, higher than December's 4.39% close and almost equal to November's 4.50% close. This 10-year yield almost equaled the yield on the two-year bond, indicating a flat yield curve. Bond returns continued to lag the returns achieved on money markets, which benefit most directly from increases in short-term interest rates. Bond results for the month and YTD are reported on page 2.

The stock market rally that began decisively in March 2003 has raised the S&P 500 by 65% from its October 2002 low. While these gains have illustrated that stocks do not go down in perpetuity (a widely-held view during the depths of the 2000-02 bear market), the question of whether this recovery will continue depends, as always, on unknown, unpredictable future events. (See John Mauldin's book, discussed on pages 8-10, for a bear market view of stock prices.) Note also that after a 50% price decline, it takes a 100% gain to return to the previous level. Since the S&P 500 reached its high of 1,527 in Q1 2000, and then declined by almost half to 777 during Q4 2002, the current level of 1,280 is 65% higher than the low, but still down (16%) from the prior high, and still 247 points, or 32%, from the prior high.

In order to keep the current recovery in perspective, we continue to show the chart below, which sets out the extent of the declines measured from the highs of Q1 2000. The chart also puts these declines in the context of results since the end of 1994 (also see the figures on page 11). Note that the three indexes have positive average annual returns ranging from 9.7% to 10.6% for the 11.1 year period from the end of 1994 through January 2006, very much in line with long-term stock returns going back to 1926. Further, as these returns converge more and more, the idea of "regression to the mean" seems quite applicable.

**The long-term investor therefore has a very different view of the stock market's returns than those measuring returns from the highest levels.**

	<u>S&amp;P 500 (1)</u>		<u>DOW (1)</u>		<u>NASDAQ (1)</u>	
1st Qtr 2000 High	1,527		11,723		5,048	
Year End 2000	1,320	(13)%	10,785	(8)%	2,470	(51)%
September 21, 2001 Low	965	(37)%	8,235	(30)%	1,425	(72)%
Year End 2001	1,148	(25)%	10,020	(17)%	1,950	(61)%
October 9, 2002 Low	777	(49)%	7,286	(38)%	1,114	(78)%
Year End 2002	880	(42)%	8,342	(29)%	1,336	(73)%
Year End 2003	1,112	(27)%	10,454	(11)%	2,003	(60)%
Year End 2004	1,212	(21)%	10,783	(8)%	2,175	(57)%
Year End 2005	1,248	(18)%	10,718	(9)%	2,205	(56)%
Year 2006 thru January 31, 2006	1,280	(16)%	10,865	(7)%	2,306	(54)%

**Context: Prior Five-Year Gains in Bull Market of 1995 - 1999**

	<u>S&amp;P 500 (1)</u>	<u>DOW (1)</u>	<u>NASDAQ (1)</u>
End 1994	459	3,834	752
End 1999	<u>1,470</u>	<u>11,500</u>	<u>4,070</u>
Gain	1,011	7,666	3,318
Avg. Ann. % Gain: '95-'99; 5 years	26.2%	24.6%	40.2%
January 2006	1,280	10,865	2,306
Gain	821	7,031	1,554
Avg. Ann. % Gain: '95-1/06; 11.1 yrs	9.7%	9.8%	10.6%

1) Results for S&P 500, Dow Jones, and NASDAQ indexes do not reflect dividends or PPA's advisory fee.

## I. UPDATE OF KEY ECONOMIC INDICATORS

The strength of the overall US and world economies is one of a number of factors likely to influence the future direction of both stock and bond prices. We, along with many market observers and academics who write about the markets, believe stock and bond prices already reflect consensus expectations of economic growth. Further, we believe that even if you could accurately predict any number of actual economic figures, the market's reaction to those figures is essentially unpredictable. In any event, an understanding of the direction of current economic trends may at times be useful as a context to help understand market conditions. This section of the Comments provides an update of key economic indicators.

- (1) Gross Domestic Product (GDP) is the broadest measure of goods and services produced in the US economy. (GDP figures are inflation-adjusted, annualized growth rates. See the August 2005 Comments for reference to a NY Times [NYT] article titled "Economic View" (7/31/05, Financial section, pg. 4), which lists the major components of GDP). The initial estimate of GDP growth for the fourth quarter was 1.1%, "the slowest rate since the fourth quarter of 2002 and well below the average 4.1% growth of the prior ten quarters... Economic growth slowed to its most sluggish pace in three years as consumers and businesses applied the brakes to spending. While a rebound is likely in the current quarter, the expansion after two brisk years appears to be moderating as higher energy prices and interest rates begin to bite" (Wall Street Journal [WSJ], 1/28-29/06, front page).
- (2) Employment for December rose just 108,000 from November, "about half the increase Wall Street economists expected, and a sign the economy may have lost some steam. However, November's job gains were revised up sharply to 305,000 from 215,000. Economists said the average of the two months was a better indication of underlying employment growth than either month alone" (WSJ, 1/7-8/06, A3). The January figures will be released Friday, February 3<sup>rd</sup>.
- (3) Interest Rates on longer-term bonds increased in January. The benchmark 10-year US Treasury interest rate, which is set by buyers and sellers in the bond market, closed at 4.52%, compared to 4.39% in December, 4.50% in November, and 4.56% in October. The Federal Reserve, as expected, raised the short term interest-rate it controls by \_ of 1%, to 4.50%, the fourteenth consecutive increase since mid-2004. The ten-year and two-year bond yields are essentially the same, indicating a flat yield curve.
- (4) Inflation, as measured by the Consumer Price Index (CPI) "core" rate, which excludes the volatile food and energy sectors, increased 0.2% in December, and was up 2.2% for the year. With food and energy included, the monthly rate declined by (0.1)%, as energy and auto costs declined, but the full year rate was up 3.4% (WSJ, 1/19/06, A2). The Producer Price Index (PPI) core rate was up 0.1% for the month and 1.8% for the previous twelve months. With food and energy included, the monthly rate rose 0.9% and the full year rate was up 5.4%, with the sharp variances due to the highly volatile energy sector (Vanguard Economic Week in Review [VEWR], 1/9-13/06). (Note: The CPI measures prices of goods and services; the PPI, only goods).

- (5) Sector Economic Activity was Mostly Higher
- (a) Durable goods orders (industrial and consumer) rose 1.3%, and, excluding aircraft, was up a much stronger 3.5% (WSJ, 1/27/06, A2).
  - (b) Industrial production increased 0.6% for December, and 2.8% for all of 2005 (the fourth quarter increase was at a 3.8% annual rate) (WSJ, 2/18/06, B2).
  - (c) Retail Sales gained 0.7%, but only 0.1% excluding auto and gasoline sales. Sales were 6.4% higher than a year earlier (WSJ, 1/11/06). (Retail sales are not adjusted for inflation, and include disparate categories such as gasoline sales, auto sales, and non-store retailers such as the Internet).
  - (d) Housing sales for existing homes declined (5.7)% in December, a third consecutive monthly decline, but new home sales rose 2.9% (VEWR, 1/23-27/06).
  - (e) Personal Income increased 0.4% in December, “matching a similar surge in November,” but personal spending rose a much higher 0.9%, “sending the personal saving rate to a 73-year low” (WSJ, 1/31/06, A2). Note, however, that the definition of personal savings is itself open to question, as discussed in previous Monthly Comments.
- (6) Consumer Confidence, as measured by the Conference Board’s Index, “reached its highest level since June 2002,...driven primarily by consumers’ brighter view of the job market,...while consumers still remain wary about business conditions improving dramatically over the next six months” (WSJ, 2/1/06, A8).
- (7) Corporate Profits for the S&P 500 stocks are “expected to ring up their 15<sup>th</sup> consecutive quarter of double digit growth in operating profits for the first time in 20 years, according to S&P analysts” (WSJ, 1/17/06, C1). A detailed discussion of the significance of corporate profits, and the many difficulties involved in determining them, follows on pages 7-10 of these Monthly Comments.

Overall, the economic news reported during January was mixed, combining disappointing GDP and employment figures with stronger figures for a number of other measures. During the month, US stocks advanced, even in the face of higher interest rates, which in turn moved bond prices modestly lower and kept overall bond returns, including interest, essentially flat. Market prices and economic news showed little correlation for the month.

## II. STOCK PRICES: DIFFICULTIES IN DETERMINING FAIR VALUE

When a new year begins, the media is full of articles and analysis as to “What’s Ahead for Stock and Bond Prices for the New Year.” Since our view of the future is that it is inherently unknowable, we treat all these articles and analysis as essentially “filler.” However, we do understand that investors have an interest in gaining some insight into the question of “what’s ahead.” Our contribution to this dialogue is to point out one of the main underlying difficulties of arriving at a judgment as to a fair level for stock prices, namely the difficulty in determining corporate profits.

First, some basic background points need to be understood:

1) Stock prices are driven by the profits (also called earnings) of the companies whose shares are bought and sold in the public markets. Broad economic conditions such as the growth rate of the economy, inflation rates and interest rates, tax rates, budget deficits, oil and other commodity prices, international competition, and the exchange rate of the dollar are all factors that are filtered into the profit results of individual businesses.

2) Once a level of profits/earnings is achieved, investors as a group buy and sell shares based on their view of the future profitability of a company. This buying and selling process establishes a price (actually a price range) for the company’s stock at any given time. The relationship between the price of a stock and the company’s profits/earnings is referred to as the stock’s Price/Earnings (P/E) ratio. As an example, if a company has 1 billion shares of its stock owned by investors, and earns profits of \$1 billion in a year, its earnings are \$1 per share. Some companies with earnings of \$1 per share will have a market price of \$10 per share (which means a P/E of 10), while another company with the same \$1 per share of earnings will have a market price of \$30 per share (and a P/E of 30). The reasons for this vastly different pricing of the same \$1 of per share earnings are numerous, and a topic for future Comments. (Indeed, the different valuation placed on the same earnings by investors presents another major difficulty in arriving at a judgment regarding a fair level for stock prices, but is not the focus of this discussion.)

3) When all the companies in a certain segment of the stock market are combined in some identifiable way, they become part of an index. The P/E of the index can be ascertained by adding the earnings of all the component companies. For example, the P/E of all the companies in the S&P 500 index is approximately 18 times the last twelve months’ earnings of the component companies in the index (as reported in the WSJ, 1/28-29/06, pg. C2).

4) On any given day, P/Es of individual companies, or indexes, are set by buyers and sellers in the stock market, based on the prices at which they are willing to buy and sell shares. That same company with \$1 per share of earnings can be trading at \$20 today (P/E of 20) and \$18 tomorrow (a P/E of 18, down 10%), based on the buyer’s and seller’s perceptions of the future earnings of the company and/or the companies in an index.

With these points as background, let’s turn to the topic of the extreme difficulty of determining the profits/earnings of companies. If this difficulty does in fact exist, then it is also fair to conclude that the stock prices that are so dependent on the reported earnings of companies are also extremely difficult to justify.

Profits are earned when the revenues of a company exceed its expenses. All companies generate sales based on the products and/or services they are in business to provide. In bringing their products and services to the marketplace, they incur expenses. The amount by which sales exceed expenses is a company's profit. While this sounds straightforward, there are many, many judgment calls made by company managements and their accountants (all perfectly legitimate), which can change the results of the reported earnings on which stock prices are based.

Some accounting issues are longstanding in nature, and fairly well understood by the investment community. For example, depreciation of an asset is a recognized expense. The longer the useful life of an asset, the lower will be each year's depreciation expense. In other words, a ten-year useful life would give rise to straight line depreciation expense of 10% of the cost of the asset each year, whereas a twenty-year useful life would give rise to a 5% annual expense.

But some accounting issues that have arisen more recently have given investors reason to question the basic credibility of reported earnings. Three major issues are worth discussing: 1) the expensing of stock options; 2) the profits reported on pension plan investments; and 3) the characterization of continuing operation results compared to overall results including so-called one-time items. By the time we finish this discussion, you will see why reported earnings, which form the basis of stock prices, are very much open to question. Consequently, the stock prices themselves become open to question as well.

**Expensing Stock Options:** Until recently, companies were able to grant stock options to their employees and not consider the value of the options as an expense. (Stock options give people the right to buy stock at a set price, but the options will only be exercised if the stock price rises above the price at which the option was granted). The background to this issue is that a number of newer companies, particularly in the technology field, would issue large amounts of stock options to their employees when short of cash to pay salaries. The options were clearly designed as compensation, but because the compensation was paid in the form of stock options, and not actual stock or cash, the grant of the option was not recorded as an expense. The accounting profession came up with rationales for this treatment, such as the difficulty of placing values on the options or the fact that they may never be exercised. But by not counting any value for these stock options, the companies that issued them were able to show earnings far in excess of what would have been reported had the options been treated as an expense. In a book published in 2004, "Bull's Eye Investing" by John Mauldin, the author cites a 2002 report "suggesting that the aggregate operating income for the S&P 500 drops 12% for 2001 when adjusted for the fair value of employee stock options" (pg. 107). The author then comments that while 12% may not "seem like a big deal" (pg. 107), for many companies, particularly large technology companies, the adverse impact to their earnings would be far greater. Actually, we think the 12% reduction in earnings is also "a big deal" since, all other things being equal, it would move stock prices down by 12%, or require a correspondingly higher P/E to justify the level of stock prices.

**Pension Plan Accounting:** Mauldin's book explains this issue as follows: "In 2001, companies reported a gain of \$104 billion from their pension funds, when they actually saw their pension fund assets go down by \$90 billion... Corporations are not required to report (pension plan) losses under current generally accepted accounting principles... But forget about reporting losses. These companies are reporting gains. How do you turn a loss into a gain? You simply go to a pension fund consultant, ask the consultant to make estimates of what the earnings will be in coming years, and if (those) estimated earnings in the future years are more than enough to cover estimated liabilities (of the plan) in the future, you get to put the positive difference on your company balance sheet. If you need more earnings, you get a higher estimate" (pg 111; comments in parenthesis are ours, to make the quoted portion clearer). The author then cites a study that 88 of the largest 100 companies with defined benefit pension plans used 9% or more as the estimated future rate of return for their pension plan investments (pg. 111). If actual returns come in at a lower figure, "companies will have to come up with large capital infusions to their pension funds over the next five years, which come directly out of earnings... Most of these companies have the ability to fund their obligations out of cash flow... But it means their earnings are going to be less" (pg. 114). Using Mauldin's numbers, the extent of the problem is in the tens of billions of dollars.

**Profit results from continuing operations:** Some companies use these figures instead of the (usually worse) overall results including one-time items. For more on this topic, we have chosen to use Professor (of Finance at Pennsylvania's Wharton School) Jeremy Siegel's well known "Stocks for the Long Run," Third Edition, as our source. "However, the Financial Accounting Standards Board also allows firms to flag unusual or extraordinary expenses and revenues when reporting earnings. Consideration of these extraordinary items is important for investors to determine the ongoing earnings that firms are capable of delivering. Since the value of a stock depends on projecting earnings into the far future, it is of prime importance for stockholders to judge those components of the earnings stream which are permanent and those which are temporary. For example, if the P/E ratio of a stock is 20, then a permanent change in earnings will have 20 times the impact on the stock price. However, if a change in earnings is considered to occur only once because of extraordinary circumstances, and long-term earnings and cash flow expectations remain unchanged, the stock price should not be affected significantly. Firms often use the term operating earnings to represent their ongoing revenues and expenses adjusted for any one-time occurrences that may distort the normal reported earnings. Unfortunately, the term operating earnings is not defined by generally accepted accounting principles, and without any established standards, firms have complete discretion over what revenues and expenses they consider extraordinary in their calculation of operating earnings... Since 1991, the average difference between operating and reported earnings has been 12%" (pp. 98-99).

Siegel's discussion does not mention another recent development, which is the annual occurrence of special items such that they become normal for certain companies. A recent example was General Electric's fourth quarter 2005 profits. A WSJ article (1/21-22/06, pg. A3) stated that quarterly income was down 46% because of a huge expense associated with the majority sale of GE's reinsurance business. The company, however, reported profits from its continuing businesses as plus 1%. The article also mentions that during each reporting period, GE, the second largest company in the US stock market by market value (Exxon-Mobil is the largest), has a number of special items, so that the very idea of normalized, operating earnings for a huge, diverse enterprise like GE is questionable.

The WSJ reported recently as (1/27/06, pg. C2) that the P/E ratio for the S&P 500 index is 18 based on the last twelve months' actual earnings, and 17 based on the next twelve months' estimated earnings. Comparable figures for the Dow Jones Industrials were 21 and 17, respectively; for the NASDAQ, 34 and 30; and for the Russell 2000 index of small cap stocks, 41 and 29. With the S&P 500 closing at 1,284, a P/E of 17 brings estimated operating earnings per share of the component companies to \$71.33 (\$71.33 times 17 equals 1,284). Mauldin discusses the huge discrepancy between reported earnings and a concept of "core earnings" used by the Standard and Poor's company to standardize reported earnings (pp. 102-105). Core earnings, which include options expensing and proper pension accounting, are well below reported earnings.

So what is the real P/E of stock prices today? 17-18 might appear reasonable, but 25, or 30, or higher, would strike many as excessive. At Park Piedmont, we have no opinion as to the correct level of earnings. We do think it important, however, that investors understand all these differences of opinion, which lead logically to the conclusion that trying to value stock prices based on earnings is an extremely difficult proposition.

We have quoted Mauldin's book extensively here, and at this point we should note that it is premised on his view that the US stock market is in a secular (i.e., long-term) bear market that is likely to deliver negative returns in the future. His time frame for this analysis is 2004 through 2010 (pp. 1 and 2). (Our note: A bear market started in 2000, and the stock market, as measured by the S&P 500, declined by 50% from its 2000 high to its 2002 low. Since that low, the S&P 500 has recovered approximately 60% of this decline through year-end 2005, leaving it still 20% below its all time highs).

We neither agree nor disagree with Mauldin, and are very uncomfortable with predictions of future stock market price movements, primarily because we believe the future is so unpredictable. Rather, we tend to follow David Swensen's observations about investing in stocks, as follows: "Finance theory predicts and practical experience demonstrates that stocks provide superior returns over reasonably long holding periods...Yet investors must guard against relying on equities to exhibit their general characteristics (that is, superior returns over reasonably long holding periods) in any specific time frame or allowing equities to account for too large a portion of the target portfolio. History may overstate the attractiveness of US stocks. Returns of bonds and cash may exceed returns on stocks for years on end. For example, from the market peak in October 1929, it took stock investors fully 21 years and 3 months to match returns generated by bond investors (Our note: the period 2000-2005, cited above, is another such period during which bonds have outperformed stocks). The best protection against the shortcomings of equity investments lies in owning an all-inclusive, market-like portfolio of equity securities in the context of a well diversified collection of asset classes" (pg 47. from "Unconventional Success, by Swensen, Yale's chief investment officer. We cited this book extensively in the October, November, and December 2005 Monthly Comments).

In other words, own stocks as part of an overall asset allocation, consistent with your specific investment goals and risk tolerance, which is a one-line summary of Park Piedmont's advice to investors.

S&P 500 (1)                      DOW JONES (1)                      NASDAQ (1)

1) Results for S&P 500, Dow Jones, and NASDAQ indexes do not reflect dividends or PPA's advisory fee.

**I. Figures From Period Starting 2000 (% Figures Are Cumulative Declines From 1/01/00)**

Start of 2000	1,470		11,500		4,070	
End of 2000	1,320	(10.1)%	10,785	(6.2)%	2,470	(39.3)%
Sept. 21, 2001 <u>Low</u>	965	(34.3)%	8,235	(28.4)%	1,425	(65.0)%
End of 2001	1,148	(21.9)%	10,020	(12.9)%	1,950	(52.0)%
Oct. 9, 2002 <u>Low</u>	777	(47.1)%	7,286	(36.6)%	1,114	(72.6)%
End of 2002	880	(40.1)%	8,342	(27.5)%	1,336	(67.2)%
End of 2003	1,112	(24.3)%	10,454	(9.1)%	2,003	(50.8)%
End of 2004	1,212	(17.5)%	10,783	(6.2)%	2,175	(46.5)%
End of 2005	1,248	(15.1)%	10,718	(6.8)%	2,205	(45.8)%
Through January 31, 2006	1,280	(12.9)%	10,865	(5.5)%	2,306	(43.3)%

**II. Figures From Period Starting 1995 (% Figures Are Gains From 1/01/95)**

Start of 1995	459		3,834		752	
End of 1999	<u>1,470</u>		<u>11,500</u>		<u>4,070</u>	
5 Year Gain; Annualized %	1,011	26.1%	7,666	24.6%	3,318	40.2%
End of 2001	<u>1,148</u>		<u>10,020</u>		<u>1,950</u>	
7 Year Gain; Annualized %	689	14.0%	6,186	14.7%	1,198	14.6%
End of 2002	<u>880</u>		<u>8,342</u>		<u>1,336</u>	
8 Year Gain; Annualized %	421	8.5%	4,508	10.2%	584	7.5%
End of 2003	<u>1,112</u>		<u>10,454</u>		<u>2,003</u>	
9 Year Gain; Annualized %	653	10.3%	6,620	11.8%	1,251	11.5%
End of 2004	<u>1,212</u>		<u>10,783</u>		<u>2,175</u>	
10 Year Gain; Annualized %	753	10.2%	6,949	10.9%	1,423	11.2%
End of 2005	<u>1,248</u>		<u>10,718</u>		<u>2,205</u>	
11 Yr Gain; Annualized %	789	9.5%	6,884	9.8%	1,453	10.3%
Through January 31, 2006	<u>1,280</u>		<u>10,865</u>		<u>2,306</u>	
11.1 Yr Gain; Annualized %	821	9.7%	7,031	9.8%	1,554	10.6%



**Victor Levinson**



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