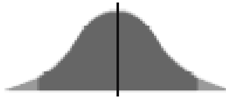

Park Piedmont Advisors LLC

Registered Investment Advisor

VICTOR LEVINSON **NICK LEVINSON, CFP®**

JUNE 2006 COMMENTS

NICK has earned his CERTIFIED FINANCIAL PLANNER (CFP) Designation:
In today's investment advisory world, in which people can provide investment advice with no professional background, Nick has earned one of the investment industry's most respected professional designations. The CFP requires study in five areas of the financial advisory field, including Investments, Insurance, Taxes, Retirement Planning, and Estate Planning. The final designation comes only after passing a 300-question test that takes 10 hours to complete over the course of two days. For all who work with Nick, this should come as no surprise; for those who do not, you can now be assured of his expertise. As for Vic, lots of experience and a law degree have provided similar expertise, which he has imparted to clients for more than twenty five years.

CHECKING ACCOUNT and CREDIT CARD FACILITIES:
You can have both a checking account and credit card from National Financial Services (NFS), the custodian of the securities in your accounts managed by Park Piedmont Advisors (PPA). NFS is 100% owned by Fidelity Investments. For further information, contact either Lynette, Victor, or Nick

REFERRALS of ACCOUNTANTS as POTENTIAL INVESTMENT ADVISORS:
PPA is looking to expand its business by associating with currently practicing accountants who also have an interest in providing investment advice to their clients using the PPA methodology of setting an appropriate asset allocation and implementing with indexed investments. If you know of an accountant who might be interested, please let us know.

IMPORTANT INSIGHT (see page 7 for full quote and cite)
On the use of historical data in trying to estimate future risk and return: …"the overwhelming historical data do not guarantee accuracy in estimating these risk-reward parameters… As Nobel laureate Paul Samuelson is fond of saying, 'We have but one sample of history.'"

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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.

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COMMENTS: INDEX RESULTS for period ending JUNE, 2006

STOCKS	YEAR 1999	YEAR 2000	YEAR 2001	YEAR 2002	YEAR 2003	YEAR 2004	YEAR 2005	YTD 2006	CURR. MONTH
Vanguard Total Stock Market Index Fund (1)	23.8%	(10.6%)	(11.0%)	(21.0%)	28.4%	12.5%	6.0%	3.3%	0.2%
Standard & Poors 500 Index (2)	19.6%	(10.1%)	(13.0%)	(23.4%)	26.4%	9.0%	3.0%	1.8%	0.0%
Vanguard S&P 500 Growth Index Fund (1)	28.8%	(22.2%)	(13.0%)	(23.7%)	25.9%	7.2%	5.1%	(0.8)%	(0.4)%
Vanguard S&P 500 Value Index Fund (1)	12.6%	6.1%	(12.0%)	(20.9%)	32.2%	15.3%	7.1%	6.2%	0.7%
Dow Jones Industrial Average Index (2)	25.2%	(6.2%)	(7.1%)	(16.8%)	25.3%	3.2%	(0.6)%	4.0%	(0.2)%
NASDAQ Composite Index (2)	85.6%	(39.3%)	(21.0%)	(31.5%)	50.0%	8.6%	1.4%	(1.5)%	(0.3)%
Vanguard Midcap US Index Fund (1)	25.0%	2.6%	(4.8%)	(16.3%)	34.1%	20.4%	13.9%	4.4%	(0.3)%
Vanguard Smallcap US Index Fund (1)	19.6%	(4.2%)	1.0%	(21.6%)	45.6%	19.9%	7.4 %	6.9%	0.2%
Vanguard International Index Fund (EAFE) (1)	25.3%	(15.2%)	(22.6%)	(17.5%)	40.3%	20.8%	15.6%	9.5%	(0.5)%
Vanguard Emerging Markets Index Fund (1)	61.6%	(21.6%)	(2.9%)	(7.4%)	57.7%	26.1%	32.1%	6.1%	(0.2)%
Vanguard Real Estate Invest. Trust Fund (1)	(0.4%)	26.4%	12.4%	3.8%	35.7%	30.8%	11.9%	13.2 %	5.7%
BONDS									
Vanguard Total Bond Market Index (1)	(0.8%)	11.3%	8.3%	8.2%	4.0%	4.2%	2.4%	(0.9)%	0.1%
Vanguard Interm. Tax-Exempt Index Fund (1)	(2.9%)	9.2%	5.0%	7.9%	4.4%	3.2%	2.4%	0.1%	(0.4)%
Vanguard Short-term Bond Index (1)	2.1%	8.9%	8.9%	6.1%	3.4%	1.7%	1.3%	0.5%	0.0%
Vanguard Short Tax-Exempt Index Fund (1)	2.6%	4.9%	4.8%	3.5%	1.6%	1.1%	1.8%	1.2%	0.1%
Vanguard High-Yield Bond Fund (1)	NA	NA	NA	1.7%	17.2%	8.5%	2.8%	1.0%	(0.4)%
Vanguard Inflation-Pro -tected Bond Fund (1)	NA	NA	7.6%	16.6%	8.0%	8.3%	2.6%	(1.7)%	0.3%

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.

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%	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q
		1999				**2000**				**2001**		
S&P 500	4.1	7.6	(7.7)	15.6	2.0	(3.0)	(1.3)	(7.8)	(12.1)	4.8	(13.8)	8.1
NASDAQ	14.6	10.0	0.0	61.0	12.4	(14.8)	(7.2)	(29.6)	(25.5)	12.9	(26.7)	18.3
BONDS	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.												
		2002				**2003**				**2004**		
S&P 500	0.0	(13.8)	(14.1)	4.5	(1.8)	12.8	2.2	13.2	1.3	1.3	(2.4)	8.8
NASDAQ	(5.5)	(19.5)	(13.5)	7.0	2.5	19.2	12.1	16.2	(0.5)	2.7	(7.5)	13.9
BONDS	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.												
		2005				**2006**				**2007**		
S&P 500	(2.6)	0.9	3.1	1.6	3.7	(1.9)						
NASDAQ	(8.1)	2.6	4.4	2.5	6.1	(7.6)						
BONDS	(0.5)	3.0	(0.7)	0.6	(0.7)	(0.2)						
Interm. Tax.												

JUNE 2006 COMMENTS

STOCK index prices for US large cap stocks were virtually unchanged in June, in spite of continued substantial day to day volatility. The S&P 500 was unchanged, while the Dow Industrials and NASDAQ declined (0.2)% and (0.3)% respectively. The Total Stock Market (TSM), which includes Midcap and Smallcap stocks and has had better results for several years, gained 0.2%, with Midcap down (0.3)% but Smallcap up 0.2% The International and Emerging Market indexes declined (0.5)% and (0.2)%, respectively. Only the REIT index had a meaningful result, up 5.7%. Largecap Value continued its substantial outperformance of Largecap Growth. See page 2 for figures for the month, YTD, and since 1999.

BOND returns (price change plus interest) were also virtually unchanged, amidst ongoing volatility. The benchmark 10-year US Treasury yield reached a high of 5.24%, but closed the month at 5.14%, only 1 basis point higher than May's close. March and April provided the year's major bond price declines, and bond prices actually rallied at the end of June following the comments that came with the Federal Reserve's 17th consecutive increase in the short term rates it controls, from 1% to the current 5.25%. YTD bond returns for short and intermediate maturities fall within a narrow range of –(0.9)% to +1.2%. Bond returns continued to lag returns from money markets, which benefit most directly from increases in short-term interest rates. Even with these disappointing returns, however, it should be remembered that **rising interest rates, while they adversely affect bond results over the short term, eventually provide higher returns in the form of higher interest rates.** See page 2 for results for the month, YTD, and since 1999.

The stock market rally that began decisively in March 2003 has raised the S&P 500 approximately 63% from its October 2002 low, but is still 257 points from its all-time high of 1,527 (this is 16% from the all-time high, and 33% from the 2002 low). This result occurs because after a 50% price decline, prices must increase by 100% to reach their previous high levels. By contrast, the Dow Jones Industrials are a mere 5% below their all-time high, while the NASDAQ remains a stunning 57% below its all-time high. Although the longer-term results of these three averages are quite similar (see next paragraph and chart below), the differences in the magnitude of both the gains and declines since 1994 are strikingly large.

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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 10). Note that the three indexes have positive average annual returns ranging from 9.2% to 9.7% for the 11.5 year period from the end of 1994 through June 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," described by Swensen as "one of the most powerful influences in the world of finance," (pg 154), comes clearly into focus.

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

	S&P 500 (1)		DOW (1)		NASDAQ (1)	
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 June 30, 2006	1,270	(16)%	11,150	(5)%	2,172	(57)%

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

	S&P 500 (1)	DOW (1)	NASDAQ (1)
End 1994	459	3,834	752
End 1999	1,470	11,500	4,070
Gain	1,011	7,666	3,318
Avg.Ann.%Gain:'95-'99; 5 years	26.2%	24.6%	40.2%
June 2006	1,270	11,150	2,172
Gain	811	7,316	1,420
Avg.Ann.%Gain:'95-6/06; 11.5 yrs	9.2 %	9.7 %	9.3 %

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

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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). The final annualized growth rate for Q1 2006 was 5.6%, "up from the previous estimate of 5.3% … but forecasters say economic growth for Q2 was substantially slower" (Wall St. Journal [WSJ], 6/30/06, A5).

(2) Employment for June will not be reported until Friday, July 6th. The most recent report for May (reported in our May Comments), showed employment rising by only 75,000, following a 126,000 gain in April, "less than half the pace of the previous four months… and adding to the body of evidence showing that the rate of growth of the US economy is clearly slowing" (WSJ, 6/3-4/06, A3).

(3) Interest Rates on longer-term bonds were little changed in June, with the benchmark 10-year US Treasury interest rate, which is set by buyers and sellers in the bond market, closing at 5.14%, up only slightly from May's 5.13% and April's 5.07%. Far more dramatic rate increases had occurred during the two previous months, with the benchmark bond yield rising a full one half of one percent. In fact, after the Federal Reserve, on June 29th, raised the short-term rate it controls for the seventeenth consecutive time, to 5.25%, up from 1% two years ago, market interest rates actually declined. The reason for the decline was that the Fed's statement accompanying this latest increase "suggested growing prospects for a pause in rate increases" (WSJ, 6/30/05, front page).

(4) Inflation, as measured by the Consumer Price Index (CPI) "core" rate, which excludes the volatile food and energy sectors, increased 0.3% in May, and is up 2.4% "from a year earlier, the highest rate of core inflation in more than a year. With food and energy included, the monthly rate was up 0.4%, and the most recent twelve-month increase was 4.2% (WSJ, 6/15/06, A3). The Producer Price Index (PPI) core rate was up 0.3%, with the twelve month increase at 1.5%. With food and energy included, the monthly increase was 0.2%, and the yearly increase 4.5%. (Vanguard Economic Week in Review [VEWR], 6/12-16/06). (Note: The CPI measures prices of goods and services; the PPI, only goods). The close relationship between inflation rates and interest rates has been discussed at length in a number of recent Monthly Comments.

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(5) Sector Economic Activity was Mixed

(a) Durable goods orders (industrial and consumer) declined 0.3% in May, "but for the first five months of 2006 were more than 9% higher than the comparable year-earlier period" (WSJ, 6/24-25/06, A4).

(b) Industrial production "declined 0.1% in May after three consecutive monthly gains, but output…is still running 4.3% higher than a year earlier…and capacity utilization fell to 81.7% from 81.9% (WSJ, 6/16/02, A2).

(c) Retail Sales increased 0.1% in May, and 7.6% over the previous twelve months. The WSJ article reporting these figures began with the statement that "lukewarm retail sales last month suggest that higher gasoline prices and the weakening housing market are taking a toll on consumers and slowing the economy" (WSJ, 6/14/06, A2). (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 by 1.2% in May, "the seventh decline in nine months" (WSJ, 6/28/06, A2). However, new home sales rose in May "for the third consecutive month,…but the pace of new home sales was 5.9% lower than a year earlier, and the housing market in general still appears to be softening from last year's peak" (WSJ, 6/27/06, A2).

(e) Personal Income increased 0.4% in May, and personal spending also grew 0.4%. The personal savings rate, which excludes gains in stock prices and housing, declined again, by -1.7%, the "second lowest level on record" (VEWR, 6/26-30/06).

(6) Consumer Confidence for June, as measured by the Conference Board's Index, rose one point, to 105.7. Consumers "remain concerned about the short term outlook," but their future expectations improved (WSJ, 6/28/06, A2).

(7) Corporate Profits for the first quarter of 2006 "climbed at an annual rate of 13.8%, to $1.2 trillion, much faster than the previous 8.8% estimate" (WSJ, 6/30/06, A5). Even at the lower prior estimated figure, "after-tax corporate profits' share of the entire economy reached the highest level in at least sixty years" (WSJ, 5/26/06, A2).

Overall, the economic news reported during June was mixed, as rising interest rates and continuing high gasoline prices continued to have some adverse impacts on segments of economic growth, and also generated higher than desired inflation. How this combination of potentially slower growth, caused at least in part by higher interest rates, higher oil prices, and increasing rates of inflation plays out in the markets going forward, remains to be seen. The final stock and bond market results for June were almost unchanged, following a significant May decline in stock prices around the world. Considerable day to day volatility remained in the markets in June, even with the overall neutral results.

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II. INVESTMENT RISKS: ALTERNATIVE INVESTMENTS, CONTINUED

This section marks the third consecutive month in which our Monthly Comments have focused on the RISKS associated with investing. April's Comments discussed the more traditional investment categories of stocks and bonds, while May's Comments began the discussion of Alternative Investments, covering Hedge Funds, Leveraged Buyout and Venture Capital Funds, and Commodities. This month's discussion will focus on Currencies, and International and Emerging Markets. We plan to discuss Annuities in detail next month.

Alternative Investments have been developed in an effort to convince investors to use, at least in some amounts, investments other than the more traditional asset classes of cash, bonds, and stocks, from US-based companies (for bonds and stocks) and US government entities (for cash and bonds). The basic ideas behind Alternative Investments are that they offer: (a) diversification and (b) either potentially higher performance with acceptable levels of risk and/or potentially lower risk with acceptable investment returns.

All investments contain elements of RISK, which we define as the likelihood of financial loss in a time frame relevant to you (see April Comments). The investment results during the past two months have reinforced this fact very clearly in the minds of investors, as all stock markets have posted significant declines, with the recent best-performing international and emerging market sectors declining the most. Once again, the danger/risk of believing that recent outstanding past performance is likely to continue has been clearly demonstrated. Further, rising interest rates have continued to send bond prices lower.

The sources quoted below include "Unconventional Success," by David Swensen (Chief Investment Officer of Yale's highly successful endowment fund); "Stocks for the Long Run," by Jeremy Siegel (Professor at Penn's Wharton School); Ibbotson's 2006 Yearbook, "Market Results for 1926-2005"; and Wall Street Journal (WSJ) articles. In both our April and May Comments, we summarized our views of risk by stating that "we of course agree (with Swensen) that asset allocation implemented with a broadly diversified portfolio of low cost indexed investments is the most appropriate method of controlling investment risk, and that the activities of chasing recent hot performers and market timing should be avoided. We also advocate rebalancing as a further step towards risk reduction, selling portions of the most recent hot performers and adding to the recent underperformers, to take advantage of the "powerful influence" of regression to the mean."

CURRENCIES: First some background: Currencies are bought and sold in the marketplace, and the value of currencies fluctuate in relation to one another. For our discussion, the focus will be on the value of the US dollar in relation to other major world currencies such as the European Union euro and the Japanese yen. When the dollar declines in value relative to other currencies, it means more US dollars are needed to buy the goods and services being imported from other countries. From a purely financial standpoint, it means that more dollars are needed to buy the currencies of the other countries. Those other currencies become more expensive relative to the dollar, and increase in value. Investments can be made that generate profits depending on the changing value of various currencies.

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There are various reasons cited for the fluctuating value of currencies, including trade deficits and/or surpluses, interest rate levels, and political considerations. There is also a fair amount of disagreement regarding the impact of these reasons. In a recent WSJ article (4/3/06, pg. C7), all of these influences, and their likely significance, are discussed. "Record deficits in the US current account, which is a broad measure of trade in goods and services plus certain financial transactions, often were cited as the impetus for the dollar's rapid weakening….Yet…historical data fail to show any meaningful correlation between dollar declines and a widening current account deficit." The article refers to both Warren Buffet and Bill Gates "voicing their long-run concerns about the value of the dollar," based on the record deficit in America's current account, but then cites Ken Fisher, head of a firm that manages over $30 billion, who argues that the United Kingdom has a strong currency and current account deficits similar to the US as a percentage of GDP. The article also makes the point that "for an economy to correct a current account deficit, it needs to earn more abroad than it is spending abroad. A weaker currency is one way to accomplish this. And if a country's policy makers won't take the necessary steps….foreign exchange traders may do the work for them."

The article cites a recent report from the Bank of International Settlements "suggesting that the difference between US and other countries' interest rates has been playing a big role in how oil producing nations invest their reserves." Currently, interest rates in the US are significantly higher than in Europe and Japan, which lends support for the value of dollar and tends to limit the amount of its decline. As for political considerations, the article discusses the point that oil producing countries, and other countries seeking to express dissatisfaction with American policies, might stop purchasing US dollars, causing the value of the dollar to decline.

There has also been considerable discussion recently about the value of the Chinese currency, the yuan, relative to the US dollar. Many in the US government believe China maintains its currency at an artificially low level in relation to the dollar, in order to continue to export huge quantities of its low priced goods into the American marketplace. Note that while this may be bad news for US companies trying to compete against Chinese firms selling these low cost goods, it is also good news for the American consumer, and America's level of inflation, that all these low priced goods are available. Another WSJ article (5/9/06, pg. A4) discusses this issue as follows: "American manufacturers and their allies in Congress have argued for several years that China is, in effect, cheating in international trade by keeping the yuan weak against the dollar. The exchange rate, they say, makes Chinese goods artificially cheap in the US and American goods artificially expensive in China, costing US factory jobs." The thrust of the article was that there were a number of economists advocating that China continue its current policy, and not be pressured into having its currency appreciate significantly.

As should be clear, the shifting value of currencies has significant ramifications far beyond whether investors can improve their overall investment returns by adding currencies to their portfolios. However, it is to this question of investing in currencies that we now turn.

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There are a variety of mutual funds with the objective of benefiting from the changing value of currencies. An article in the Sunday NY Times Financial section (4/30/06, pg. 6), covers the rising number of alternatives now available. "Those who follow a buy and hold strategy but want to buffer their holdings against currency shifts may be interested in a small but growing category of investments: foreign currency mutual funds. Until last year, there was only one, the Franklin Templeton Hard Currency fund (FTHC), which has been around since 1989. But in the wave of the dollar's big decline in 2004, a few more foreign currency funds began trading last year…. FTHC essentially bets against the dollar with holdings in short-term, foreign-denominated fixed income securities from a variety of countries. It is generally designed to rise sharply when the dollar takes a big fall, but is likely to decline in periods when the dollar is surging. At other times it should return money market rates…. A fund with a similar strategy is Merk Hard Currency (MHC)…. Both funds buy bonds denominated in so called hard currencies - the euro, British pound and Canadian dollar, countries where the economics and politics are widely viewed as stable. But there are differences in the funds' approaches. FTHC emphasizes Asian currencies; the MHC holds none of them (it owns the euro, British pound, Swiss franc and Swedish krona, along with the Australian and Canadian dollars.)" Newer funds in this sector include entries from Profunds and Rydex, both of which have funds that can benefit from either the declining, or rising, value of the dollar.

Is this simply a passing fad, or is there real benefit to adding such funds to an investment portfolio? The same NY Times article states that "the main reason to invest in these funds would be for diversification in portfolios that don't already have a big stake in foreign stock or bond funds." It also cites a Morningstar analyst who commented that "someone with most of their investments in domestic assets has a lot of risk concentrated in the dollar," and who "likened investing in foreign currency funds to buying insurance against a big decline in the dollar." This same analyst also "cautioned that most people would be wise to keep such holdings as a small part of their portfolios and to treat them as long-term assets, rather than to jump in and out of them to place quick bets against the dollar." In a WSJ article (5/3/06, pg. D3), currency investing is also discussed as a relatively new asset class being added to the recommended list of a number of Wall Street investment management firms. As for Swensen, he makes no mention of using currencies as an asset class, which means he does not recommend their use by individual investors.

We have been using the FTHC fund in certain client portfolios for some period of time, emphasizing their use in retirement accounts so that the yield from the investments can be received untaxed. The primary purpose for using a declining dollar currency fund is for diversification, working on the idea that a declining dollar may occur in a time frame when other US investments are not performing well. However, given the many factors that can affect currency values, we agree that there is no clear correlation between a declining dollar and the performance of other asset classes.

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We discussed the idea of correlation as related to risk, in May's Comments, as follows: Low correlation among investments is desirable for investors looking to lower risk and to achieve the benefits of diversification, while giving up some of the upside. Why? Because if some investment categories are going down, while others are rising in the same time frame, this may reduce returns in times of generally rising market prices. But by the same token, portfolio declines can be reduced during times when those previously rising categories encounter lower prices. Low correlation therefore tends to reduce risk.

INTERNATIONAL INVESTING, including EMERGING MARKETS

One reason provided for investing in currencies was to add an element of diversification to a portfolio of mostly US investments. An even more direct way to accomplish this diversification, and the approach favored by Swensen, is to add stock investments from both developed and developing, or "emerging market", countries, to a portfolio. Before presenting Swensen's views on these investment categories, it is worth noting that the recent popularity of both categories is no doubt attributable to their recent outstanding performance, as compared to the Total US Stock Market indexes (all Vanguard index funds; see page 2).

	International	**Emerging Markets**	**Total US Stock Index**
2003	40.3%	57.7%	28.4%
2004	20.8%	26.1%	12.5%
2005	15.6%	32.1%	6.0%
2006			
As of April 30	15.1%	19.1%	6.5%
As of May 31	10.0%	6.3%	3.1%
As of June 30	9.5%	6.1%	3.3%

The fact that the most recent two months since April 30, 2006 (particularly the month of May) have resulted in significant declines to both the international and emerging market sectors serves to reinforce the caution against chasing recent performance, a point we stress in our Comments and which is reemphasized by Swensen in the paragraphs which follow.

The diversification argument for international and emerging market investing, as distinguished from the effort to identify and overweight sectors with the potential to outperform, is made persuasively by Swensen. "The lack of correlation between foreign markets and the US market provides a valuable diversification opportunity for investors. Some observers speculate that the process of global economic integration has caused world equity markets to behave increasingly one like the other, leading to less prospective diversification. As evidence of increasing correlation between markets, diversification skeptics point to the behavior of equity markets in the Crash of 1987 and in the financial dislocations during the crisis of 1998. In both instances, stock markets worldwide exhibited similar, extraordinary declines. Yet market declines in 1987 and 1998 constituted short-term events in which market players expressed extreme preferences for liquidity and quality. After brief periods during which many developed equity markets moved in concert, individual country markets reverted to fluctuation in response to country specific drivers of relative market performance" (pg. 58).

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Swensen continues by citing the history of the US and Japanese markets since 1980. During the 1980s, "Japan dominated all other world markets, returning 28.4% annual return compared to 16.5% for other non-US markets and 17.4% for the US equity market. Near the end of the extraordinary bull run in Japanese stocks, Japan boasted the largest market capitalization in the world, surpassing even the massive US market in size" (pg. 59). But in the 1990s, Japan's stock market declined 0.9% annually for the entire decade, compared to gains of 13.5% for other non-US markets and an "astonishing" gain of 18.2% for the US market. "At one point, Japan's equity market capitalization amounted to less than one-fifth the US market's capitalization. Clearly, investments in individual equity markets behave differently, generating returns that differ from one another, thereby providing diversification to portfolio holdings" (pg. 59).

Swensen also notes that as of 1993, "after an extended period of poor relative foreign equity performance, foreign market exposure accounted for only 5% of aggregate mutual fund equity holdings." Then in 1993 and 1994, foreign developed stock markets strongly outperformed the US market, and by October 1994 foreign equity holdings had risen to an all time high of 14% of mutual fund equity holdings. "As might be expected from performance chasing activity, the timing of the diversification move proved costly," as domestic markets then outperformed foreign developed markets for the next four years, and investors reduced their foreign equity positions to 8% of fund equity holdings (pg. 59).

Swensen's conclusion to the discussion of international investing, in the context of diversification and performance chasing, is as follows: "Strong relative performance of foreign equities caused mutual fund owners to dramatically increase non-US equity holdings, with investors frequently citing diversification as the rationale for boosting foreign allocations. Disappointing performance from the diversifying asset caused investors to reduce allocations at an inopportune time. SENSIBLE INVESTORS PURSUE DIVERSIFICATION AS A POLICY TO REDUCE RISK, NOT AS A TACTIC TO CHASE PERFORMANCE (our emphasis). In any case, foreign equities provide an important tool for reducing portfolio risk without sacrificing expected returns" (pg. 60).

Turning to EMERGING MARKETS EQUITY, Swensen states that "investing in emerging markets represents a high risk, high expected return segment of the marketable equities universe. Defined as a group of countries with economies in an intermediate stage of development, neither undeveloped nor developed, emerging markets present a formidable array of fundamental risks for investors" (pg. 62). Countries included in the major index reflecting this category include Mexico, Jordan, Thailand, India, Korea, Taiwan, South Africa and Russia. "Market observers frequently confuse strong economic growth with strong equity market prospects. In emerging markets, as elsewhere, economic growth may not translate into stock market success" (pg. 63-64). Even with these caveats, Swensen concludes that "a modest allocation to emerging markets stocks contains the potential to enhance the risk and return characteristics of most investment portfolios" (pg. 66).

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Given the strong performance of both the developed and emerging market sectors over the past few years, and the sharp declines during the past few months, the daily financial press has had a number of recent articles on these sectors. Starting with a NY Times Sunday Financial section article (5/14/06, pg. 5), when international and emerging markets were still showing outstanding returns, the author began as follows: "Whenever an asset class performs exceedingly well, investors invariably come up with an endless list of reasons why they should own more of it – and convince themselves that it's not particularly risky to do so. With foreign stocks, many of which have performed spectacularly over the past few years, the prevailing argument appeals to our sense of conservatism. It's O.K. to load up on international equities, the argument goes, because foreign holdings help diversify our investments. And what could be safer than a well-diversified portfolio? Of course, a decade ago, the diversification argument didn't hold much sway. That's when foreign shares were being lapped by domestic blue chip socks. But today, it's foreign shares that are outperforming, and it's a whole lot easier to embrace diversification when it means stepping into an asset that's already up more than 30% a year for the last three years…. Diversifying overseas can lower the risk in your portfolio over the long term. But 'in light of the fact that things have gone up so much in recent years, investors need to be mindful of short term risk' (the author quoting a strategist from Standard & Poor's). The biggest problem, as anyone who invested in technology stocks in the late 1990's will recall, is that investments invariably 'revert to the mean.' This is a fancy way of saying that stocks that are outperforming today will eventually fall back in line with their historic average gains. But to do so, they need to go through a period of underperformance."

The article continues by noting various ways to mitigate some of the short term risks, including: (a) dollar cost averaging into new positions; (b) buying after a price decline of some predetermined amount; and (c) rebalancing, by taking some gains off the table. Further, these techniques apply to positions in both developed international stocks and emerging market holdings. The article concludes that "if you're moving a portion of your portfolio overseas for the long term, it's all about diversification. And that means being disciplined enough to stick with your asset allocation strategy through thick and thin." (Note: We quote this article at length because we agree with most of it. Our caveat is that when the period of underperformance sets in, it can last for a long time, which tests the long-term investor's resolve to hold the underperforming portion of the diversified portfolio).

As if on perfect cue to this article pointing out the risks in chasing the outperforming asset classes of international and emerging market stocks, both sectors began a major decline from the highs reached in early May. Indeed, less than one month later, two articles appeared in the WSJ on the same day (6/9/06, front page and page C1), reporting on the extent of the declines in these two sectors. The front page article states that emerging markets, which "have outperformed all others for the past three years, surging nearly 200% based on the Morgan Stanley International Emerging Market Index,…has tumbled 21% since reaching its all time high on May 9th." To put this into absolute numbers, a $100,000 investment in emerging markets would have risen to nearly $300,000 (at the time it was up nearly 200%), but then in the last month would have given back $63,000. Of course for the investor who started a few years ago at $100,000, the result would still be highly favorable. The real risk to investors is that they make their initial purchases only after reading about the outperformance of the sector, and then suffer the decline without having participated in any of the gain. That is what is meant by chasing the recent past performance of an investment category.

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While the WSJ articles did not provide a percentage decline figure for the developed international markets, the front page article provided the following piece of information. "Overall, emerging markets have shed $250 billion in market capitalization in the past month, while all stock markets outside the US have shed about $1.3 trillion over that period, according to the Morgan Stanley data." While the percentage decline for the developed international markets was less than the emerging market decline, the absolute dollar amount of the declines was obviously quite substantial. The article further comments that "the sell-off comes as Americans' exposure to overseas markets may be at an all-time high. Foreign markets in 2005 outperformed US stocks for the third straight year, and US net purchases of foreign stocks exceeded $100 billion for the first time last year." This comment also puts into focus the tendency of investors to buy the currently hot performing sectors far closer to their highs, and this tendency adds to the likelihood of sustaining loss. The typical scenario is for investors to buy as the sectors near their high prices, and then the declining prices lead these same investors to sell at lower prices. The sector does well; the investors do not.

The other WSJ article (pg. C1) makes precisely this point. "The steep decline in emerging markets – hot performers for years – is stoking investors' fears about putting more of their money into these investments…. Many individual investors, and even some big money managers, started moving into these markets only relatively recently, pouring in huge sums this year. Now they are taking a hit….Veteran emerging markets investors say this sell-off amounts to one of the toughest in recent memory. Some financial advisors and market strategists say it is time to scale back. That advice is a sharp turnabout in some cases from as recently as a few months ago, when many of the same advisors were encouraging boosting such allocations." And to add to the conflicting opinions, there is the observation that "investors who don't have much international exposure should hold on in the interest of having a diversified portfolio."

What is our position on the issues raised in this discussion? We advise our clients to focus first on the risks they are willing to take in order to achieve an investment return consistent with their needs. We present risk as the amount of downside any broad-based investment category is likely to sustain over a given period of time, and the average long-term gain associated with that same category. While long-term historical results are the basis of the analysis, we recognize there is no certainty, and indeed many questions, about the likelihood of any historical result occurring in a time frame relevant to our clients. There is no doubt that emerging market returns, and even developed international markets, carry a wider range of average gain and near-term declines than the 100 largest dividend-paying US stocks, or a broadly diversified intermediate bond fund. So our advice would focus on whether our client needs to take the greater risk associated with any particular asset class in order to gain the larger potential return. Clients who can achieve their objectives with a 4% or 5% average annual return have no need to take the extra risk associated with certain market sectors, regardless of how well they perform in some short time frame. Notice that our advice is not based on maximizing investment returns, but rather on achieving reasonable returns with the least amount of risk that our clients need to take to reach their objectives.

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	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)

	S&P 500		DOW JONES		NASDAQ	
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 Low	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 Low	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 June 30, 2006	1,270	(13.6)%	11,150	(3.0)%	2,172	(46.7)%

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

	S&P 500		DOW JONES		NASDAQ	
Start of 1995	459		3,834		752	
End of 1999	1,470		11,500		4,070	
5 Year Gain; Annualized %	1,011	26.1%	7,666	24.6%	3,318	40.2%
End of 2001	1,148		10,020		1,950	
7 Year Gain; Annualized %	689	14.0%	6,186	14.7%	1,198	14.6%
End of 2002	880		8,342		1,336	
8 Year Gain; Annualized %	421	8.5%	4,508	10.2%	584	7.5%
End of 2003	1,112		10,454		2,003	
9 Year Gain; Annualized %	653	10.3%	6,620	11.8%	1,251	11.5.%
End of 2004	1,212		10,783		2,175	
10 Year Gain; Annualized %	753	10.2%	6,949	10.9%	1,423	11.2%
End of 2005	1,248		10,718		2,205	
11 Yr Gain; Annualized %	789	9.5%	6,884	9.8%	1,453	10.3%
Through June 30, 2006	1,270		11,150		2,172	
11.5 Yr Gain; Annualized %	811	9.3%	7,316	9.7%	1,420	9.3%

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