



Park Piedmont Advisors LLC

Registered Investment Advisor

VICTOR LEVINSON

NICK LEVINSON, CFP®

NOVEMBER 2006 COMMENTS

WINTER TRAVEL PLANS:

Vic will continue to spend the winter working in Florida. All his contact information remains exactly as it is when he is in New York; all phone calls are forwarded into his cell phone number, 917-741-5450. Send all regular mail and faxes to Lynette in the New York office.

LONG-TERM CARE INSURANCE

For those of you who do not have this insurance, and have an interest in obtaining it, please let us know, as we are able to provide advice on this subject.

YEAR END ITEMS:

I. Required Minimum Distributions (RMD) from IRA Accounts:

All RMD amounts for IRA accounts are set out on the first page of the NFS (National Financial Services) monthly statement. (RMDs are generally only for clients over age 70 .) Anyone with an IRA account requiring an RMD should already have received a letter from NFS, which is the custodian for all IRA accounts managed by Park Piedmont. As in prior years, we will process all RMDs by mid December for clients who have not already taken the full amounts required to be distributed for the year.

II. Annual Gifts and Other Year End Distributions:

For those interested in making gifts or other year end distributions, please let us know what actions you want us to implement on your behalf.

III. Annual \$35 IRA Maintenance Charge from NFS:

You should have received a letter from NFS regarding its \$35 annual IRA custodian charge. We suggest you NOT send payment, but rather let NFS debit the \$35 from your account, which it will do in December if you do not send payment.

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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 NOVEMBER 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%	14.2%	2.5%
Standard & Poors 500 Index (2)	19.6%	(10.1%)	(13.0%)	(23.4%)	26.4%	9.0%	3.0%	12.2%	1.8%
Vanguard S&P 500 Growth Index Fund (1)	28.8%	(22.2%)	(13.0%)	(23.7%)	25.9%	7.2%	5.1%	8.9%	2.4%
Vanguard S&P 500 Value Index Fund (1)	12.6%	6.1%	(12.0%)	(20.9%)	32.2%	15.3%	7.1%	19.3%	2.4%
Dow Jones Industrial Average Index (2)	25.2%	(6.2%)	(7.1%)	(16.8%)	25.3%	3.2%	(0.6)%	14.0%	1.3%
NASDAQ Composite Index (2)	85.6%	(39.3%)	(21.0%)	(31.5%)	50.0%	8.6%	1.4%	10.3%	4.0%
Vanguard Midcap US Index Fund (1)	25.0%	2.6%	(4.8%)	(16.3%)	34.1%	20.4%	13.9%	13.9%	4.2%
Vanguard Smallcap US Index Fund (1)	19.6%	(4.2%)	1.0%	(21.6%)	45.6%	19.9%	7.4%	15.6%	3.5%
Vanguard International Index Fund (EAFE) (1)	25.3%	(15.2%)	(22.6%)	(17.5%)	40.3%	20.8%	15.6%	22.8%	4.4%
Vanguard Emerging Markets Index Fund (1)	61.6%	(21.6%)	(2.9%)	(7.4%)	57.7%	26.1%	32.1%	24.2%	8.6%
Vanguard Real Estate Invest. Trust Fund (1)	(0.4%)	26.4%	12.4%	3.8%	35.7%	30.8%	11.9%	37.6%	6.2%
<u>BONDS</u>									
Vanguard Total Bond Market Index (1)	(0.8%)	11.3%	8.3%	8.2%	4.0%	4.2%	2.4%	4.8%	1.2%
Vanguard Interm. Tax-Exempt Index Fund (1)	(2.9%)	9.2%	5.0%	7.9%	4.4%	3.2%	2.4%	4.6%	0.7%
Vanguard Short-term Bond Index (1)	2.1%	8.9%	8.9%	6.1%	3.4%	1.7%	1.3%	4.2%	0.7%
Vanguard Short Tax-Exempt Index Fund (1)	2.6%	4.9%	4.8%	3.5%	1.6%	1.1%	1.8%	3.0%	0.2%
Vanguard High-Yield Bond Fund (1)	NA	NA	NA	1.7%	17.2%	8.5%	2.8%	7.2%	1.6%
Vanguard Inflation-Pro- -tected Bond Fund (1)	NA	NA	7.6%	16.6%	8.0%	8.3%	2.6%	2.8%	1.2%

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>			
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.															
		<u>2002</u>					<u>2003</u>					<u>2004</u>			
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.															
		<u>2005</u>					<u>2006</u>					<u>2007</u>			
S&P 500	(2.6)	0.9	3.1	1.6	3.7	(1.9)	5.2%								
NASDAQ	(8.1)	2.6	4.4	2.5	6.1	(7.6)	3.9%								
BONDS	(0.5)	3.0	(0.7)	0.6	(0.7)	(0.2)	3.8%								
Interm. Tax.															

NOVEMBER 2006 COMMENTS

STOCK index prices were, once again, uniformly higher in November, continuing their remarkable second-half run of gains. Further (see next paragraph), bond prices have continued to rise. Many market observers find these tandem increases to be based on conflicting views of the economy, with higher stock prices indicating a reasonably strong economy, and higher bond prices (with 10-year interest rates more than of 1% below the short-term Fed funds rate) indicating an economy that is weakening (see NY Times, Sunday Financial section, 11/26/06, pg. 4). For the month, the S&P 500, Dow, NASDAQ, and Total Stock Market (TSM) index, which includes Midcap and Smallcap stocks, were up 1.8%, 1.3%, 4.0%, and 2.5%, respectively. Midcap and Smallcap had gains of 4.2% and 3.5% respectively, with the International and Emerging Market indices up 4.4% and 8.6%, respectively. The REIT index continued its remarkable performance, up 6.2% for the month and 37.6% YTD. Largecap Value and Largecap Growth had similar monthly gains, but Value continued its significant longer-term outperformance. See page 2 for figures for the month, YTD, and since 1999.

BOND returns (price change plus interest) had their fifth consecutive month of gains. The benchmark 10-year US Treasury yield closed at 4.47%, well below the previous month's close of 4.61%, and far below the current 5.25% short-term overnight rate set by the Federal Reserve. However, 10-year yields are not likely to continue below short-term yields for any considerable length of time, since the normal relationship (also known as the "yield curve") of 10-year yields to short-term yields is positive 200 bps or more, not negative 78 bps. The conflicting views of the economy, referred to in the previous paragraph, are at work in this "inverted" yield curve environment. Therefore, we are likely to see either rising longer-term rates or declining shorter-term rates in the coming months. YTD bond returns range from +3.0% to +4.8% for both short and intermediate maturities, and are now higher than the returns from money markets, which most directly reflect short-term 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 now, as of the end of November 2006, raised the three major indices reported below to their highest levels of the recovery. Indeed, the Dow Industrials index has actually reached and passed its all time high. But it took almost seven years for the Dow to reach these levels, and the S&P 500 and NASDAQ are still trailing their all-time highs, reached in early 2000, by 8% and a stunning 52%, respectively. So investment returns on stocks for the entire decade starting in 2000 remain far below their long-term historical averages. In a fascinating observation, the mutual fund company Vanguard notes that since 1926, in only six of 80 years did stock prices fall within 2%, up or down, of their long-term historical annual average return of 10.4%.

Measuring stock returns from the beginning of 1994, which began the spectacular bull market of 1994-1999, we see the three major indexes all up more than three times, and all with remarkably similar average annual returns (ranging from 9.8% to 10.3%) that are close to the 10.4% average annual return of the stock market dating back to 1926. As these returns converge, 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. And yet, the Vanguard observation noted above is also meaningful, since the annual returns during the bull market period were far higher than the long-term average annual return. **The moral: Stock returns are truly unpredictable and volatile in short time frames, and can be over long time periods as well, in the context of a fairly stable very-long-term average return.**

	<u>S&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 Nov 30, 2006	1,401	(8)%	12,222	+4%	2,432	(52)%

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

	<u>S&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%
November 2006	1,401	12,222	2,432
Gain	942	8,388	1,680
Avg. Ann. % Gain: '95-11/06; 11.92 yrs	9.8 %	10.2 %	10.3 %

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). The initial report for Q3 growth (ending September 30th) was 1.6%, but this figure was revised upward to 2.2%, "mainly the result of a downward revision in imports and stronger inventory buildup by businesses, while consumer spending was revised downward" (Vanguard Economic Week in Review [VEWR], 11/27-12/1/06).
- (2) Employment growth for October (reported Friday, November 3rd) was 92,000, but "more importantly, large revisions boosted the estimate of August and September payroll growth by a total of 139,000 jobs, ... while the unemployment rate dropped to 4.4%, its lowest level since May 2001" (WSJ, 11/4-5/06, front page). November's figures will be reported on December 8th.
- (3) Interest Rates on longer-term bonds declined in November for the fifth consecutive month, with the benchmark 10-year US Treasury interest rate, which is set by buyers and sellers in the bond market, closing at a remarkable 4.47%, fully 78 basis points (bps) below the overnight rate of 5.25%, which is controlled by the Federal Reserve. The 10-year yield was as high as 5.25% in June, but has declined every month since then, coinciding with the Fed stopping its campaign of raising short-term rates. The fact that the yield curve is now sharply inverted, with overnight rates more than 3/4 of 1% higher than the 10-year Treasury, is discussed in the BOND section on page 3 of these Comments.
- (4) Inflation rates declined dramatically in October. The "core" Consumer Price Index (CPI), which excludes the volatile food and energy sectors, increased 0.1%, and was up 2.7% from a year earlier. With food and energy included, the monthly rate was down (0.5%), and the most recent twelve-month increase was 1.3%, "the smallest year to year increase since June 2002" (WSJ, 11/17/06, A2). The overall decline "suggests that inflation is being contained by declining energy prices and a gradually slowing economy," ... and "this comes as good news to the Federal Reserve, appearing to validate its decision to stop raising interest rates after the last increase in June" (New York Times [NYT], 11/17/06, C1). The Producer Price Index (PPI) core rate fell (0.9%), "its biggest fall in 13 years," and with food and energy included, fell (1.6%), "matching the steepest decline on record, set in 2002" (NYT, 11/15/06, C1). (Note: The CPI measures prices of goods and services; the PPI, only goods.)

- (5) Sector Economic Activity Continued Mixed, But with Signs of a Slowdown
- (a) Durable goods orders (industrial and consumer) declined (8.3%) in October; the highly volatile transportation sector fell (1.7%) (VEWR, 11/27-12/1/06).
 - (b) Industrial production (which includes manufacturing, utilities and mining) was up 0.2% in October, while capacity utilization advanced 0.1% (VEWR, 11/13-17/06). However, a later report on manufacturing “suggested that the manufacturing sector is beginning to contract, ... which, if sustained could spell more trouble for the economy” (WSJ, 12/2-3/06, A3).
 - (c) Retail Sales declined 0.2% in October, but were still up 4.5% from a year earlier. Declining gasoline sales continued to be the major factor in the decline (WSJ, 11/15/06, A2). (Retail sales are not adjusted for inflation, and include such disparate categories as gasoline, autos, and the Internet.)
 - (d) Housing sales for existing homes increased by 0.5% in October, but were down (11.5%) from a year earlier (VEWR 11/27-12/1/06). New home sales declined in October by (5.3%), and the year-over-year decline reached (25.4%). Prices “rose in the third quarter at their slowest pace since 1998, and were essentially flat when adjusted for inflation” (NYT, 12/1/06, C4) The housing slowdown is often cited as posing a significant issue for US economic growth for the second half of this year (WSJ, 11/30/06, A2)
 - (e) Personal Income increased 0.4% in October, slightly below September’s gain of 0.4%. Personal spending rose 0.2%, following a (0.2%) decline in September. Personal savings as a percentage of disposable personal income rose, although it is still negative (NYT, 12/1/06, C4).
- (6) Consumer Confidence, as measured by the Conference Board’s Index, “slipped slightly in November, “but still remained near a 15 month high”(NYT,11/23, C4).
- (7) Corporate Profits “... have grown at double digit rates for 17 consecutive quarters, helping equity markets overcome the twin poisons of rising interest rates and high energy prices... Profits of S&P 500 companies more than doubled from 2001 to 2005, ...and analysts predict that the median S&P 500 company will enjoy 12.8% profit growth this year” (NYT, Financial section, 10/1/06, pg. 6; the article discusses the likelihood of these favorable profits continuing into the future). There was no new corporate profit news reported in November.

Overall, November’s economic news pointed to the continuation of a moderately slowing economy. Slow GDP growth, modest declines in retail sales and manufacturing, and the continued weakness in housing, all pointed to a slower economy. However, the decline in oil prices has added purchasing power for the consumer. With the modest slowdown has come lower inflation rates and lower interest rates, both of which continued to provide good news for stock and bond prices. How the reality of slower growth plays out in the future price movements of stocks and bonds remains to be seen, and much depends on whether the slowdown continues to be moderate, or accelerates into a more serious downturn.

II. MORE ON HEDGE FUNDS

A number of our clients in recent months have inquired about our view of Hedge Funds, and although we have written extensively on the subject already (see this year's September and May Comments), we sense that the subject calls for additional discussion. Further, we have identified an additional source on the subject that should add to your general knowledge and understanding. This new source is an Alliance Bernstein research report, dated June 2006 and titled, "Hedge Funds, Too Much of a Good Thing?" (All quotes are from this report unless otherwise noted).

In its Introduction section (pg. 3), the report states that "between 1990 and 2005, the number of hedge funds burgeoned from a few hundred to some 8,200, representing more than \$1.1 trillion in net assets." (Our note: To put this figure in perspective, at the end of October 2006 it was reported that, for the first time, the total assets invested in the 8,000 plus mutual funds topped \$10 trillion; see WSJ article, 12/2-3/06, pg. B4, discussing index funds, an article which will be discussed in greater detail next month). The Introduction goes on to say that investors have "difficulty in finding a road map or a means of assessing how hedge funds earn returns and assume risk, information that is essential when determining how much to allocate to them."

The report next defines the territory occupied by these investments. "Hedge funds are lightly regulated investment pools, generally limited to high net worth individuals and institutions, in which the manager is given great flexibility to exploit inefficiencies in the global investment markets... Hedge fund managers utilize a far wider set of tools than traditional portfolio managers... They can "go long" securities they believe are likely to appreciate, but also "short sell" securities poised, in their judgment to fall in price. But these aren't the only tools available... They may use financial derivatives or employ leverage. Some invest in nontraditional or illiquid assets. Others may invest in distressed assets or employ arbitrage to capitalize on merger opportunities or perceived misvaluations between two closely related securities. The objective is to capture more return while at the same time hedging out many unwanted investment risks" (pg. 4).

"Given the wide array of hedge fund strategies, it is not surprising that the return profile of hedge funds is heavily dependent on a manager's investment skills – much more so than most traditional investment portfolios. If investment strategies are arrayed according to their dependence on the market, index funds, which aim to replicate a benchmark, are at one end of the spectrum. In the middle are traditionally managed portfolios, which usually aren't structured very differently from the market – but rely on managers' investment selections to earn a premium return. At the far end of the spectrum are hedge funds, whose returns are driven primarily by manager strategies rather than by broad market direction" (pg. 4). The report states that for the ten-year period ending 2005, "the market accounted for better than 80% of the ups and downs generated by the average traditional equity manager, while hedge funds were only 20% dependent on the broad market and fully 80% on manager decision making (the technical term for the portion of an investment's return deriving from the manager's decisions is "alpha")... Such heavy reliance on manager skill is a double-edged sword: If achieving returns derived from managers' skill proves elusive, a fund can do very poorly" (pg. 5).

The report continues by setting out hedge fund returns and volatility measures for the ten years from 1996 to 2005, factoring in a variety of biases that tend to overstate these results. While acknowledging favorable results in both the up and down periods within those highly volatile ten years, the report also states that “simply using annualized return and standard deviations to make allocation decisions (to hedge funds) would be a serious mistake, because hedge fund risks aren't adequately captured by volatility alone” (pg. 7).

The discussion of hedge fund risk begins with the observation that “as more assets chase “alpha” in the global markets, the heightened competition may make it harder for managers to add value. But the need to carefully assess hedge fund risks runs deeper. Hedge funds are not an asset class – like stocks or bonds – whose returns are underpinned by fundamentals like corporate earnings growth or the cash flow generating power of companies or governments. Rather, they are collections of discrete managers, each relying on his own ability to exploit inefficiencies in the capital markets by means of a specific tool set and orientation (stock picking, arbitrage, wagering on macro scenarios, and so forth). As a result, performance dispersion – the difference between the results of a particular manager and the index – runs high in hedge funds; much higher than in traditionally-managed stock and bond portfolios... Unfortunately, simple techniques to differentiate between managers, such as relying on a fund's past return levels, are a poor guide to future success... For example, between 1996 and 2005, only 28% of top quartile hedge fund managers over three year periods maintained their edge over the next three year period, and 28% of these managers fell to the bottom of the pack (bottom quartile)” (pp. 8-9).

The report next categorizes hedge funds into two broad classes: “Market neutral” funds, which hedge out broad market exposure so that most of their return comes from the manager's skills (i.e., alpha); and “directional” funds, which maintain some exposure to the market and therefore combine alpha and “beta.” (Beta is the term used for returns that are caused by the market). The report states that hedge funds provided an annual 3% return over the 10-year period, net of fees, attributable to alpha, which is “in addition to the return generated by however much the fund was exposed to the markets,... an impressive result compared with the median traditional active manager, whose security selections marginally DETRACTED (our emphasis) from performance” (pg. 10).

The report poses the following question: “How does a strategy that is far more reliant on alpha (manager skill) than on beta (the market) affect risk and return? For one thing, while losses can be severe over the short-term in the stock market, they tend to turn positive over time, lifted by the long-term upward trend in corporate profits. Although the alpha opportunity is enticing, it doesn't necessarily grow over time and is not dependable” (pg. 11).

Most of the balance of the report provides detailed information on investment results and ranges of returns of various strategies. Rather than providing this detail, we will return to the Significant Conclusions section (pg. 1):

- 1) Even with higher returns and lower volatility over the ten years from 1996 to 2005, the far wider dispersion of returns, combined with the difficulty of sustaining superior performance, creates “uncertainties crucial in assessing the potential impact of a hedge fund investment on long-term wealth;”

- 2) certain strategies that may look like bond substitutes have often not provided protection against equity risk (which traditional bonds are designed to do); and
- 3) funds of funds have provided little additional diversification benefit, and have multiple layers of fees, in addition to the typical tax inefficiencies of most hedge funds, which have adversely affected investor returns.

Our conclusion to this section on Hedge Funds: Park Piedmont's investment advice is geared to the indexed investments in which we specialize. As the report points out, indexed investments rely exclusively on the market's returns (beta), and are at the opposite extreme of the investment world from hedge funds, which rely so heavily on the skills of the portfolio managers (alpha). To succeed for their investors (as compared to succeeding for themselves), hedge fund managers need to be able to outperform not only the markets, but all the other active traditional managers, and all the competing hedge fund managers seeking to provide superior returns to their investors. We believe the odds of achieving this success are slim, and therefore do not undertake analysis of different hedge funds. We do, however, continue to search for an investable hedge fund index that can provide diversification benefits to traditional stock and bond investing at a reasonable cost. If such an index becomes available, we will discuss it with clients.

For now, we continue to adhere to Swensen's observations that "on top of the enormous difficulties of identifying a group of genuinely skilled investment managers and overcoming the obstacle of extremely rich fee arrangements, investors confront a fundamental misalignment of interests created by the option-like payoff embedded in most hedge fund fee arrangements... Hedge fund investing belongs in the domain of sophisticated investors who commit significant resources to the manager evaluation process. While the promise of hedge funds proves attractive..., those investors who fail to identify truly superior active managers face a dismal reality. In the absence of superior security selection, investment strategies that avoid market exposure deliver money market-like expected returns... Investors in hedge funds find generating risk-adjusted excess returns nearly an impossible task" (from "Unconventional Success," by David Swensen, pp. 132-133).

III. INVESTMENTS WE USE TO IMPLEMENT YOUR ASSET ALLOCATION

We began this section last month, in an effort to provide clients with additional information about the specific investments we use. For this month, we have chosen two such investments:

- 1) Total International Market index funds, which invest in companies located in developed countries outside the US; and
- 2) Emerging Markets index funds, which invest in companies located in developing countries.

Total International Market index fund:

Key Statistics for Vanguard's International index fund (symbol VGTSX):

- 1) Size: \$18 billion
- 2) Annual Expenses: approximately 0.31%, or \$31 on a \$10,000 investment
- 3) Load: None
- 4) Annual Yield: 1.74%
- 5) PE Ratio: 15
- 6) % in Top 10 Holdings: approximately 19%
- 7) Top Sectors (as of 12/4/06): Fin., 30%; Indus. Mats., 15%; Cons., 13%; En., 10%
- 8) YTD Return through 11/30/06: 22.8%

This category represents the broadest-based selection of non-US stocks. Started in 1996, the Vanguard fund is based on the Total International Composite index, which consists of three other Vanguard funds in the following percentages: Europe (symbol VEURX), 58%; Pacific (symbol VPACX), 28%; and Emerging Markets (symbol VEIEX), 14%.

- The Europe fund is based on Morgan Stanley Capital International's (MSCI) index of 550 stocks from 16 European countries. The top 10 holdings include energy companies such as BP and Shell; financial companies such as HSBC and UBS; and consumer-oriented companies such as Nestle and Vodafone.
- The Pacific fund is based on MSCI's index of 400 stocks from Pacific-rim countries including Japan, Hong Kong, Singapore, Australia, and New Zealand. The top 10 holdings include industrial companies such as Toyota, Mitsubishi, and Honda; financial companies such as Mizuho Financial and the Bank of Australia; and consumer-oriented companies such as Sony.
- The Emerging Markets fund is based on an index of 500 stocks from South Korea, Taiwan, the "BRIC" countries (Brazil, Russia, India, and China), and other developing countries in Asia, Eastern Europe, and South America. The top 10 holdings represent sectors including financial, industrial, consumer, energy, and telecommunications companies.

In combination with the Total Stock Market index fund (see discussion on page 9 of the October 2006 Comments), which provides broad diversification among US companies of all sizes, this International fund adds diversification from companies throughout the world. Although globalization has in many ways created a global economy, in which large US companies have significant businesses located in other countries, there are still important differences in local and regional economies and their rates of growth, and in turn how companies based outside the US perform. For example, a slowdown in the US economy, which could lead to slower growth or even declines for US companies, might occur along with faster growth in Europe or Japan, which could benefit companies based in and doing most of their business in those countries. At the same time, companies in developing countries typically have higher rates of growth, which can (but doesn't necessarily) translate into comparable stock market gains. But they also have the potential for more significant declines due to additional sources of risk, including political instability. Yet another source of diversification from owning non-US stocks comes from the different currencies used in other countries, which we will discuss in more detail next month. (See also our June 2006 Comments, pages 7-13, for a more detailed discussion of the pros and cons of international investing, with sections on emerging markets and currencies as well).

Emerging Markets index fund:

Key Statistics for iShares Emerging Markets exchange-traded fund (ETF) (symbol EEM):

- 1) Size: \$13 billion
- 2) Annual Expenses: 0.77%, or \$77 on a \$10,000 investment
- 3) Load: None
- 4) Annual Yield: 0.96%
- 5) PE Ratio: 13%
- 6) % in Top 10 Holdings: 29%
- 7) Top Sectors (as of 12/4/06): Fin., 21%; En., 16%; Ind. Mats., 16%; Telecom., 13%
- 8) YTD Return through 11/30/06: 24.5%

Unlike the International fund, which provides exposure to non-US companies throughout the world, this ETF focuses on companies based in the developing countries. (Note: We use the iShares ETF because, in practice, the Vanguard fund is not currently available for certain accounts. The two funds are similar in terms of holdings and costs, with the main difference being that EEM has a larger allocation to energy stocks than VEIEX. Until VEIEX becomes more widely available, we are comfortable recommending EEM for our clients' portfolios).

As mentioned above, the emerging markets funds historically have bigger ups and downs than the more diversified International fund (VGTSX), as shown in the chart below (EEM's first full year was 2004, so we've included past returns for VEIEX as well. We've also included return history for the Total Stock Market index fund (VTSMX) for comparison):

	<u>EEM</u>	<u>VEIEX</u>	<u>VGTSX</u>	<u>VTSMX</u>
Thru 11/30				
2006	24.5%	24.2%	22.8%	14.2%
2005	33.8%	32.1%	15.6%	6.0%
2004	25.6%	26.1%	20.8%	12.5%
2003	NA	57.7%	40.3%	28.4%
2002	NA	(7.4%)	(17.5%)	(21.0%)
2001	NA	(2.9%)	(22.6%)	(11.0%)
2000	NA	(21.6%)	(15.2%)	(10.6%)
1999	NA	61.6%	25.3%	23.8%
1998	NA	(18.1%)	15.6%	23.3%
1997	NA	(16.9%)	(0.8%)	31.0%

As always, we present these historical returns not in an attempt to make any predictions about future performance, but to show that diverse investments perform differently over time. You'll notice that since 1999, all of the funds have moved in the same direction, either up or down, although at significantly different rates. Some have argued that this pattern reflects an increasingly globalized economy, with the implication that diversification might not provide as much benefit –i.e., international markets increasing to counter a drop in US markets, and vice-versa-- as it did previously. The divergence in returns, especially for the emerging markets, was particularly stark prior to 1999, which featured currency crises in Thailand (1997) and Russia (1998) and the implosion of an influential US hedge fund (1998 as well).

We continue to believe, however, along with Swensen, that there are and will be significant benefits to broad diversification, and that investing in companies based outside the US makes sense for clients with portfolios that include allocations to stocks.

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 Nov 30, 2006	1,401	(4.7)%	12,222	+6.3%	2,432	(40.2)%

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 Nov 30, 2006	1,401		<u>12,222</u>		<u>2,432</u>	
11.92 Yr Gain; Annualized %	942	9.8%	8,388	10.2%	1,680	10.3%



Victor Levinson



Nicholas Levinson