



Park Piedmont Advisors LLC

Registered Investment Advisor

VICTOR LEVINSON

NICK LEVINSON

DECEMBER 2005 COMMENTS

IMPORTANT NOTICES: HAPPY and HEALTHY NEW YEAR to ALL

<PLEASE REFER TO AND COMPLETE THE ENCLOSED ONE PAGE SURVEY>

THOUGHT for the MONTH: (from the Sunday, Dec. 25th, NY Times Magazine section, pg. 44, in a brief article describing John Slade, who worked for one Wall Street securities firm, Bear Stearns, from 1936 until his death this year at age 97 (69 years). Slade was not his real name; he was a Jew who left Germany in 1936). “He would tell friends he equated retirement with death. Work was not about the wealth. Work, to which you should always walk, was about the work.”

TAX MATTERS for 2006:

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

You will be receiving Form 1099s from National Financial Services (NFS) by the end of January. 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 before the end of January.

CONTENTS

Page 1:	Important Notices: What’s in This Edition?
Pages 2-4:	Index Results for December, 2005 and Year-to-Date 2005; Also Years 1999 – 2004, and Various Other Longer Time Periods
Pages 5-11:	Investment Concepts:
Pages 5-6:	I. Update of Key Economic Indicators
Pages 7-8:	II. Contradictory Views of the Same Information: A Rationale for Why Market Prices Are So Difficult to Predict
Pages 9-11:	III. Choices for Implementing Asset Allocations: Swensen and Others
Page 12:	Investment Returns from 2000 to Present, and 1995 to Present

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 DECEMBER, 2005

<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>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%	0.2%
Standard & Poors 500 Index (2)	19.6%	(10.1%)	(13.0%)	(23.4%)	26.4%	9.0%	3.0%	(0.1)%
Vanguard S&P 500 Growth Index Fund (1)	28.8%	(22.2%)	(13.0%)	(23.7%)	25.9%	7.2%	5.1%	(0.4)%
Vanguard S&P 500 Value Index Fund (1)	12.6%	6.1%	(12.0%)	(20.9%)	32.2%	15.3%	7.1%	0.8%
Dow Jones Industrial Average Index (2)	25.2%	(6.2%)	(7.1%)	(16.8%)	25.3%	3.2%	(0.6)%	(0.8)%
NASDAQ Composite Index (2)	85.6%	(39.3%)	(21.0%)	(31.5%)	50.0%	8.6%	1.4%	(1.2)%
Vanguard Midcap US Index Fund (1)	25.0%	2.6%	(4.8%)	(16.3%)	34.1%	20.4%	13.9%	1.5%
Vanguard Smallcap US Index Fund (1)	19.6%	(4.2%)	1.0%	(21.6%)	45.6%	19.9%	7.4 %	0.0%
Vanguard International Index Fund (EAFE) (1)	25.3%	(15.2%)	(22.6%)	(17.5%)	40.3%	20.8%	15.6%	5.7%
Vanguard Real Estate Invest. Trust Fund (1)	(0.4%)	26.4%	12.4%	3.8%	35.7%	30.8%	11.9%	(0.1)%
<u>BONDS</u>								
Vanguard Total Bond Market Index (1)	(0.8%)	11.3%	8.3%	8.2%	4.0%	4.2%	2.4%	1.0%
Vanguard Interm. Tax-Exempt Index Fund (1)	(2.9%)	9.2%	5.0%	7.9%	4.4%	3.2%	2.4%	1.0%
Vanguard Short-term Bond Index (1)	2.1%	8.9%	8.9%	6.1%	3.4%	1.7%	1.3%	0.4%
Vanguard Short Tax-Exempt Index Fund (1)	2.6%	4.9%	4.8%	3.5%	1.6%	1.1%	1.8%	0.4%
Vanguard High-Yield	NA	NA	NA	1.7%	17.2%	8.5%	2.8%	1.0%

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%											
NASDAQ	(8.1)	2.6%	4.4%	2.5%											
BONDS	(0.5)	3.0%	(0.7%)	0.6%											
Interm. Tax.															

DECEMBER 2005 COMMENTS

STOCK index prices for US large cap stocks were essentially unchanged in December. The S&P 500, Dow Industrials, and NASDAQ all declined between (0.1)% and (1.2)%. The Total Stock Market (TSM), Midcap, Smallcap, and REIT indexes were also little changed, but International had an excellent month, up 5.7%. For the full year 2005, the S&P 500 was up 3.0%, the NASDAQ up 1.4%, and the Dow Industrials declined (0.6)%. By contrast, the Midcap, Smallcap, REIT and International indexes were up between 7.4% and 15.6%, continuing to significantly outperform the Largecap indexes. The Total Stock Market index was up 6.0%, benefiting from the Midcap and Smallcap performance. 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) posted gains in December, as longer-term interest rates declined and short-term rates continued to rise. In fact, one of the big news items of the month was the so-called inverted yield curve, a condition in which longer-term interest rates fall below short-term rates (more on this on page 7). The benchmark 10-year US Treasury yield closed the month at 4.39%, below November's close of 4.50%, and essentially back to September's level of 4.33%. Full year figures for most intermediate- and short-term bond funds are now between plus 1.3% and 2.4%, finishing below 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 61% 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 is, as always, dependent on unknown, unpredictable future events. Indeed, full year 2005 Largecap US stock prices showed little change. (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 1,248 is 61% higher than the low but still down (18%) from the prior high, and still 279 points, or 36%, from the prior high. Note also that the NASDAQ, even after doubling from its low, remains down (56%) from its 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 12). Note that the three indexes have positive average annual returns ranging from 9.5% to 10.3% for the 11-year period from the end of 1994 through December 2005, 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&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)%
April 10, 2001 Low	1,103	(28)%	9,390	(20)%	1,684	(67)%
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)%

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%
December 2005	1,248	10,718	2,205
Gain	789	6,884	1,453
Avg. Ann. % Gain: '95-12/05; 11.0 yrs	9.5%	9.8%	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. 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 third quarter was 3.8%, but was adjusted higher, to 4.3%. The final figure was 4.1%, "slightly weaker than reported earlier, but growth was still the strongest since early 2004" (Wall Street Journal [WSJ], 12/22/05, pg. B2).
- (2) Employment for December will be reported January 6th. The most recent figures were for November, which were reported on in last month's Comments. The economy added 215,000 jobs in November, "as the economy rebounded from the devastating impact of Hurricane Katrina" (NYT, 12/3/05, pg C1). "Employers outside the farm sector added 215,000 jobs in November after adding only 44,000 in October and 17,000 in September in the wake of devastating hurricanes" (WSJ, 12/3-4/05, front page; October and September figures as adjusted).
- (3) Interest Rates on longer-term bonds declined in December, even as the Federal Reserve continued to raise the short term rates it controls. The benchmark 10-year US Treasury interest rate, which is set by buyers and sellers in the bond market, closed at 4.39%, compared to 4.50% in November and 4.56% in October. At the same time, the Federal Reserve, as expected, raised the short term interest rate it controls by of 1%, to 4.25%, the thirteenth consecutive increase since mid-2004. During December, the "yield curve," which compares the yields on long-term bonds with short-term bonds, became inverted, meaning that longer-term bonds had lower yields than shorter term bonds. Normally, longer-term bonds yield more to take account of the greater price volatility risk associated with bonds that mature further in the future.
- (4) Inflation, as measured by the Consumer Price Index (CPI) "core" rate, which excludes the volatile food and energy sectors, increased 0.2% in November, and was up 2.1% for the previous twelve months. With food and energy included, the monthly rate declined -(0.6)%, as energy prices fell significantly (Vanguard Economic Week in Review [VEWR], 12/12-16/05), but the overall twelve-month rate was up 3.5% (NYT, 12/16/05, pg. C1). The Producer Price Index (PPI) core rate was up 0.1% for the month, and 1.7% for the previous twelve months. With food and energy included, the monthly rate declined -(0.7)%, but the twelve-month rate was up 4.4%, with the sharp variances due to the highly volatile energy sector (VEWR, 12/19-23/05). (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 4.4%, but, excluding the volatile transportation sector, declined $-(0.6)\%$ (WSJ, 12/24/05, pg. A2).
 - (b) Industrial production increased 0.7% in November, and October was revised upward to a gain of 1.3%. "Industrial production surged as the post-hurricane recovery continued" (WSJ, 2/16/05, pg. A2).
 - (c) Retail Sales gained 0.5% in November (excluding auto and gasoline sales), and 0.3% overall (VEWR, 12/12-16/05). (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 $-(1.7)\%$ in November, the second consecutive monthly decline. New home sales declined $-(11)\%$ but were still up 6% from a year earlier, indicating that "while housing is slowing down, sales remain healthy by historical standards" (WSJ, 12/24/05, pg. A2).
 - (e) Personal Income increased 0.3% in November and personal spending also rose 0.3%. Personal savings declined $(0.2)\%$, which meant "consumers were dipping into previous savings or borrowing to finance spending" (NYT, 12/23/05, pg. C4). Note, however, that the definition of personal savings is itself open to question.
- (6) Consumer Confidence, as measured by the Conference Board's Index, "rose to its highest reading since August... The Director of the Center said that "the resilience of the US economy, job growth and recent declines in gasoline prices have consumers feeling more confident at year end than they felt at the start of 2005" (WSJ, 12/29/05, pg. A2).
- (7) Corporate Profits for the S&P 500 stocks increased 14% in the first quarter and 12% in the second quarter, both figures significantly higher than analysts' expectations (see cite below). Expectations for the third quarter were for profits to exceed 15% (NYT, Sunday Financial section, 10/2/05, pg. 7), but no final figures have been reported as yet. While corporate profits are a major driver of stock prices, it is important to note that over extended periods of time, the rate of profit growth is closely related to the rate of overall economic growth.

Overall, the economic news continued to be favorable in December, but the large company U.S. stock market made no progress for the month, and recorded a highly disappointing year in the context of sound economic growth and continued strong corporate profits. Either the markets are anticipating slower economic and profit growth (presumably from the combination of higher energy prices and higher short-term interest rates), or there is some other disconnect between the good news and the lackluster market results. The next section examines how the same facts can be treated as either good news or bad news in the markets.

II. CONTRADICTIONARY VIEWS OF THE SAME INFORMATION: A RATIONALE FOR WHY MARKET PRICES ARE SO DIFFICULT TO PREDICT

In at least four major articles during December, the Wall Street Journal discussed the financial community's most recent highly significant development, that is the "inverted yield curve" (12/12, pg. C1; 12/17, pg. D1; 12/28, front page; and 12/29, pg. C1). An inverted yield curve occurs "when yields on longer-term US Treasuries fall below those of short-term securities...called an inversion because it is a reversal of the normal upward slope of bond yields, from short- to longer-term" (WSJ, 12/29, pg. C1). Given this fact, the real question is what significance, if any, this development is likely to have on future market prices. And as with many facts, there is a "good news" and a "bad news" interpretation that comes with the exact same piece of factual information.

First the bad news interpretation: "Investors tend to view a flattening yield curve as a precursor to an economic slowdown" (WSJ, 12/12, pg. C1). "When investors are willing to accept a lower yield (on longer-term bonds), it means they are persuaded that the Fed...will soon have to bring interest rates down to mitigate, or ward off, a recession. Yield inversions have preceded all of the last six recessions, but have also sounded two false alarms, most recently in 1998" (WSJ, 12/28, front page, continued on pg. A10).

The good news comes in two main forms: First, "The Fed's attempts to cool the economy don't always provoke a recession, and many economists, including Fed Chairman Greenspan, suggest that the yield curve might have lost its predictive ability...because foreign buying of US Treasuries and the Fed's success in controlling inflation have kept long-term interest rates unusually low, providing US consumers and companies with relatively cheap access to money" (WSJ, 12/28, same cite). Secondly, if and when the Fed does stop raising its short term interest rates, that is supposed to be good news for both economic growth and corporate profits. The problem arises if the interest rate increases stop only in the midst of an economic slowdown, compared to stopping prior to such a slowdown. And yet one of the main reasons for the Fed raising those short-term rates is to create a slowdown, which is supposed to help control the spread of future inflation.

If all this appears circular, it is, and helps explain why even if you know a particular fact --in this case the yield curve inversion-- it is not possible to accurately predict the impact of the fact on market prices. With the "experts" providing different views, it appears to be a coin-flip whether the yield curve inversion will eventually be good or bad for stock or bond prices.

A WSJ editorial (12/2, editorial page) states the point this way: "When bond yields (interest rates) rise, it is considered bad for the housing market and the consumer. But if bond yields fall and the yield curve narrows toward inversion, that is bad too, because an inverted yield curve could signal a recession." The author then provides additional examples: "If housing data weakens, that is a sign of a bursting housing bubble...but if housing data strengthen, that is negative because the Fed may raise rates further. If foreigners buy our bonds, we are not saving for ourselves. If foreigners do not buy our bonds, interest rates could rise. If wages go up, inflation is coming. If wages go down, the economy is in trouble."

The list continues: “The trade deficit was supposed to cause a collapse in the dollar, but the dollar is up 10% versus the euro in the past eight months. The budget deficit was supposed to push up interest rates, yet the 10-year Treasury yield of 4.5% is well below the 2000 yield of 6%, when the US faced surpluses as far as the eye could see. Sharp declines in consumer confidence and rising oil prices were supposed to hurt retail sales, but holiday shopping is strong... Many fear China is stealing our jobs, but there is a shortage of skilled production workers in the US... And since the Fed started raising interest rates, 3.5 million new jobs and \$750 billion in additional personal income have been created.”

Each point that the author raises has a good news/bad news component. Weaker housing sales could slow the economy, but could also accelerate the end of the Fed's interest rate increases. Stronger housing sales would signal continued economic growth, but could also call for more stringent future moves to curb growth and hold off inflation. Wages and employment tell the same story: Lower wages and lower employment, while bad news for the economy, would presumably call for the Fed to lower interest rates to keep the economy moving; and yet higher wages and stronger employment reports, while signaling a strong economy, would likely cause the Fed to raise interest rates further, again with the goal of keeping inflation under control.

The large trade deficits put more US dollars in the hands of non-US investors, which is considered a negative, but those same trade deficits are what keeps the economies of many developing countries vibrant, and keep the cost of goods in the US lower.

The problem is not with the reporting of the facts, nor even in their multiple interpretations by the experts. The problem is that each fact can legitimately give rise to actions designed to reverse the trend created by the fact, so that the market prices that are supposed to reflect all the facts end up moving in highly unpredictable ways. This view of the markets should not discourage investors from participating in the markets. Instead, it should persuade them to shift from trying to figure out what the latest news will do to prices in the short term to allocating their investable assets over a range of choices, consistent with their specific goals and risk tolerances, that take advantage of the long-term, world-wide economic growth that history suggests is likely to continue.

The next section discusses the various investment choices available in implementing asset allocations, as presented by David Swensen (the head of Yale's endowment and author of the book we have been discussing in recent Comments, “Unconventional Success...”), Jonathan Clements of the Wall Street Journal, and others.

III. INVESTMENT CHOICES FOR IMPLEMENTING ASSET ALLOCATIONS

Swensen states that “asset allocation decisions play a central role in determining investor results. A number of well regarded studies of institutional portfolios conclude that approximately 90% of the variability of returns stems from asset allocation, leaving approximately 10% of the variability to be determined by security selection and market timing” (pg. 12). He cites another investment professional, Charles Ellis, who observed that “investors generally fail to spend the most time and the most resources on the most important investment decisions. Seduced by the appeal of security-trading decisions and the allure of market timing moves, investors tend to focus on the unproductive and expensive portfolio churning activities” (pg. 13).

Swensen defines asset allocation as “the long-term decision regarding the proportion of assets that the investor chooses to place in particular classes of investments” (pg. 11). We define asset allocation similarly, as the percentage mix of an investment portfolio divided among stocks, bonds, and cash equivalents. Swensen also adds, and we totally agree with this point, that “ultimately, successful portfolios reflect the specific preferences and risk tolerances of individual investors” (pg. 34). We focus much of our advice on choosing the most appropriate allocation for each of our clients, based on his/her specific goals, preferences, and risk tolerance, with the idea of having our clients maintain their allocations during difficult market times. In Swensen’s words, designing appropriate “long-term portfolio targets increases the likelihood that investors will develop the conviction necessary to maintain a steady long-term course amid the turbulent crosscurrents endemic to security markets” (pg. 81).

Once an asset allocation has been determined, what securities should be used to implement that allocation? As Ellis noted above, this is the part of the process on which most people spend the most time and effort. Swensen simplifies the process greatly by using only six “core” assets classes, namely domestic (US) equity, foreign developed equity, emerging market equity, real estate, US Treasury bonds, and US Inflation Protected bonds. These asset classes “share a number of critical characteristics. First, they contribute basic, valuable, differentiable characteristics to an investment portfolio. Second, they rely fundamentally on market-generated returns, not on active management of portfolios. Third, they derive from broad, deep investable markets” (pg. 35). In advocating passive (market-indexed) investments over active management, he writes that “satisfying investment objectives proves too important to rely on serendipity or the supposed expertise of market players. Core asset classes depend fundamentally on market-driven returns” (pg. 36).

Swensen describes the role of each of the six core asset classes as follows: “Asset classes that investors employ to drive portfolio returns include domestic equities, foreign developed market equities, and emerging market equities. Asset classes used to create diversification include US Treasury bonds, which promise protection from financial catastrophe, and US Treasury Inflation Protected securities, which provide ironclad assurance against inflation-induced asset erosion. Finally, exposure to equity real estate produces a hybrid of equity-like and bond-like attributes, generating inflation protection at a lower opportunity cost than other alternatives” (pg. 36).

In choosing the particular investment to fill the domestic equity portion of the portfolio, Swensen states that “the enormous size of the US stock market prompts many participants to divide the whole into any number of parts. Typical categories include size of market (small, medium, and large), character of security (growth or value), and nature of business (utility, technology, and health care, for example)” (pg. 47). But, he continues, “the best protection for investors 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). So rather than discussing how to pick and choose among small, medium and large, growth and value, and industry sectors, Swensen advocates owning an “all-inclusive, market-like” portfolio, very much along the lines of the Vanguard Total Stock Market index fund (or well-crafted Exchange-Traded Funds [ETFs] covering the entire market; pp. 313-337).

In advocating investing in developed foreign markets, Swensen cites “the lack of correlation between foreign markets and the US market as providing a valuable diversification opportunity for investors” (pg. 59). In advocating investing in emerging markets, he states that they “represent a high risk, high expected return segment of the marketable equities universe” (pg. 62). In advocating investing in real estate, he writes that “real estate assets combine characteristics of fixed income and equity” (pg. 67), and continues that “market mimicking index management represents the starting point for investors who wish to gain exposure to real estate securities. The passive approach to portfolio construction assures that investors realize market-like returns, eliminating the slippage (positive or negative) that comes with active management. . . . As the pre-eminent practitioner of indexing for individual investors, Vanguard stands atop the industry in terms of excellence in tracking a wide variety of markets. Along with its market-replicating record of low tracking error comes a well deserved reputation for low fees. Like all of Vanguard's index products, the Vanguard REIT Index Fund provides high quality, low cost exposure to its target market” (pg. 76). Park Piedmont uses this and other Vanguard index funds for many of its investment choices.

For bond investing, Swensen advocates only US Treasuries and US Inflation Protected Treasuries. There are no corporate, municipal, or junk bonds among Swensen's core asset classes. In this regard, Park Piedmont diverges from Swensen's advice, but we are not alone. In an article about rebalancing (WSJ, 12/21/05, pg. D1), Jonathan Clements cites the following market segments: “Large US stocks, small US companies, REITs, developed foreign stock market, emerging market shares, gold stocks, high quality US bonds, junk bonds, and foreign bonds.” He also notes the fact that many people “divide their US stock market money between funds that focus on rapidly expanding “growth” companies and funds that specialize in bargain priced “value” shares.”

In an article appearing in the December 2005 Financial Planning Magazine (pp. 109-113), which also discusses rebalancing, the author, managing director of Nuveen Investments Wealth Management Group in Chicago, uses the following five asset classes in his analysis of the benefits of rebalancing: US Large Cap Growth, US Large Cap Value, US Small cap, Developed international, and municipals bonds (all indexed).

And in an article interviewing David Darst, author of "The Art of Asset Allocation" (WSJ, 12/12/05, special section, pg. R6), the following asset categories are mentioned: "US and international equities, US and non-US bonds, alternative investments, and cash. Alternative investments include real estate, real assets (commodities), private equity/venture capital, managed futures, hedge funds, and inflation protected securities." The article cites Swensen as advising individuals against certain asset classes such as private equity/venture capital and hedge funds, "because individual investors don't have access to the same managers in these asset classes as a Yale or Harvard. And manager selection is extremely important in these less efficient asset classes – the difference in performance between a good manager and a bad manager is very wide."

It is not our purpose here to analyze which set of assets is best in terms of implementing an asset allocation, but rather to note that there is a diversity of respected opinion on the subject. In our view, whether investors stick with Swensen's six core classes, or broaden to the number used by Clements (which most closely approximates the Park Piedmont approach), or go even further (per Darst) and incorporate certain alternative assets, the central points for investors are: (a) to understand the various asset classes employed, and (b) to monitor the percentages using the rebalancing technique advocated by all of the commentators mentioned above (see November's Comments for a detailed discussion of rebalancing).

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)%

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%
December 31, 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%



Victor Levinson



Nicholas Levinson