

Market Commentary
January 5, 2006

We are as pleased as you are to close out the year with a strong finish to what turned out to be a wonderful year.

What made 2006 particularly satisfying is that it neatly followed a mediocre year in 2005 for the equity markets in general and RCB specifically. The key to our long-term performance and success which spans over four decades is the ability of the firm's investment team to think as long term as humanly possible and not be shaken or stirred by the overwhelming short-term emphasis of Wall Street and the financial information business.

Specifically, 2006 saw terrific performance from many holdings in a variety of industries, as well as the success from two distinct themes - one deliberate and one involuntary. The planned success was an overweighting in P&C insurance stocks as we felt the hype concerning a bad hurricane season was overblown and somewhat irrelevant as our companies were all well capitalized, enjoyed much higher pricing as well as better terms & conditions on their storm related policies. Our unplanned theme involved a number of our holdings either being acquired or taken private. Then again, picking stocks that are undervalued, hold hidden assets, and generate strong free cash flows is what we do best and is what generates solid long-term returns, and consequently make good acquisition targets for the very same reasons. So perhaps, in this case, unplanned is the wrong theme.

Fixed income performed as expected. Our continuing concern entering 2006 centered on the Federal Reserve's desire to quash any signs of inflation - with the side benefit of demonstrating that the new Fed regime hadn't gone soft. Hence, our fixed income portfolios saw our emphasis on the shorter end of the yield curve deliver nice results in the first half, while the Fed's pause in the second half brought in the proverbial tide that lifted all boats.

Since history has already been printed, what about 2007 and beyond? The simplest and probably the most effective way to approach stock market forecasting is to forget it entirely and move on with other activities more correlated with success. There is 80 to 150 years of data, depending on your comfort level with the older years, that suggests the long-term annualized return on stocks is around 10% thus making it as good a place to start as any. We would add to that the help or hindrance of a particular starting point - a series of strong returns in excess of the benchmark's 10% are usually followed by a series of weaker than benchmark returns and vice versa. This concept is very simple: AFTER prices have risen, valuations are usually less attractive and this elevated starting point takes money away from subsequent returns and again, the opposite is true. Thus, we might look for a slightly less than benchmark year in 2007 to allow fundamentals to



catch-up with the stellar results of 2006.

We also view the fixed income market with caution, as the current question du jour – “When will the Fed begin to cut rates?” – may be a bit premature. A healthy global economy, a domestic business climate that isn’t slowing down as fast as some predicted, a weak dollar, and inflation that stays stubbornly stuck a bit higher than desired, all lead us to ponder why the Fed will be in any hurry to cut rates. Rates are in a neutral range and will stay there until there are clear signs of a slowing economy, so given the market’s expectations, we are buying bonds at the shorter end of our fixed income philosophy which is admittedly short to intermediate.

As is always the case, there are a variety of “issues” that the financial markets will confront in 2007, and naturally which ones will have a material impact remains comfortably obscured in a hazy crystal ball. These would include Federal Reserve policy, economic policy changes out of the new Congress, a continuance or deepening of the housing slump, Yuan/Dollar politics and the usual host of nasty geo-political issues.

As we enter 2007, RCB is in excellent shape as far as people and systems. We have recently completed a firm-wide performance verification and we are now reporting performance in compliance with the GIPS®(Global Investment Performance Standards), issued by the CFA Institute. GIPS® provides a uniform standard by which managers report their account performance in a complete and fair manner. Additionally, these Standards are recognized by the investment industry worldwide. For a copy of our verification report, please contact us at marketing@rcbinvest.com. We are highly confident that we will continue to deliver high levels of performance and service to our diverse client base.

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