January 31, 2006

Dear Client:

For as long as I can remember I have been a baseball fan. My interest in the game truly solidified when one summer when I was a young boy my father took my brothers and me on a long drive to St. Louis to watch the Cardinals play the Philadelphia Phillies and the Cincinnati Reds. We even stayed at the Chase Park Plaza Hotel where the players from the visiting teams were housed. What a treat it was to see baseball players up close. Every day we would go to the ballpark early to get autographs from the home team players.

Early in life I was in awe of baseball players because I had found the game to be exceptionally challenging. Indeed, many believe the most difficult undertaking in all of sports is to hit a baseball with a stick when it is coming toward you in a twisting looping manner at 90+ miles per hour. While still admiring the physical skill it takes to play the game well, as I have grown older, I have begun to appreciate the mental toughness and stamina the game requires. A single season is played out over an incredible 162 games! The best team or the best players cannot be determined in a week or a month. A much longer period is required to make that judgment. The ultimate honor for a baseball player is induction into the Baseball Hall of Fame. Many professional players possess outstanding physical skills. Only those with the mental toughness to harness those skills over an entire career of 10-15 seasons or more are inducted into the Baseball Hall of Fame.

I have often dreamt of what it would be like to have a team of my favorite Hall of Fame baseball players together in their prime. Of those players that I have seen play in person or on television, my personal Hall of Fame team would have Willie Mays, Hank Aaron, and Stan Musial in the outfield. Around the infield you would find Eddie Murray, Rod Carew, Robin Yount and Brooks Robinson. On the mound we would have Tom Seaver, Bob Gibson, and Greg Maddux. Johnny Bench would be catcher. If it were possible to assemble all these players together in their prime as one team, they would be unstoppable over the course of a season. Even so, our fictional team would still likely lose 30% of their games in a year and would almost certainly lose 2-3 games in a row at some point during a season. If that happened, would it mean that these guys were not a good team? Even the best of hitters in

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baseball history like Willie Mays had periods when he would not get a hit for several games in a row. Would that make him a bad choice to be included on my fictional "dream" team? The answer to both questions is obvious even if you are not a baseball fan.

There are numerous parallels between how best to judge a baseball player or baseball team and how best to judge one's capabilities as an investor. In each case, it is what happens in the long run that means the most. Our equity performance in 2005 on average was down 2% (*gross of fees*) versus a return for the S&P 500 of 4.9%. This is the equivalent of a good hitter not getting a hit for 3-4 games in succession. However, our equity composite is up 14.2% (*gross of fees*) per year over the past 15 years versus 11.6% for the market over the same period – a much better indication of our capabilities (*Explanation of how composite is compiled*). While I am not suggesting I am a candidate for the Investment Hall of Fame, my goal is to have performance numbers that are as good as those who I know are candidates for such. So far we are meeting that goal.

We underperformed the market last year for two reasons. First, we did not own any energy stocks in our portfolio. Energy and other commodity type stocks performed well last year. Without energy stocks, last year's market average would barely have been positive. Historically, every 7-8 years the stocks of energy and other commodity-type businesses move up in price a lot due to a spike in the price of the underlying commodity. We know, however, we can more consistently compound your money by investing in companies with unique intellectual capital rather than commodity capital. The second reason for our underperformance in 2005 is one of the major reasons we have outperformed in the long run - our heavy exposure in the insurance industry. Last year was not the best year to be invested in the property and casualty industry. Three out of the top seven costliest storms in our nation's history occurred last year. While not unscathed, the insurance companies in our portfolio withstood the onslaught far better than most. There will be a better day for our companies in this industry. For a new client I would buy our major insurance holdings at current prices. In summary, we are going to stick with what we know works best in the long run.

At this time last year I accurately predicted the market and our portfolio were due for a lackluster year. I do not expect extra points for being accurate with that prediction. At this juncture, I am considerably more upbeat about the coming year. While the prices of stocks we own have had a near zero return over the past twelve months, the underlying values of the companies have increased and in some cases dramatically so. Additionally, the new investment opportunities that I am finding now are as compelling as I have found in years. Some of them have already shown up in your portfolio. Others are soon to follow. In short, I expect 2006 returns to be more in line with our long term goals. I wish you and your family the best of health and happiness in the coming year.

Sincerely,

Gary L. Watkins
President