QUARTERLY REPORT

Second Quarter 2005

In the second quarter stock and bond markets reacted to a broad mixture of both positive and negative economic and monetary news. Oil prices rose to more than $60 per barrel, while the Federal Reserve tacked on two more quarter point increases to short-term interest rates. For the most part, corporate earnings continue to grow, although at a declining rate. Federal Reserve Chairman Alan Greenspan repeatedly categorized US business conditions as sound. The Federal Reserve maintained its forecast of interest rate increases at a "measured pace".

The bond "conundrum" continued as longer term interest rates declined despite the Federal Reserve's upward pressure on short rates. Bond rating agencies downgraded to junk status the debt of corporate giants Ford and General Motors.

Speculation levels in the markets are rising. There are now over 8,000 loosely regulated hedge funds, most of them competing with one another for short-term profits. Their combined force tends to exaggerate market moves, both up and down. In the second quarter, over 54% of the volume on the New York Stock Exchange came from computer-aided program trading of baskets of stocks. This is a growing sign that less and less Wall Street activity represents traditional investment, while an increasing amount is for purely speculative purposes. As evidence of that trend, we're seeing that companies with minimal or negative earnings have again begun to jump in price, as they did in the bubble era of the late 1990's. These phenomena do not tell us whether stocks will rise or fall in the short run, but such speculation typically leads to a bad end eventually, as it did in 2000. Every investor needs to decide whether he/she wants to be a speculator or an investor. While there is a certain amount of speculation in virtually all securities activity, we come down firmly on the side of investment.

Despite the cross-currents, most of the major market indexes did not show dramatic movement in either the second quarter or year-to-date. In the second quarter, stocks, bonds and cash equivalents all provided small positive returns. For the first six months of 2005, most bond indexes were up about 2% while stocks showed slight losses.

Typically, our portfolios perform quite similarly, one to the next. In this quarter we observed a greater than normal dispersion of results. Those portfolios that have been with us for a number of years outperformed more recently acquired portfolios. The strongest stocks so far this year for our clients were the home builders and the energy stocks. While these positions have not hit sell targets, neither have they been in our buy range for more than a year, so more recently acquired portfolios would not have holdings in those industries.

While the general level of stock market valuations remains unattractive, we continue to look for opportunities to increase yield and for individual securities that offer relatively attractive risk/reward return characteristics. We look forward to an environment in which far more securities will meet our purchase criteria.

Thomas J. Feeney
Managing Director
Chief Investment Officer
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