The Lam Group
Investment Management

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The Big Picture: Now We Return to Our Regularly Scheduled Program…
At the beginning of 2005, there were few that believed that the US dollar would not continue its downward spiral against the currencies of other developed countries. After all, by the end of 2004 the US dollar had fallen over 15% since the Euro's inception in January of 1999, and fallen over 9% vs. the Yen over the same period. With the unchecked growth of the US trade and budget deficits, the continued weakness in the US dollar seemed like a pretty safe bet to many (including us).

Markets are hard to predict. In 2005, the US dollar strengthened over 14% vs. both the Euro and the Yen.

What caused the US dollar to strengthen?

No doubt the Fed's tighter monetary policy (raising short-term interest rates from 2.25% to 4.25%) had something to do with the Dollar's strength. However, higher US interest rates may not be the whole story. On October 22, 2004, President Bush signed the American Jobs Creation Act of 2004 (also known as the Homeland Investment Act) that allowed US multinationals in 2005 to repatriate funds (profits in foreign currencies) held at offshore subsidiaries back to the US at a favorable tax rate (5.25% down from 35.0%).

It is worth noting that the US dollar weakened dramatically from October 22, 2004 to December 31, 2004 since there was a large incentive for US multinational companies to wait until 2005 before bringing these foreign funds back home. **In 2005, the strength of the US dollar was the market's biggest surprise.**

As a consequence of the Homeland Investment Act, it is estimated that over $300 billion of foreign funds were repatriated to the US in 2005. To bring these funds back onshore, foreign currencies were sold to buy US dollars, strengthening the US dollar against other currencies. To put the $300 billion repatriation estimate in context, the US Treasury issued approximately $500 billion (net) in US government securities in 2005, and $300 billion is about 2.5% of our domestic GDP.

The favorable tax provisions of the Homeland Investment Act ended on December 31, 2005. As it is likely that any US multinational that had offshore funds to repatriate has already done so, the future value of the US will not have the benefit of this substantial, yet one-time legislative act.

While Fed monetary policy may continue to influence the value and direction of the US dollar, the Fed's incentive to continue raising short-term rates is unclear given the flatness of the yield curve and the impending change of leadership from Alan Greenspan to Ben "Helicopter" Bernanke. In a 2002 speech, Mr. Bernanke famously suggested the Fed could drop money from helicopters, if necessary, to add liquidity to the financial system in a time of crisis. Mr. Bernanke's approach to the Fed Chairman job is expected to be markedly different than that of his predecessor in the sense that he fears deflation more than he fears inflation. This inclination towards accommodative monetary policy may lead to greater inflationary pressures and US currency weakness.

With stimulative effects of the Homeland Investment Act behind us and the continuing problems inherent with our growing budget and trade deficits, the future of the value of the US dollar is unclear at best. That being said, to the degree there were legitimate reasons to believe the US dollar would weaken in 2005, there are now 14% more reasons to believe in the likeliness of weakness of the US dollar compared with a year ago.

In 2005, non-US equity and fixed income asset classes were affected by the strong US dollar in different ways:

Non-US Equity	**2005**
MSCI EAFE Index (International Large Cap Stocks)	+13.54%
MSCI EAFE Small Cap Index (International Small Cap Stocks)	+26.65%
MSCI EMF Index (Emerging Markets Stocks)	+30.31%
Non-US Fixed Income	**2005**
Citigroup Non-$ Bond Index (International Bonds, unhedged)	- 9.20%
JP Morgan Emerging Markets Debt Index (Emerging Markets Debt)	+10.74 %

Data provided by MSCI, Morningstar and PIMCO

It was no surprise that non-$ bonds (w/unhedged currencies) suffered the most from the US dollar's strength. What is surprising is the relative strength of other non-US asset classes relative to their US counterparts given the strength of the US dollar.

US Equity	**2005**
S&P 500 Index (Domestic Large Cap Stocks)	+ 4.91%
Russell 2000 Index (Domestic Small Cap Stocks)	+ 4.55%
Nasdaq Composite Index (Domestic Large Cap Growth Stocks)	+ 1.37%
US Fixed Income	**2005**
Lehman Aggregate Bond (Domestic Investment Grade Bonds)	+ 2.43%
CSFB High Yield Bond Index (Non-Investment Grade Bonds)	+ 2.26%

Data provided by MSCI, Morningstar and PIMCO

The importance of portfolio diversification including non-$ equity and fixed income assets remain important considerations when managing global investment portfolios. As the non-$ bond asset class was the only asset class to post a negative return for 2005 amongst the asset classes we employ in our balanced strategies, we believe it is an asset class worthy of attention as we rebalance our portfolios.

2006 Investment Outlook

Our investment outlook for 2006 is not that much different from our outlook a year ago. We continue to believe that a weaker US dollar, rising global inflation and the question of which country's central bank will raise US interest rates (and to what degree) will be 2006's greatest investment challenges and drivers. As a consequence of these factors, maintaining meaningful portfolio allocations to non-US and real asset classes will be as important in 2006 as it has been in previous years. Here are our 2006 predictions, strategies, ideas and biases:

General:

- The US dollar will weaken against the currencies of other developed and emerging countries. The Homeland Investment Act of 2004 which allowed US multinationals in 2005 to repatriate over $300 billion of offshore funds back to the US at a favorable tax rate ended on December 31, 2005 which may be the basis for a weakening US dollar in 2006.
- No investment decisions should be based solely on the direction of US interest rates as it is unclear which direction rates will go in 2006. On one hand, the Federal Reserve may not be able to continue raising rates due to a weakening domestic economy. On the other hand, foreign investors/central banks may demand higher bond yields if the US dollar resumes a weakening trend.
- A weaker US dollar will result in broader-based domestic inflation: higher commodities prices.

Bonds:

- Domestic Fixed Income: Look to this asset class not for absolute return, but as a portfolio diversifier and risk dampener. Keep durations short and credit quality high for investment grade holdings and keep non-investment grade exposure to a minimum.
- International Fixed Income: Rebalance non-$ bond exposure back to 2004 targets. Maintain emerging markets debt allocation as emerging markets countries have strengthening economies and improving trade surpluses with developed countries.
- Inflation-linked Fixed Income: Rebalance commodities exposures back to 2004 targets to manage portfolio risk and be prepared for continued volatility. Maintain adequate Treasury Inflation Protected Securities (TIPS) exposure.

Stocks:

- As it is our belief the US dollar will resume weakening against developed market currencies, it is likely that international stocks will continue to outperform domestic stocks, particularly in the small cap asset class as international small cap stocks have greater correlation to their local economies and currencies.
- The emerging markets equity asset class should continue to benefit from their lower labor costs and growing economies (particularly commodities-producing nations).
- The valuation of REIT and commercial real estate investments (real assets) will be less sensitive to the overall level of interest rates and more sensitive to the weakness of the US dollar and inflation. Since commercial real estate can't be "printed" as quickly or readily as the US Treasury can "print" more debt, real assets may hold their value better than financial assets.

At this time, while all investment asset classes seem high relative to the economic environment, it is important to remember that as investors, we cannot have an expectation of positive return without assuming some level of risk. The investment risks The Lam Group take for ourselves and our clients are purposeful, yet mitigated by the diversifying effects of combining various asset classes with low relative correlations in our global portfolios.

The Lam Group
We are extremely pleased with our results this year. While the absolute 2005 performance of our globally-balanced portfolio strategies did not match our performance for 2004, we are proud of our results this year since 2005 was a much more difficult investment climate.

As the direction of currencies, like the direction of markets and investment asset classes in general, are impossible to predict, The Lam Group continues to focus on designing and managing globally diversified investment portfolios and overseeing our client's portfolio risks by employing investment asset classes which have low relative correlation in the context of an aggregate portfolio.

It is worth noting that despite having meaningful positions in non-$ bonds in 2005 across all portfolios, our balanced and globally diversified strategy performed strongly; the low-correlation characteristics of the asset classes we employ optimized aggregate portfolio return while limiting overall portfolio risk.

The Lam Group is an independent, fee-only, SEC-registered investment advisory firm with over $150 million in assets under management and clients in Oregon, Washington State, California, Connecticut, New York, and New Jersey. We offer both investment management and portfolio consulting services for taxable investors, family offices, foundations, and endowments.

Our asset allocation approach utilizes a highly analytical process to determine the appropriate combination of asset classes to build investment portfolios and strategies that realistically and optimally reflect the needs, risk tolerances, and investment horizons of our clients.

Due to our growth, The Lam Group is accepting new clients on a referral-basis only, with a $2 million initial minimum.

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Archives for The Lam Group Newsletter are available at our website: www.thelamgroup.com

Asset Class Investment Results:
All portfolios constructed and managed by The Lam Group are designed for an individual client's specific risk tolerances, income requirements and investment horizon. Our investment management approach includes the design of a customized asset allocation plan, the research and selection of the most appropriate and cost-effective asset class investments for the client's specific investment policy, and the on-going monitoring and disciplined rebalancing of the aggregate portfolio to optimize return, manage risk and minimize taxes.

As different clients have different goals, risk profiles and investment horizons, it is not useful to publish a track record of specifically-managed portfolios. The investment performance data below illustrate the returns of some of the actual mutual funds utilized by The Lam Group for specific asset class allocations in the construction of investment portfolios we manage.

Equity Asset Class Category	4Q2005	2005	3 Year Annualized	Correlation w/ S&P 500*
Domestic Total Equity Market				
-Wilshire 5000 Index (Total Dom. Eq. Market)	*+ 2.32%*	*+ 6.32%*	*+ 16.37%*	*+0.99*
US Total Market Fund	+ 2.19%	+ 15.57%	+ 16.22%	+0.99
Domestic Large Cap Stocks				
-S&P 500 Index	*+ 2.08%*	*+ 4.91%*	*+14.38%*	*+1.00*
Domestic Large Cap Value Fund	+ 1.33%	+10.24%	+20.56%	+0.90
Domestic Small Cap Stocks				
-CRSP 6 -10 Index	*+ 1.24%*	*+ 5.72%*	*+26.00%*	*+0.85*
-Russell 2000 Index	*+ 1.13%*	*+ 4.55%*	*+22.13%*	*+0.84*
Domestic Small Cap Value Fund	+ 1.50%	+ 7.79%	+29.16%	+0.76
Real Estate Investment Trusts (REITs)				
-Wilshire REIT Index	*+ 2.50%*	*+14.00%*	*+27.34%*	*+0.36*
REIT Fund	+ 2.16%	+13.15%	+26.54%	+0.45
Real Estate Fund	+ 3.37%	+14.38%	+26.27%	+0.52
International Large Cap Stocks				
-MSCI EAFE Index	*+ 4.08%*	*+13.54%*	*+23.68%*	*+0.87*
International Large Cap Value Fund	+ 5.10%	+15.27%	+30.57%	+0.79
International Small Cap Stocks				
-MSCI Small Cap EAFE Index	*+ 7.85%*	*+26.65%*	*+37.17%*	*N/A*
International Small Cap Value Fund	+ 5.90%	+23.23%	+40.37%	+0.59
Emerging Markets Equity				
-MSCI Emerging Markets Free Index	*+ 6.83%*	*+30.31%*	*+34.23%*	*+0.81*
Emerging Markets Value Fund	+ 6.98%	+30.81%	+47.61%	+0.78

* 5 yr correlation using monthly data

Fixed Income Asset Class Category	4Q2005	2005	3 Year Annualized	Correlation w/ S&P 500*
Domestic Investment Grade Bonds				
-Lehman 1-3 year Govt Bond Index	*+ 0.69%*	*+ 1.73%*	*+ 1.60%*	*-0.49*
Short Duration Domestic Inv. Gr. Bond Fund	+ 0.10%	+ 0.98%	+ 2.80%	-0.14
Short Duration Domestic Muni Bond Fund	+ 0.36%	+ 1.00%	+ 1.55%	-0.02
-Lehman Aggregate Bond Index	*+ 0.59%*	*+ 2.43%*	*+ 3.62%*	*-0.34*
Domestic Investment Grade Bond Fund	+ 0.48%	+ 2.89%	+ 4.53%	-0.02
Domestic High Yield Bonds				
-CSFB High Yield Bond Index	*+ 0.57%*	*+ 2.26%*	*+13.57%*	*+0.52*
High Yield Bond Fund	+ 0.63%	+ 2.23%	+10.17%	+0.52
Inflation-Linked Bonds				
-Lehman TIPS Index	*+ 0.11%*	*+ 2.84%*	*+ 7.02%*	*-0.28*
TIPS Fund	- 0.15%	+ 2.64%	+ 6.74%	-0.27
Commodities-Linked Fund	- 4.10%	+20.50%	+22.10%	N/A
International (non-US $) Bonds				
-Citigroup Non-$ World Govt Index	*- 2.61%*	*- 9.20%*	*+ 6.46%*	*-0.09*
Non-$ Bond Fund	- 2.59%	-10.08%	+ 6.58%	-0.04
Emerging Markets Debt				
-JP Morgan EMBI+ Index	*+ 1.88%*	*+10.74%*	*+16.78%*	*+0.41*
Emerging Markets Debt Fund	+ 1.94%	+11.74%	+18.46%	+0.47

* 5 yr correlation using monthly data