Sound Investments Inc.

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Quarterly Investment Commentary

Our Mutual Fund picks did considerable better than the market averages. We did this by focusing on investments that are moving – mainly International funds, Emerging markets and Mid-Cap funds.

Upgrading is based upon the observation, that few, if any money consistently excel. Instead we observe a wide range of performance returns, with only a small percentage of professional money managers investing in the right sectors of the equity markets at any given time.

This is because each money manager has a particular style that works well in some, but not all market environments. Market leadership rotates between large-caps and small-caps, growth and value styles, international and domestic areas. Leadership changes because economic conditions change. However most fund managers don't change their particular styles when the market leadership changes.

Since market leadership is forever changing we move incrementally towards the top ranked funds by progressively selling the lower ranked funds and investing in the new leaders. This continuous process provides an effective way to **invest in a broad range of investment opportunities as they develop.**

We use no load funds as they provide access to the talents and research of the country's leading money managers while they are at the top of their game.

US Stocks once again lived through a year of worries and ended 2005 with modest gains. Total returns for the S& P 500 in 2005 were 4.9%, beating out the Dow –Jones average at 1.7% and the NASDAQ at 1.4%. Most of the mutual funds we picked did considerably better. I believe the average was better than 10% with some doing over 25%.

The markets primary concern last year was raising interest rates and oil prices. The Federal Reserve Board continued to raise short-term interest rates all year long, although the long-term rates hardly moved at all. At the close of the year, it was cheaper to borrow money for10 years rather than 2. Such an anomaly, known as an inverted yield curve, often indicates that bond investors expect a slower economy. But all the concern about interest rates may overlook the fact that interest rates came off a 45 year low of 1%, and are still low by historical standards.

Last year a 40% spike in oil prices also did remarkable little damage to the world economies. Looking forward stable oil prices and a still low core inflation rate may give the fed reason to slow rate hikes. Economic growth continues to remain strong around the globe, but inflation should remain benign because of productivity gains.

Among diversified funds, leadership last year began to shift towards large and growth orientated funds indicating that the trend may have turned away from small-caps and value orientated investments. No matter how you figure it small-cap value had a heck of a run returning nearly 16% on an annualized bias from 2000 to 2005. In 2006 Mid-cap growth performed the best at 10% closely followed by Mid-cap blend and Mid -Cap Value. We expect to see Large –Caps Growth move soon. We have been gradually moving assets into these areas.

While the US averages were virtually flat, many overseas markets soared. International funds enjoyed one of their broadest rallies in recent memory, beating their US counterparts for a third straight year, despite the rising dollar. We were well represented in this group with a number of international funds most notable Dodge and Cox International Stock. Emerging markets also did quite well with most accounts holding the Excelsior Emerging Markets mutual fund.

WHAT'S AHEAD FOR 2006

Growth prospects are improving around the world as the business cycles move into economic expansion phase. However, in a lot of ways 2006 is fraught with risks outlined as follows:

- Inflation – This may force the Federal Reserve Bank to raise rates further.
- Housing Markets – the housing market has enjoyed a stellar run during the past several years. This sector is a major employer and while we see it stabilizing, it will not add to the economy as it did over the last 3-5 years.
- Price of Oil - As I write this the price is over $65 per barrel which seems high to me but some of the oil exporters (Iraqi, Venezuela and Nigeria) could limit their production and prices could rise more. This would be a serious blow to consumer spending.
- US Deficits - A long time concern of mind is the failure of consumers to built savings and/or the government to bring spending under control could push the deficit to a new low and trigger a sell off in the US dollar. While it seems farfetched the rising price of gold/oil is telling us the same thing.

SO WHAT DO WE DO

<u>The trend is our friend!</u> We continue with our successes; that is investing in International Funds, emerging markets and reallocate to madcap funds. These funds are diversified but overweighed towards energy investments. As I outlined on the sidebar, since market leadership is forever changing we move incrementally towards the top ranked funds by progressively selling the lower ranked funds and investing in the new leaders. This continuous process provides an effective way to invest in a broad range of investment opportunities as they develop.

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Yours Truly,

Ken Gilpin

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