



**APRIL 2006**

Equity markets worldwide rallied during the first quarter of 2006. The S&P 500 index of large cap US stocks rose 4.2%; the Russell 2000 small cap US stock index shot up 13.9% and the EAFE foreign stock index gained 9.4%. The Lehman aggregate bond index declined by 0.7%.

**Model Portfolio Performance**

Our four model portfolios gained between 1.9-4.9% for the quarter. The more equity-weighted portfolios earned the higher returns, as expected when stocks are rising.

In a rare occurrence, our models failed to outperform their index benchmarks this period. Variations ranged from the Conservative model matching its benchmark to the All Equity model lagging by more than a full percentage point. Two factors were responsible. An underweight to small cap stocks from late 2005 cost each portfolio approximately 2/10% of return during the quarter. But the principal cause was our specific allocation to large cap US stock funds. These accounted for underperformance of between 0.5-1.1% versus each portfolio's benchmark. To borrow a phrase from Warren Buffett - for this quarter at least, our investment choices subtracted from, rather than added to, our clients' portfolio returns.

<b>MUTUAL FUND MODEL PORTFOLIOS CURRENT PERFORMANCE<sup>i</sup></b>				
<b>MODEL</b>	<b>NEUTRAL ALLOCATION</b>	<b>1<sup>ST</sup> QTR</b>	<b>TRAILING 12 MONTHS</b>	<b>CUMULATIVE SINCE JAN 99</b>
<b>All Equity</b>	<b>80% US Stocks/20% International</b>	<b>4.9%</b>	<b>16.0%</b>	<b>87.0%</b>
<b>Growth</b>	<b>65% US Stocks/15% International/20% Fixed Income</b>	<b>3.6%</b>	<b>12.8%</b>	<b>74.8%</b>
<b>Balanced</b>	<b>53% US Stocks/12% International/35% Fixed Income</b>	<b>3.2%</b>	<b>10.9%</b>	<b>74.7%</b>
<b>Conservative</b>	<b>35% US Stocks/5% International/60% Fixed Income</b>	<b>1.9%</b>	<b>7.4%</b>	<b>62.1%</b>
<b>S&amp;P 500</b>		<b>4.2%</b>	<b>11.7%</b>	<b>17.5%</b>

On a brighter note, we had excellent performance from our US small cap and foreign stock funds, and our fixed income allocations outperformed the negative return of the bond market index.

**Worry, worry, worry**

Soaring oil prices, turmoil in Iraq, one of the worst natural disasters in US history, higher short-term interest rates, an out-of-control Federal budget and historic US trade deficits. That was just 2005. For early 2006, add the threat of declining home prices and you have a potent cocktail of anxieties. Yet, the US stock market has zigzagged its way higher.

There will always be plenty of things for investors to worry about. While we share the above concerns, our objective is to not overreact to the headlines. We rely on a risk-management and investment discipline that is based on fundamental valuation. When an asset class valuation deviates

significantly from its norm (the overvaluation of growth stocks in the late 1990's is an extreme example), we take advantage of this mispricing by moderately adjusting our model allocations. This approach is definitely contrarian and we often find ourselves selling the most popular sectors of the market to buy what is then out of favor.

On this topic, PIMCO's Bill Gross writes in a recent column that the riskier segments of the global debt market are showing signs of overvaluation – a consequence of low interest rates and lack of market volatility over the past two years. Speaking on the same subject, Alan Greenspan testified before Congress last summer that “*History cautions that long periods of relative stability often engender unrealistic expectations of its permanence and, at times, may lead to financial excess and economic stress.*” Hyman Minsky, a 20<sup>th</sup> century economist, put it more succinctly, “*Stability is unstable.*” We would view any resurgence of market volatility in the debt or equity markets as an investment opportunity.

### About the funds in our portfolios

<b>LARGEST MWI HOLDINGS<sup>1</sup></b>	<b>Asset Class</b>	<b>% of Client Fund Assets</b>	<b>Expense Ratio</b>	<b>2005 Turnover</b>	<b>Number of holdings</b>	<b>5 Year % rank in category</b>
<b>Selected American</b>	US Lg. Cap	15%	0.92	3%	72	13
<b>Loomis Sayles Bond</b>	Fixed Inc.	9%	0.85	22%	311	5
<b>PIMCO Tot. Ret.</b>	Fixed Inc	9%	0.43	152%	2319	6
<b>TCW Galileo Select</b>	US Lg. Cap	8%	1.20	16%	28	20
<b>Oakmark Global</b>	Foreign Equity	8%	1.26	17%	52	1
<b>Oakmark Select</b>	US Lg. Cap	7%	1.00	21%	29	11
<b>PIMCO Dev. Local Mkts</b>	Fixed Inc.	6%	1.35	6%	262	NA
<b>Harbor Cap</b>	US Lg. Cap	5%	0.68	69%	64	38
<b>Laudus Discovery</b>	US Sm. Cap	4%	1.20	63%	1020	NA
<b>Longleaf Partners</b>	US Lg. Cap	4%	0.90	13%	30	3
<b>Thornburg Intl</b>	Foreign Equity	4%	1.11	34%	72	NA
<b>AVERAGE OF ALL FUNDS</b>						
<i>US Lg. Cap. (12666 funds)</i>			1.45	87%	166	
<i>US Sm. Cap. (1634 funds)</i>			1.59	103%	225	
<i>Foreign Equity (1121 funds)</i>			1.67	74%	196	
<i>Fixed Inc. (4971 funds)</i>			1.10	89%	284	

The financial press likes to repeat that the average mutual fund investor earns a far lower return than does the average mutual fund. There is a simple reason for this. Individual investors are forever selling good funds that have had poor recent performance, and buying others with shorter-term “hot” performance. The cost of this sell-low/buy-high behavior is considerable. Our discipline of determining a target asset allocation, identifying superior managers, and then adhering to both over the long term is the key to the superior performance of our portfolios.

From more than 21,000 mutual funds, we rely on a comprehensive research process to select only two-dozen or so for our client portfolios. On the qualitative front, we benefit from Litman Gregory's research team, whose exhaustive approach seeks to isolate funds with an exceptional degree of

<sup>1</sup> Data from Morningstar and PIMCO asset management for the largest fund holdings in our client composite.

manager skills, a clearly adhered to investment discipline, and an investor-friendly corporate culture. Investors best understand the real value of these attributes when markets turn difficult.

For quantitative analysis, we also look to Morningstar. Like other investors, we compare past performance. In this light, each of our funds (chart above) ranks near the top of their categories, with all but one ranking in the top 20% of their peer group over the past five years. However, "past performance is no guarantee of future success." Sometimes great performance is truly just luck. So what else do we look for?

We look to three measures that are especially important to ongoing superior performance. (In the chart on the previous page, these measures are compared for our largest holdings.)

1. A **low expense ratio** means more of a fund's gross return is delivered back to the investor. Our funds have among the lowest expense ratios for actively managed funds in the industry.
2. **Low turnover** is indicative of a buy-and-hold investor, that is, a fund manager who buys businesses, not trade stocks. It also means lower capital gains and fewer transactions costs. Selected American, our largest holding, had an astonishingly low 3% turnover rate in 2005, while at the same time besting the S&P by 5%.
3. The **number of holdings** in the portfolios of each of our stock fund managers, with one exception, is far lower than their category average. The best fund managers are generally not afraid to concentrate their portfolios. We call these "high conviction" managers.

### **A few observations**

We are reviewing two funds for possible inclusion in our models: Brandywine and Clipper. Brandywine would supplement our position in TCW Galileo Select, a fund that has lagged expectations since the departure of manager Glen Bickerstaff in 2005. Clipper, with new managers Chris Davis & Ken Feinberg, will be run as a more concentrated version of Selected American.

During the past three years, foreign stocks have largely outpaced US stocks. As we believe this will continue, we have not rebalanced the foreign allocations in our client accounts as often as we might otherwise do. We will adjust these allocations should they further exceed their current 2-3% over target. Small cap US stocks have also outperformed during this timeframe. As noted, we cut back somewhat on the small cap allocations in our models in anticipation of greater relative performance by larger cap stocks.

The past two years have often been frustrating, as the markets seemed to begrudge investors every gain. Yet our four model portfolios, and our client accounts, have risen a cumulative 15-30% since December 2003. A few great investors that we respect have observed that sometimes money can be made only in the waiting. Having the discipline to wait is something that we take particular pride in. While waiting for the next sizeable valuation opportunity, we have our money invested with terrific fund managers who we believe will continue to add significant value over the long-term.

**Martin Weil**  
**President**

PS. Our most recent disclosure form ADV part II is now available. If you would like a copy mailed or emailed to you, please let us know.

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## Model Portfolio Performance Disclosures:

- a) Performance data is for model portfolios and is not a composite of actual client accounts.
- b) All MWI managed client accounts are based on one of four diversified mutual fund model portfolios. These four models are geared to different investor levels of risk tolerance, generally expressed as a one-year maximum loss threshold. New accounts are invested following one of these models, typically using dollar-cost averaging over a period of months, not to exceed one year. Once an account is fully invested, it is expected to track the performance of its underlying model. Exceptions to this include accounts with restrictions such as: the client-directed retention of legacy holdings and/or excess cash, substantial withdrawals or additions. Accounts smaller than \$100,000 are restricted by purchase minimums at certain mutual funds and the performance of these accounts may differ somewhat from the models. Taxable accounts employing municipal bond funds in place of the taxable bond funds used in the models will slightly underperform on a pre-tax basis.
- c) Benchmarks are custom created following the neutral asset allocation for each portfolio. They are constructed from Vanguard's S&P 500 index fund, iShares Russell 2000 index, Vanguard Total International and Total Bond index funds. The S&P 500 index is calculated with dividends included.
- d) Net of fees: The performance for MWI model portfolios is calculated net of our maximum annual management fee. The returns of the portfolio benchmarks and market indices do not include these management charges. All returns assume dividends and income are reinvested.
- e) Rebalancing: Model portfolios are routinely rebalanced every six to twelve months on the last day of a quarter. Actual client accounts may be rebalanced at other times. With tax-efficiency a part of our decision criteria, taxable accounts may be rebalanced less often and/or less completely than retirement and other accounts not subject to current taxation. This may result in performance discrepancies between taxable and non-taxable accounts managed following the same portfolio model.
- f) Model allocation changes: Changes to model allocations are infrequent but can and do occur at any time. When a model is changed, allocations to client accounts are changed as soon as is practical. However, changes to the model portfolios are only recorded, for performance purposes, on the last day of any quarter.
- g) Closed funds: From time to time, mutual funds that form part of MWI model portfolios close to new investors. Clients already owning closed funds in their accounts will generally continue to hold and/or add to their positions. New client accounts will be invested in alternate funds. At year-end, MWI will substitute in its models for any funds that have closed during the year with alternate funds available at that time to new clients. As a result, performance disparities may develop between older and newer client accounts, and between older client accounts and current model performance.
- h) Historical performance is not a guarantee of future results. While the performance period since January 1999 includes both rising and falling stock markets, there can be no assurance that the portfolios will perform as well under future market conditions. In particular, the performance of our Conservative and Balanced models relative to the S&P benefited from the severe bear market in US stocks between 2000-2002. In a rising equity market, the Balanced and Conservative models would be expected to underperform a similar investment in the S&P 500.