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MW INVESTMENT STRATEGY GROUP

OCTOBER 2005

US stocks moved moderately higher as the broad market S&P 500 index gained 3.6% during the third quarter. International stocks rose sharply with the EAFE foreign index ahead a full 10% for the three months ended September 30. Energy and commodity-related issues once again led the advance in the equity markets. Bonds were mixed as high quality Treasuries declined, while corporate and lesser quality bonds rose in value.

Model Portfolio Performance

Our four model portfolios gained between 2.0-5.0% for the quarter, generally outperforming the S&P and their benchmarks. In a challenging investment environment, each of our portfolios is again ahead of its index benchmark for the year.

Growth stock funds were strong performers in the quarter; TCW Select Equity rose 5.4% and Harbor Capital Appreciation 7.3%. Bonds continued to be a difficult place to earn a return and the bond funds we own were flat or down for the period. PIMCO Commodity Real Return fund, added to our portfolios principally as an inflation hedge, rose 16% during the quarter - contributing an average ½% of return to the three model portfolios[1] that own it.

MUTUAL FUND MODEL PORTFOLIOS CURRENT PERFORMANCE[i]

Model	Neutral Allocation	3rd Qtr	Year to Date	Cumulative since Jan 99
All Equity	80% US Stocks/20% International	5.2%	5.3%	72.3%
Growth	65% US Stocks/15% International/20% Fixed Income	4.9%	4.9%	64.6%
Balanced	53% US Stocks/12% International/35% Fixed Income	4.1%	3.7%	65.9%
Conservative	35% US Stocks/5% International/60% Fixed Income	2.6%	2.1%	56.7%
S&P 500		3.6%	2.8%	10.5%

During 2005, our account performance has been enhanced by our allocations to several foreign stock funds. Year-to-date, Thornburg International & Oakmark Global, our two core foreign funds, have gained 13% & 10% respectively, while Matthews Asian Growth & Income has risen 13% and Artisan Small Cap International 19% in 2005. These funds have contributed nearly 50% of our portfolios' total returns year to date.

Hurricane Aftermath

Hurricane Katrina is arguably the greatest natural disaster in the history of the United States. Had it not followed in the wake of Katrina, Hurricane Rita would have been a major catastrophe in its own right. Our thoughts and prayers remain with those who have lost loved ones, homes, and livelihoods in both these storms.

[1] *Our All Equity portfolio, as its name implies, owns only US and foreign stock funds.*

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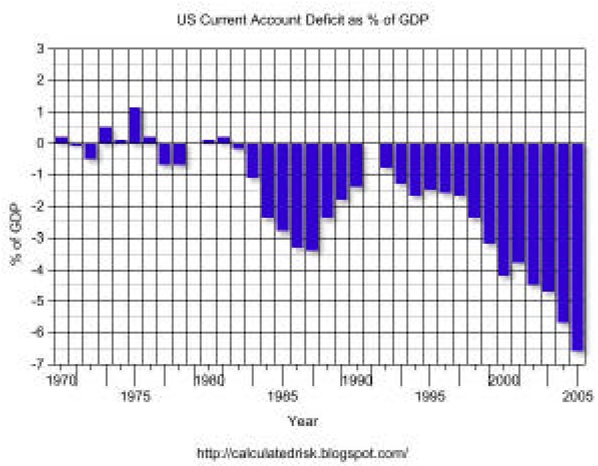
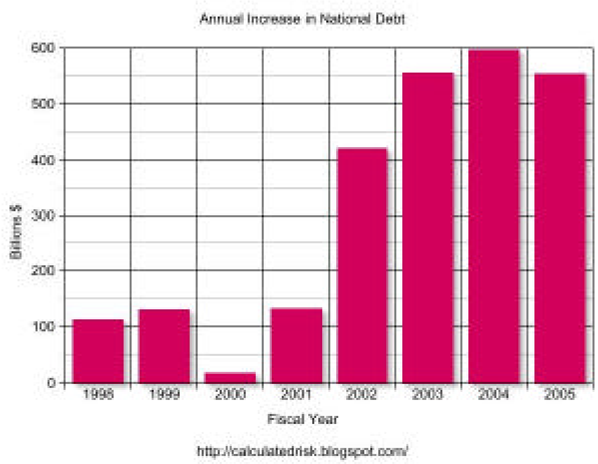
The tasks of reconstruction and restoration in the wake of the storms will be a national priority for some time to come. The economic impact is expected to be more far-reaching than the typical natural disaster. In the short-term, major oil production and shipping facilities in the Gulf area will take months, and in some cases longer, to bring back to full capacity. While this infrastructure is impaired, energy as well as other major commodities will be in shorter than usual supply and prices will be elevated. As reconstruction commences, supplies of construction materials and labor will be diverted to the Gulf region, pressuring building prices throughout the country. These effects however, already anticipated in the market's rising expectations for inflation, are forecast by most analysts to be short term.

The primary economic consequence of the storms may well be the added burden on an already-strained Federal deficit and the quandary this poses for the Federal Reserve. The Federal Reserve has for the past year and a half made clear its intentions to combat any signs of mounting inflation. There is little question that rising energy prices and the effects of the hurricanes are adding to inflationary pressures. Our best surmise is that the Fed will have no choice but to continue to raise short-term interest rates, even at the risk of slowing the economy or throwing it back into recession, in order to pre-empt rising inflation taking hold. Thus while an uptick in inflation may pose an immediate concern, we view a slowing economy as a longer-term risk.

The Year of Living Dangerously





Two pictures that tell a disturbing tale. As we have written previously, the United States is importing more and more goods from abroad than we have been exporting. Our yearly shortfall with our trading partners is now approaching 7% (top graph[2]) of our Gross Domestic Product each year, a level that has historically provoked serious economic consequences for other nations.

The debate rages amongst economists over the causes of this trade imbalance. There are those who believe it is "our" fault – a result of the US' over-consumption and under-saving; and there are those who believe it is "their" fault, the result of under-consumption and over-saving by developing nations. For us, the causes are less important than the possible outcomes of what most agree is an unsustainable situation.

As a consequence of our excess purchases, foreign nations are accumulating more dollars than they need for the purchase of our goods. These nations have decided for now not to trade those dollars back into their own currencies, but to invest instead into the US Treasury bond market. Since they are in effect "hoarding" dollars and/or Treasury bonds, the value of the US dollar has remained higher, and our interest rates lower, than would normally be expected

[2] *Graphs of the US Current Account Deficit and Annual Increase of National Debt by Calculated Risk*

Low long-term US interest rates have allowed consumers to borrow freely and this borrowing has in turn financed further purchases of foreign goods. Low rates have spurred housing and other asset prices to rocket higher. They have reduced the cost of borrowing for the Federal government as well, adding an unwelcome incentive to greater Federal deficits (lower graph). Trade-surplus R a high dollar & low interest rates R additional public & private debt and skyrocketing asset values R more and more consumption…around and around it goes.

For investors, the question is not "How did this start?" but "Where will it end?" Our highest probability scenario still has the dollar coming under renewed pressure when the links in this chain start to unravel. This is why we are overweighting foreign currency exposure through our selection of foreign equity and bond funds that do not hedge their currency exposure. And while we can easily envisage interest rates moving sharply higher, an economic slowdown would have the opposite effect. So we remain conservative with our bond allocations.

Wrapping Up

Looking to the future, we can honestly say that we do not know where the markets are headed from here. We rarely, if ever, do. While there are many things to worry about – and worry about them we do, the US economy continues to show remarkable strength in the face of a significant energy shock. We would no more be surprised by a strong year-end rally than we would be by an extended market correction. We would view either as an opportunity.

Our longer-range view is that equity markets are still working through the long hangover left after the 1990's market binge. We continue to expect modest long-term gains for several years, punctuated by periods of brief "excitement." Equity valuations today, as opposed to the late 1990's, are not unreasonable. However, compared to the early 1980's, they are not bargains. Our approach is based upon diversification, an approach that allows us to invest for long-term capital appreciation, but with an eye over our shoulder for major risks to our investor's capital. This approach will dampen our returns in the unlikely event of a renewed all-out bull market. But we view this cost to be well worth the protection afforded against events that might cause catastrophic loss of equity.

We are making a change to the bond portion of our portfolios this month, trading out of PIMCO Foreign Bond and into PIMCO Developing Local Markets. The latter fund, an ultra-short term emerging markets bond fund, should better capture any possible dollar weakness going forward. We are, at the same time, eliminating the cash in our accounts and adding the funds to our core bond holding, PIMCO Total Return.

Martin Weil
President

PS: In our recent "Client Satisfaction Survey,"[3] our clients uniformly chose "Trustworthiness" as the most important characteristic in their selection of an Investment Advisor. Happily, they also rated MW Investment Strategy Group a "5" out of a possible 5 in this "Trustworthiness" category.

One of our core goals has been building a strong foundation of trust with our clients. We are passingly amused by the recent ad campaigns of several major financial services firms emphasizing "trust" and "human values" in place of their prior promises of market-beating returns. These are the same firms, we recall, who brought us day-trading and the Internet stock bubble. For us, trust is achieved only through a diligent and ongoing approach to integrity, honesty and openness. We like to think we are earning our clients' trust every day, often in ways that are invisible to our investors. So far, it appears that we are succeeding. But we do not take this for granted. If we are not earning your trust, please let us know.

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[3] *A complete report on our Client Satisfaction Survey will ready in November.*

[i] **Model Portfolio Performance Disclosures:**

a) MWI managed client accounts are based on one of four portfolio models. New accounts are typically invested following one of the models over a period of months, not to exceed one year. Once an account is fully invested, it is expected to track the performance of the underlying model. Exceptions to this include accounts with individual restrictions such as: the retention of legacy holdings, substantial withdrawals or additions, individual accounts smaller than $100,000, client-directed retention of additional cash. 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.
b) The results represent the performance of each of four MWI model portfolios and the S&P 500 index. The results do not reflect the performance of an actual client account or accounts.
c) The indicated performance for MWI model portfolios is net of our maximum management fee while the portfolio benchmarks and S&P returns do not include these charges. All returns assume dividends and income are reinvested.
d) Model portfolios are rebalanced every six to twelve months on the last day of the quarter. Actual client accounts are rebalanced as needed on a rotating basis.
e) Historical performance is not a guarantee of future results. While the performance period since 1998 includes both rising and falling stock markets, there can be no assurance that the portfolios will perform as well under future market conditions. The performance of the Conservative and Balanced models relative to the S&P in particular 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.