



HOWE & RUSLING

INVESTMENT STRATEGY NEWS

JANUARY 2006

2005: Better Than Expected

We always find it fun to look at some of the previous year's more outlandish predictions. All of the following were made heading into 2005 (as quoted in *Business Week* on December 26, 2005):

"The Dow Jones Industrial average will finish 2005 at 8,000 points."

—Bernie Schaeffer, Schaeffer's Investment Research, Dec. 27, 2004

"2005 will be a "year of economic difficulty."

—A majority of the American people; 54% of respondents to a Gallup poll. Dec. 17-19, 2004.

And our personal favorite:

"The U.S. will have fewer hurricanes in 2005 than in 2004."

—Tropical Meteorology Project of Colorado State University, Dec. 3, 2004

Overproduction by OPEC could cause a steep decline in oil prices:

"We are concerned about the future. We are concerned about a new severe drop in price like we have witnessed in recent days."

—Iranian Minister of Petroleum Bijan Zanganeh, Nov. 22, 2004

Howe & Rusling's 2005 Thesis

To be fair, we also read Howe & Rusling' January 2005 newsletter to see how we made out:

"The outlook remains strong. There are always concerns—terrorism or unexpected inflation remain at the top of our list, but corporations are generally in good financial shape and demand for their goods is up. This has led to added capacity and increased capital spending. Historically, capital spending and job growth move together. With inflation fairly tame and the long-term expectation remaining low, all of this should bode well for a positive 2005."

—Howe & Rusling newsletter, January 2005

We don't mean simply to pat ourselves on the back. But we do intend to point out that the most important factors in predicting what will occur in an upcoming year are those that deal with the economy and corporations. Despite the hotly contested election of 2004 and the feeling of unease surrounding the direction of the Iraq war, the economy appeared to us to be in pretty good shape.

That is not to say that for many Americans it wasn't a difficult year because it was. However, the economy is growing quickly, the unemployment rate hovers around 5% which is well below

the 30-year average, and household wealth continues to hit all-time highs.

The fourth calendar quarter was a microcosm of the year 2005. In early October, it was very difficult to find good news in the popular press, which was very frustrating for us. The wake of the aftermath of Katrina continued to be awful and there was no end in sight to hurricane season. The news as reported from Iraq continued to be quite negative and the predictions for the increase in home heating costs skyrocketed as we headed into winter. Investors seemed to lose heart as the S&P dropped 4% and the NASDAQ dropped more than 5% in the first 12 days of October alone. The call volume inbound and outbound at Howe & Rusling increased as well.

Our biggest frustration was that investors did not seem to be paying attention to what truly mattered—the world's largest economy. In the third quarter, the U.S. economy grew at a remarkable 4.1%, which meant the economy has expanded by more than 3% for 10 straight quarters. The current expansion is the longest run of growth at more than 3% per quarter since the 13 quarters which ended in March 1986. The 3.7% average growth for the first three quarters this year is faster than the 20-year average of 3.1%.

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AT A GLANCE

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Bond Market Overview



In general and depending on our client risk profile, we were fortunate to have strong double digit equity performance in 2005. This marks the third consecutive year we have outperformed our various benchmarks and provided solid, positive returns to our clients.

Economic growth was led primarily by consumer spending which remained extremely strong. Also, productivity continued to increase dramatically with new equipment purchases increasing productivity at an annual rate of 4.7% in the third quarter, the most in two years, which made it an extraordinary quarter for productivity growth given the dire predictions after Hurricane Katrina.

Despite the daily bad news from Iraq in October, the Iraqi people drove headstrong toward a vote culminating in an amazing turnout of 11 million Iraqis in the December 15th election representing nearly 70% of eligible voters, far above the voting rates in the United States.

Inflation stayed fairly tame as the core rate of inflation, excluding food and energy, remained relatively unchanged at 2% as it had for the past six months. Oil prices drifted downward as the cleanup from the hurricanes continued. Producer prices stayed fairly low as the core Producer Price Index of finished goods rate fell to a 13 month low of 1.7% in November after peaking at 2.9% in July. Globalization continues to keep inflation fairly tame and fairly low.

Finally, even the Federal Reserve's policy-making Open Market Committee weighed in. "Despite elevated energy prices and hurricane-related disruptions, the expansion in economic activity appears solid," the Committee said in a Dec. 13 statement.

"Core inflation has stayed relatively low in recent months and longer-term inflation expectations remain contained."

The stock market recovered somewhat from the early downturn in October and into November. As of this writing on December 27th, for the year, the S&P was up approximately 6%, the NASDAQ was up 3.53% and the Russell 2000 small cap measure was up 5.53%. Bonds fared less well as the Lehman Government Credit Index was up approximately 1.38%. The annualized three year rolling return was currently 2.96% which marked the worst rolling three year period by far for the index since its inception thirty-two years ago.

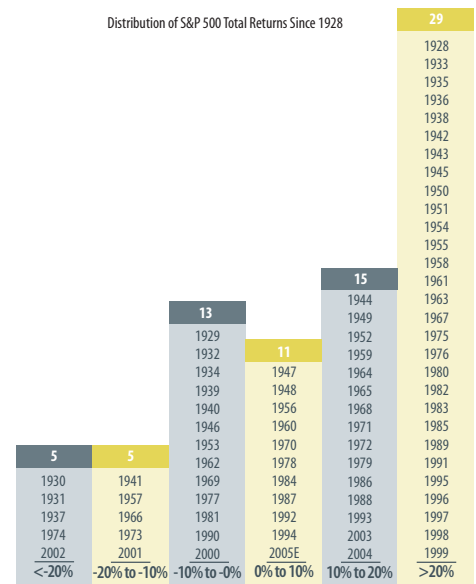
In general and depending on our client risk profile, we were fortunate to have strong double digit equity performance in 2005. This marks the third consecutive year we have outperformed our various benchmarks and provided solid, positive returns to our clients. We are very proud of our how our investment process has evolved and the experience of our team. Our analysts generate stock ideas which are presented to and reviewed by our very experienced Portfolio Managers. Decisions are typically made by consensus and occasionally by vote. The analysts are responsible for ongoing daily monitoring of the companies in the portfolio. We are proud also of the current results.

Howe & Rusling's 2006 Thesis

We expect positive equity returns in 2006, as well. Although it is likely the economy slowed in the fourth quarter of 2005, there is good reason to expect the combination of high employment, economic growth and low long-term inflation will continue. Another reason to be optimistic is that a combination of a mid-cycle slowdown and the Federal Reserve stopping the steady increase in short-term rates seems to bode well for the stock market. The years 1984 and 1994 were similar to the current year of 2005, all marked by steady increases in short-term rates by the Federal Reserve. Stocks rose significantly in the following years of 1985 and 1995 when the Fed stopped raising rates and the economy slowed.

Of course there are concerns for 2006 as well. Tighter capacity utilization rates in the US could allow companies to raise prices causing inflation. Also, tighter labor markets in the US will push wages up at a faster pace. Higher energy costs may curb spending by some consumers as households that use heating oil to warm their homes can expect to pay an average of \$1,454 this winter, 21% more than last year, according to the U.S. Energy Department.

Distribution of S&P 500 Total Returns Since 1928



S&P 500 Annual Total Return Ranges

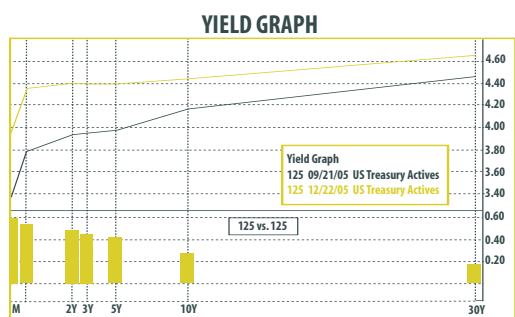
ISI, 2005

Stay the Course

We have learned to expect the unexpected such as terror attacks or natural disasters such as Hurricane Katrina. Such worry can paralyze an investor into inactivity. Rather, we look forward to the challenges in the year ahead and we are confident our investment process is equipped to deal with them. We will continue to be disciplined in our process and not be swayed by the emotions of the moment.

Bond Market Overview

The 4th quarter of 2005 continued a trend that's been ongoing throughout the year – more rate increases by the Federal Reserve and more flattening of the Treasury yield curve. It is difficult to find value investments in such a flat yield curve environment.

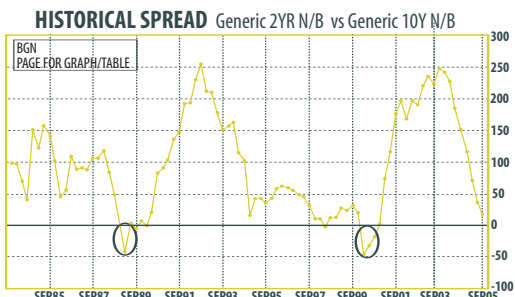


Bloomberg, 2005

In our last quarterly newsletter we summarized how the yield difference (spread) between short-term rates and long-term rates has changed over the year.

Date	Two Year Treasury Yield	Ten Year Treasury Yield	Spread
Dec. 04	3.00%	4.22%	1.22%
Dec. 05	4.36%	4.44%	0.08%

As we can see, the spread is virtually zero between the two and the ten year maturities. In some instances the spread may also be negative (inversion), meaning short term rates are higher than long term rates.



Bloomberg, 2005

The relationship between short-term rates and long-term rates is influenced by completely different factors. As we have mentioned many times before, short rates are affected by monetary policy while long rates are affected by inflation

expectations. As the Fed continues to increase the Federal funds rate they are directly pushing short-term rates higher. Longer rates, on the other hand, have not increased proportionately to reflect the Federal Reserve's tightening of monetary policy. This normally implies that the market is comfortable with inflation expectations and that the risk of inflation is low or well contained.

The graph at the bottom left shows the quarterly spread between the 2-year U.S. Treasury Note yield and the 10-year U.S. Treasury bond yield from December 1983 to present. The circled areas represent those quarters where the spread has been negative. What is interesting to note is that it does not occur often, and when it does, it usually does not persist for a very long time.

Economists are divided in their opinions regarding what the inversion of the yield curve signals for the economy. Some believe in the traditional viewpoint that an inverted yield curve is a precursor to a slowing or recessionary economic period ahead. Others believe that in this particular cycle the flattening or inversion is not signaling recession, but rather strong demand for assets having longer maturities. Much of this demand is coming from foreign central bank purchases of ten-year U.S. Treasury Notes.

Which point of view is correct? We don't know. Historically, the flattening of the yield curve occurs during interest rate tightening cycles and normally these trends end right around the end of monetary tightening. During the past three tightening cycles, (1989, 1994, and 2000) the curve was either flat or slightly inverted. Therefore, this cycle does not appear to be different. The slight inversion that occurred in 1998 was not caused by tightening monetary policy, but rather a brief economic crisis caused by devaluation of Russian currency and turmoil in the Asian markets. Global investors sought the safety of the U.S. Treasury market during this period of time which caused strong demand for the ten-year Treasury. The Federal Reserve actually eased monetary policy at this time in order to avoid a possible collapse of confidence in the capital markets.

As mentioned above, the last two out of three monetary tightening cycles produced an inverted yield curve. In both cases they were followed by recessions eight to ten months later. On the other hand, the tightening cycle of 1994 did not produce an

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inversion and there was no recession that followed. While there is evidence that there is a higher probability that inverted yield curves are precursors to slow or negative economic growth, it is not a given result.

We believe that a recession is not imminent, and tend to agree with the notion that strong demand for longer maturity bonds has created artificially low yields for these securities. Inflation is well contained, but the Federal Reserve has not finished raising short-term rates. The first half of 2006 should prove to be pivotal to reinforcing the debate surrounding inversion and the economic signals it transmits. We'll be tuned in.

Economic Scorecard

We thought it would be interesting to go back to the end of 2004 and summarize a survey of economists' forecasts for 2005 and compare them to what actually occurred.

U.S. Economic Forecasts: Bloomberg Monthly Survey (Table) 2004-12-9 00:00 (New York)

Time Period	1Q 2005	2Q 2005	3Q 2005	4Q 2005
Gross domestic product	3.40%	3.50%	3.70%	3.50%
Consumer spending	3.10%	3.20%	3.20%	3.30%
Unemployment rate	5.30%	5.30%	5.20%	5.20%
Consumer prices YOY%	2.80%	2.30%	2.40%	2.20%
Fed funds target	2.50%	3.00%	3.25%	3.50%
Ten-year note	4.60%	4.78%	5.00%	5.10%

The above represents the median (middle value of all responses) forecasts by a sample of between 58 and 64 economists surveyed by Bloomberg, LLC, a leading distributor of financial media. It is clear from the above responses that the expectations for economic growth were fairly constant throughout the year. The first three indicators show little or no change from quarter to quarter. However, it is also clear that inflation (as measured by CPI) was expected to decrease while yields on the Ten-year note were expected to increase during the year. Also, there seemed to be the expectation that, as inflation diminished, the Federal Reserve would reduce the pace at which it was raising short-term interest rates (as expressed by the Fed funds target).

Actual data as reported by Bloomberg LLC, as released by the respective agencies compiling the data

Time Period	1Q 2005	2Q 2005	3Q 2005	4Q 2005
Gross domestic product	3.80%	3.30%	4.10%	?
Consumer spending	3.60%	3.40%	4.10%	?
Unemployment rate	5.27%	5.10%	5.00%	5.00%
Consumer prices YOY%	3.03%	2.93%	3.83%	3.90%
Fed funds target	2.50%	3.00%	3.50%	4.00%
Ten-year note	4.31%	4.16%	4.21%	4.50%

Since Gross Domestic Product and Consumer spending are "trailing" economic indicators, we have yet to receive quarterly data. However, based on the first three quarters it would appear that the economy is more "robust" than had been anticipated. The first three indicators all support a more "bullish" view of the economy. On the other hand, Inflation is higher than expected, which supports the Fed funds target rate being higher than expected, as the Federal Reserve continues to tighten monetary policy. The effects of rising energy and food prices in the second half of the year are reflected in the actual CPI data. It is also important to note that the ten-year Treasury yield has not increased as expected. We suppose that many of the economists who participated in this survey at the end of last year must share Federal Reserve Chairman Greenspan's "conundrum" of rising inflation yet decreasing long-term interest rates.

While economics is a "science," it is not "perfect." The cause and effect of most economic variables, when taken in isolation, are predictable. However, the task of predicting the future when more and more variables are added, or expectations change, becomes considerably more difficult. That is why diversification across asset classes and market sectors is so important. Equally important is recognizing trends and being able to adjust, just in case things don't go according to plan. Having said that, what does the crystal ball for 2006 have in store?

U.S. Economic Forecasts: Monthly Survey Table (Update) 2005-12-9 09:22 (New York)

Time Period	1Q 2006	2Q 2006	3Q 2006	4Q 2006
Gross domestic product	3.80%	3.50%	3.20%	3.10%
Consumer spending	3.30%	3.00%	3.00%	3.00%
Unemployment rate	4.90%	4.90%	4.90%	4.90%
Consumer prices YOY%	3.50%	3.20%	2.50%	2.40%
Fed funds target	4.50%	4.75%	4.75%	4.75%
Ten-year note	4.80%	4.90%	5.00%	5.00%

Fact or fiction, we'll see how these economists do next year.

If you are interested in learning more about our affiliate, Cook Mayer Taylor, and their small-cap portfolio management, please contact your portfolio manager or Craig Cairns, President of Howe & Rusling.

JANUARY 2006

THE TOP TEN WAYS TO MAKE SURE YOUR HEIRS FIGHT OVER YOUR ESTATE

Philip L. Burke, Esq., Woods Oviatt Gilman, LLP

One of the basic principles of estate planning is to make sure that your beneficiaries receive their inheritance in a timely, efficient matter. While this is normally the case, there are circumstances where the heirs will fight over the provisions of a Will or a Trust which exclude them or leave them less than what they feel they are entitled. Also, there are circumstances (discussed in more detail below) where certain pre-death activities affect the distribution of the estate after death which, again, can lead to litigation.

The following “tips” are a “tongue-in-cheek” look at how to make sure a large part of your estate is spent in litigation fees.

1. Do it yourself. The old adage “you get what you pay for” clearly applies to the preparation of an estate plan. While there are abundant forms, instructions, guidelines, etc, available on the internet or through “self-help” publications, having your estate plan reviewed and prepared by a competent professional is well worth the cost. In addition to making sure you don’t pay unnecessary estate tax due to an improperly planned estate, there are other nuances that many “self-helpers” fail to grasp. For example, what happens to someone’s inheritance if they die before you? Does that inheritance pass to their spouse, children, charity, or just lapse? Is there a beneficiary who may not be able to handle money, or may be eligible for some form of government benefit in the future? If so, should the inheritance be paid outright, be held in trust, given to a third party for the benefit of that person? These are just a few of the many practical questions that an estate planning professional can help you address.

2. Don’t worry how your Will is executed.

While some states do not require witnesses to an individual’s signature on their Will, most do. Signing a piece of paper purporting to be someone’s Will, and having their signature notarized will not, in most states, result in a valid, sustainable Will. Remember, the laws surrounding Wills and Trust have been in existence for hundreds of years and any deviation from the requirements of “due execution” can result in an ineffective document.

3. Rely on state law to distribute your assets on death. If someone dies without a Will (“intestate”), state law will determine who will receive your assets. State law, however, does not dictate how assets like life insurance, retirement accounts and annuities will pass since these types of assets are normally paid to whomever is designated as beneficiary. Obviously, the individuals who will inherit your estate under state law may not be the same individuals you wish to benefit. For example, close friends and charities are not part of the statutory scheme for distribution in the event there is no Will. If your life insurance is paid to one individual and your “intestate” estate passes to others, whom really did you intend to benefit overall? Litigation may provide the answer.

4. Create joint accounts or “TOD” accounts with only one of your children/beneficiaries, since he or she will “do the right thing.” As indicated above, jointly owned assets or accounts that “transfer on death” will pass to the surviving joint owner/beneficiary. These assets are not part of the “probate” estate that is controlled by the provisions of an individual’s Will. There is a great deal of estate litigation surrounding joint bank accounts and beneficiary designations, and whether or not the decedent intended the surviving joint owner to receive all of the assets in the account, or to merely have access during lifetime to pay bills, etc. Your idea of the “right thing” may not be the same as the beneficiary’s.

5. Don’t worry about who pays the estate tax. Planning to provide for the payment of estate taxes is often as important as planning to avoid paying any tax at all. For example, if you provide that estate taxes will be paid out of your “residuary estate” beneficiaries of life insurance, retirement accounts and other “beneficiary designated” assets, may not have to contribute to the taxes. This could result in some beneficiaries receiving less than anticipated with litigation attempting to recover these taxes to follow suit.

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6. Don't worry about a Prenuptial Agreement for your second marriage. Why take the romance out of your new relationship by insisting on a prenuptial agreement? Under the laws of most (if not all) States, a surviving spouse is given substantial rights in the estate of the deceased. These rights can be waived in a prenuptial agreement for the benefit of the children from the prior marriage. Without these waivers, assets passing to the surviving spouse will pass to his or her heirs and not necessarily to yours.

7. Ignore beneficiary designations on life insurance, retirement accounts, annuities, etc. As indicated, these assets pass to whomever is named as the beneficiary which, when an estate plan is updated, need to be reviewed as well. Is a former spouse named as the beneficiary of an old life insurance policy? What about the retirement plan from your job three employers ago? If these types of assets don't end up where your heirs think they should, litigation is sure to follow.

8. Give unlimited Durable Power of Attorney to one individual, to the exclusion of your family, spouse, etc. A Durable Power of Attorney, especially one with "gifting authority," is for all intents and purposes a "blank check." If the agent that you appoint has the authority to transfer your assets to himself or herself, and does so, there may be little or nothing your other heirs can do after death regardless of how hard the issue is litigated (and how much of your estate is spent on litigation fees).

9. Make sure that you leave the stock in the family business to all of your children, even if some of them are not involved with the business at all. You've built a successful business, groomed some of the family members as your successors, so go ahead and leave the stock to all of the children. It is probably worthless to those children who have no interest in the company, so they are going to try and sell it back to your successor (if there are funds available to pay for it). If not, the stock could be sold to anyone who will pay including, possibly, a competitor. Also, if they don't like the way your "groomed successor" is running the business, they can disrupt the business affairs, litigate issues such as compensation, capital expenditures, etc. Bye, bye business.

10. Make sure that your children from your first marriage are the Trustees of the Trust for the benefit of your surviving spouse (their step-parent). Depending on the terms of the Trust, the Trustee controls the distribution of the Trust property to the beneficiary. Where the Trustees have a vested interest in keeping as much money in the Trust as possible (so that when the beneficiary dies they inherit more) they have little reason to make distributions to their stepmother or stepfather. See you in court.

As you can see, estate planning is not a "one size fits all" exercise. The reality of modern life dictates that issues like estate taxes, second marriages, life partners, and other considerations be reviewed in developing a complete and hopefully "litigation-proof" (if such a thing exists) estate plan.

(The author would like to thank his partner, Gordon S. Dickens, Esq., for assistance in the preparation of this article.)

