Quarter Notes

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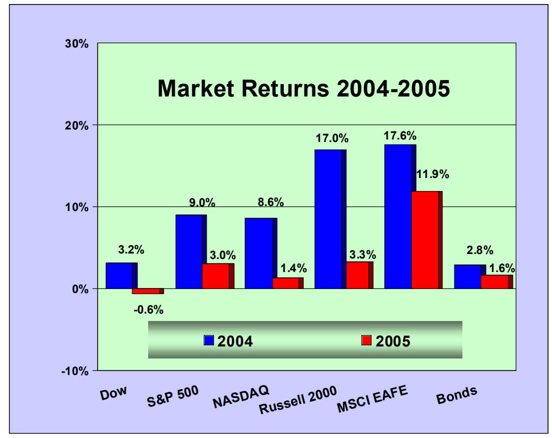
Economy Strong, Stock Markets Weak in 2005

Despite a strong US economy, market returns were weak for 2005. The Dow closed the year in the red, down 0.6% from last New Year's Day. The S&P 500 ended the year in positive territory with a meager 3% gain. The NASDAQ barely eked out a 1.4% gain. The Small Cap Russell 2000 fared only a little better with 3.3% gain. We had expected the fourth quarter to help pull the year out of the doldrums. While we have earned positive returns because of diversification, most investors had little to celebrate at year's end.

The US dollar gained nearly 5% against the Euro for the year. With strong performance by international stocks, international holdings did well. MSEAFE, the international index, gained 11.9% for 2005. Commodity positions helped ease the pain of the stagnant US stock market; a 40% rise in the price of oil was responsible for most of the gain here. Metals also did well.

Bonds and bond funds gave us very little in 2005. By year's end, the yield on the 10 year Treasury had dropped below the yield for the 2 year. This describes a condition called an inverted yield curve, the first since 2000. Bond managers are hoping that this is an indication that the Fed may have raised rates too far. If the Fed does begin to lower rates, it would be bullish for bonds. A bullish bond market, however, causes concerns for equity managers. The only time in the last 30 years that an inverted curve wasn't followed by a recession was in 1998, when it inverted briefly during the Asian financial crisis.



Global Outlook for 2006

The global economy has been expanding at a solid pace over the past three years. For the year just ended, the final number is expected to be 4.3%. Strong growth in the US has driven the expansion.

Since 2001, the US economy has been stimulated by both monetary policy in the form of historically low interest rates and fiscal policy in the form of tax reduction. These policies have allowed us to maintain high levels of consumption. Low rates have helped foster a housing boom, recovering markets, and low unemployment levels.

However, while the US consumer seems to keep spending, there is reason to believe a modest slowdown in growth is likely. We are not forecasting a contraction, just a slowdown in the rate of growth. Revised estimates put 2006 GDP growth at about 3%, down from the previously estimated 3.5% to 3.6% range.

The main reason to expect a slowdown in US consumer spending is that the ability to extract cash from refinancing of homes is just about tapped out. Rising

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We are Moving our Offices

Firestone Capital is moving during the last week in January. We will be in the same building at 1500 San Remo Ave., but we will be moving downstairs to Suite 176 with double the space so that we can serve you better. We will be down a private hallway just off the main atrium.

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Fourth Quarter Market Summary

After a promising beginning, the markets disappoint as the year comes to a close.

For the fourth quarter, the major market indices posted only modest positive gains. The Dow rose 1.4%, the S&P 500 gained 1.6% and the Russell 2000 was up 4.8%.

MSEAFE, the international index, rose 4.8%

ADV Annual Offer

Each year the SEC requires that we notify clients when we are updating our ADV Part II. If you would like a copy of the updated form, please call the office. We will be happy to send one out to you.

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Our Investment Philosophy

√ Clients' goals and risk tolerance drive the investment policy.

√ We believe in dynamic asset allocation. Asset allocation is the primary determinant of investment return.

√ We believe in diversified portfolios with tactical rebalancing while paying attention to the current economic environment and opportunities.

√ We endeavor to manage risk.

√ Systematic rebalancing creates the discipline to harvest profits while using funds to add to undervalued categories.

√ We value experience in selecting professional management.

√ Expenses matter.

√ Taxes affect net returns.

√ We try to keep abreast of new strategies and investments that can assist our clients in attaining their goals.

Tax-Efficient Investing: Asset Allocation and Asset Location

Although tax planning is a year-round endeavor, in the fourth quarter we sharpen our focus on taxes. In retirement accounts or for institutional investors and endowments, taxes are not an issue. But when we are dealing with real clients with a tax burden, we must consider the tax consequences of our investment choices.

Most clients understand that the mix of assets, what we call asset allocation, is a primary determinant of investment return. In other words, the percentage and return of each type of asset in the portfolio tell us within a narrow margin of error what the returns of that portfolio will be. But when taxes are considered, in which accounts should we put investments for optimal tax planning?

Traditional portfolio thinking had put stocks in retirement accounts and tax-free bonds or like investments in the taxable portfolio. However, with changes in the tax laws, stock dividends and long-term capital gains are now taxed at 15%. Putting all your stocks, especially dividend-paying stocks and investments designed to produce long term capital gains, in tax-deferred accounts might be a mistake.

Tax-efficient investments now include qualified dividend-paying stocks and mutual funds which primarily distribute qualified dividends and long-term capital gains. Funds which use rapid computer programs or actively managed, high turnover strategies generate short-term taxable gains and therefore work best in retirement portfolios. The same goes for real estate investment trusts (REITS) which pay non-qualified dividends.

When considering bonds for clients in high marginal tax brackets, we would primarily use tax-free bonds in taxable portfolios so more of the interest earned stays in the clients' pockets. In retirement accounts we can use higher yielding corporate or agency bonds and various other higher paying debt instruments.

In summary, asset location is every bit as much a consideration in building portfolios as is asset allocation.

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interest rates and stabilizing home prices leave less room for consumers to borrow against the equity in their homes. Supporting higher debt payments is also difficult in the face of higher energy costs. Household energy prices have almost doubled since the beginning of 2005.

Some analysts expect US businesses to pick up the slack that US consumers leave when they reduce spending. Although businesses are currently sitting on substantial cash reserves, consumers represent 70% of US Gross Domestic Product (GDP) and it is unlikely that business spending will accelerate in the face of a slowdown in consumer demand.

What about the rest of the world? Does it follow that a modest slowdown in US consumption will result in a decline in growth worldwide?

Although the US economy contributes about 25% to worldwide GDP, foreign economies are in better shape to be able to sustain growth even in the face of a slowing US economy. In the past, Europe, Japan, and the emerging market countries were totally reliant on the US market for their export-driven economies. Now, European companies are increasing profitability by shifting production to sites in Eastern Europe and Asia to lower costs.

Japan is experiencing renewed vitality, having strengthened its banking system and made progress increasing profits, wages, and employment. Trade surpluses, fiscal responsibility, and stronger currencies have made the emerging market countries healthier. China and India continue to rapidly convert from their agricultural-based economies to manufacturing and services. They have the potential to provide a non-US consumption source for worldwide products and services.