

Fagan Financial Report

VOLUME 9, ISSUE 1

JANUARY 2006

Year End Letter

To Our Clients:

Calendar year 2005 brought American investors a relatively flat domestic U.S. stock market; rising short-term rates, stagnant long-term rates resulting in a flat yield-curve, and approximate economic growth of 4.0%. Portfolio returns were similar.

We believe that the major stock indices, including dividends, will conform to their longer term historical returns of between nine and twelve percent with the Dow Jones Industrial Average rising from its 2005 closing value of 10,717 to 11,890 for a gain of 10.94%; the Standard & Poor's 500 rising to 1,395 from its 2005 closing value of 1,248 for a gain of 11.77% and the NASDAQ Composite rising to 2,528 from its 2005 closing level of 2,205 for a gain of 14.64%. Furthermore, we believe that the year will be "saucer-shaped" with the best two quarters being the first and fourth with the second and third quarters lagging. That said, should these estimations prove too optimistic and the market does not perform as anticipated, we would expect more robust returns in calendar year 2007 than we would otherwise anticipate.

2006 Outlook

During 2005 the Oil & Gas, Utilities, Health Care and Financial sectors outperformed the stock market, while Telecommunications, Consumer Services and Consumer Goods underperformed.

We believe that 2006 will result in solid over-performance in Health Care, Technology, Financials, Oil & Gas and Industrials; market-performance in Telecommunications and Basic Materials and under-performance in Consumer Services, Consumer Goods, and Utilities. Looking in greater depth, we also think that large cap growth should rebound, technology hardware should prosper, financials should do well as the Fed ceases its interest rate hikes, and oil and gas companies should continue to prosper as energy costs remain at historically high levels. Furthermore, we continue to see opportunities in companies domiciled in other countries, specifically in South America, the Far East and Central Europe. Israeli companies also have great long-term appeal.

On the interest rate front, we believe that the Fed will hike interest rates once again as Ben Bernanke assumes the chair at its upcoming meeting on January 31st. An analysis of the economic impact of the previous fifteen rate hikes, along with the upward spiraling energy costs, supports this position. Longer-term rates should trend up slightly resulting in a normalized yield-curve (longer-term rates higher than short-term rates). We project the yield spread (difference between the two and ten year treasury notes) to be between .25% and .50% by the end of 2006.

We are NOT concerned about rampant inflation. Productivity growth in high-end industries such as technology and biotechnology in the United States remains strong and global competition for the commoditized industries is keen. This global competition quite often results in production overseas for many basic industries therefore keeping "wage pull" inflation in check.

The risks to the assumptions noted above are many, not the least of which is the ever-present threat of terrorism. Other risks include unanticipated actions by Iraq, a spike in energy prices, and the potential of the Fed raising interest rates too much thereby pushing the economy into recession. The question remains is to whether Mr. Bernanke will chart his own course or will he try to come right out of the gate and establish himself as an inflation "hawk" and therefore continue to raise interest rates. If the latter proves true, this may be a long year for the economy and the stock market. Paraphrasing a guest on a national business show, "trying to slow down the economy is like trying to add milk to hot coffee. If you add too little you can always add more. If you add too much, you're done!"

New Pricing Structure for Individual Stock Trades

For our clients with **combined household portfolios** of \$50,000 to \$1,000,000, Charles Schwab & Company has instituted a new pricing policy for individual stock trades *assuming that the client accepts Electronic Delivery (e-mail) for both confirms and monthly statements. The new pricing structure for eligible accounts is \$12.95 plus \$0.015/share above 1,000 shares transacted.* Many of our clients have already enrolled in this program and need not re-enroll. For those that have not previously enrolled, complete and return the en-

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closed Electronic Delivery Addendum or e-mail us at Dennis-faganasset@nycap.rr.com as soon as possible. If you need help completing the form, please don't hesitate to give us a call. *For those household with more than \$1,000,000 invested at Charles Schwab, transactions costs will remain at \$9.95.*

Please note that both the trade confirms and statements are printable and in the same format as those that you are currently receiving. Furthermore, Fagan Associates maintains the information contained with the trade confirms and statements should you misplace the data.

Review of Stock Trading Disciplines

The brutality of the bear market that ravaged most stock investors throughout the first three years of the twenty-first century has not been wasted. With this in mind, generally speaking, we adhere to the following tenets:

1. Procrastination, by no means, pays off in the marketplace. We therefore always assign an exit strategy (stop/loss targets) to each and every trade.
2. When possible, we cut our losses and let our winners run.
3. When possible, we never lower our stop/loss target and raise the stop/loss, when appropriate.

Our goal regarding the above disciplines is to preserve capital in bear markets and grow capital at a faster pace than the market during bull markets. *Furthermore, we regularly review portfolios and trade laggard stocks for those with more potential to be market leaders. The result may be more transactions in your portfolio(s), but hopefully with measurably better results.*

Update on Website Enhancements (www.faganasset.com)

For a list of all of our stop/loss **targets** for individual stocks purchased by Fagan Associates for the benefit of our client(s), please go to our website, click on "Client Resources" and then click on "Stop/Loss Targets." Please note that these are targets and not etched in stone. However, it will give our clients an idea of potential transactions in the portfolio.

Tax Guidance and Preparation

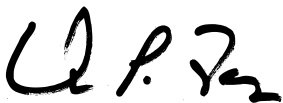
Enclosed you will find general tax information as well as Realized Gains and Losses for all non-qualified accounts. Additionally, Charles Schwab & Company will provide pertinent tax information.

Once again, we are pleased to offer a tax preparation service to our clients with combined household portfolio values of more than \$100,000. As in the past, Fagan Associates will underwrite the preparation fee up to \$150. when you have your return prepared by Mary Grogan, CPA. Please call our office for details and a referral.

Finally, remember to contact us if there are any changes in your financial situation or investment objectives or if you wish to impose, add, or modify any reasonable restrictions to our investment management services.

Best wishes for a Happy, Healthy, Profitable 2006!

Sincerely,



Dennis P. Fagan,
President/Portfolio Manager

Tax Form Guide

[1099 Composite](#) includes taxable income in these areas:

- **1099-DIV:** dividends
- **1099-INT:** interest
- **1099-MISC:** royalty trust income, [payments in lieu of dividends and interest](#) to non-corporate accounts
- **1099-B:** net proceeds in brokerage accounts (excluding retirement, corporate and pension trusts)
- **1099-OID:** income earned on securities (a) whose original issue price is less than proceeds payable at maturity and (b) which are reportable on an accrual basis.

Refer to IRS Publications 15, 15A, 17, 550, 564, and 1212.

[1099-MISC](#) reports income from

Consent Payments:

- Investment advisory fees for unincorporated investment advisors
- Gross-up on [payments in lieu of dividends and interest](#).
- Payments in lieu of dividends and interest to corporate accounts
- Client service gestures
- Other miscellaneous sources

Refer to IRS Publication 15, 15A and 550.

[1099-C](#) reports cancellation of debt.

Refer to IRS Publication 544.

[Substitute Form 1099 OID \(REMIC\)](#) reports Original Issue Discount (OID) amounts that may have accrued during the tax year on Real Estate Mortgage Investment Conduits (REMIC) and other Collateralized Mortgage Obligations (CMO).

Refer to IRS Publications 938 and 1212.

[1099-R](#) reports distributions taken during the tax year from IRAs, SEP-IRAs, SIMPLE IRAs, QRP, Keoghs and 403b accounts.

Refer to IRS Publications 560, 575, 590 and 590 SUPP.

[1099-Q](#) reports distributions taken during the tax year from Coverdell Education Savings Accounts (ESAs). Refer to IRS Publication 970.

Refer to IRS Publication 970.

[1042-S](#) reports income earned from U.S. sources by non-resident aliens (except gross proceeds from sales) and any taxes withheld.

Refer to IRS Publications 515, 519, 597 and 901.

[2439](#) reports net undistributed long-term capital gains of regulated investment companies (RICs) and real estate investment trusts (REITs) and the related tax paid by the issuer on the shareholders behalf. The RIC/REIT reports this information directly to the IRS.

Refer to IRS Publications 550 and 564.

[5498](#) reports tax year contributions and fair market values for IRAs, SEP-IRAs and SIMPLE IRAs. Tax year contributions for Coverdell Education Savings Accounts (formerly Education IRAs) are reported on IRS Form 5498-ESA.

For information on IRAs, SEP-IRAs and SIMPLE IRAs, refer to IRS Publications 560, 575, 590 and 590 SUPP. For information on Education Savings Accounts (formerly Education IRAs), refer to IRS Publication 970.

IRS publications are available at the IRS web site, www.irs.gov.

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Contribution Limits for Retirement Accounts

Type of retirement account	Contribution limit		Additional "catch-up" contribution for account holders age 50+ as of December 31
	Tax year 2005	Tax year 2006	
Traditional IRA, Roth IRA, Custodial IRA	\$4000 or 100% of compensation, whichever is less	\$4000 or 100% of compensation, whichever is less	\$500 for 2005 \$1000 for 2006
SEP-IRA	Lesser of \$42,000 or 25% of compensation (20%* if self-employed)	Lesser of \$44,000 or 25% of compensation (20%* if self-employed)	None
Qualified Retirement Plan (QRP)	Lesser of \$42,000 or: <ul style="list-style-type: none"> • Employer tax deduction-25% of compensation (20%* if self-employed) • Participant contribution-100% of compensation 	Lesser of \$44,000 or: <ul style="list-style-type: none"> • Employer tax deduction-25% of compensation (20%* if self-employed) • Participant contribution-100% of compensation 	None
SIMPLE IRA salary deferral	\$10,000 or 100% of compensation, whichever is less	\$10,000 or 100% of compensation, whichever is less	\$2000 for 2005 \$2500 for 2006
SIMPLE IRA non-elective contribution	\$4200	\$4400	None
Individual 401(K) Includes employer contribution and salary deferral	\$42,000 total: <ul style="list-style-type: none"> • Employer contribution-25% of compensation (20%* if self-employed) • Salary deferral-Lesser of \$14,000 or 100% of compensation 	\$44,000 total: <ul style="list-style-type: none"> • Employer contribution-25% of compensation (20%* if self-employed) • Salary deferral-Lesser of \$15,000 or 100% of compensation 	\$4000 for 2005 \$5000 for 2006

Name	Contribution Deadline	Account Establishment Deadline
<u>Traditional Contributory IRA</u>	April 15 (no extensions)	April 15 (no extensions)
Rollover IRA	N/A	N/A
<u>Roth Contributory IRA</u>	April 15 (no extensions)	April 15 (no extensions)
<u>Roth Conversion IRA</u>	N/A	Dec. 31
<u>Inherited/Beneficiary IRA</u>	N/A	N/A
<u>403(b)(7) Custodial Account</u>	N/A- Transfers Only	N/A
<u>Custodial Account</u>	Dec. 31	Dec. 31
<u>Custodial IRA</u>	April 15 (no extensions)	April 15 (no extensions)
<u>529 College Savings Plan</u>	Dec. 31	Dec. 31
<u>Education Savings Account</u>	April 15 (no extensions)	Dec. 31
<u>SEP-IRA</u>	Employer contribution deadline: Tax filing deadline, including extensions.	Tax filing deadline, including extensions
<u>SIMPLE IRA (Master Accounts)</u>		By Oct. 1 if deferrals are to be made for that calendar year. (Employer must notify employees of plan adoption 60 days prior to salary deferrals.)
<u>SIMPLE IRA (Participant Accounts)</u>	Employer contribution deadline: Tax filing deadline, including extensions Salary Deferral: Must be sent to plan custodian 30 days from the end of the month of withholding.	By the time the first salary deferral and/or the first employer contribution is made.
<u>Qualified Retirement Plan (QRP)</u>	Employer contribution deadline: April 15 (plus extensions)	Adoption and participant account deadlines: By employer's fiscal year end
<u>Personal Defined Benefit Plan*</u>	Employer's tax filing deadline, including extensions but not later than September 15 following tax year-end.Plans that become under-funded will require quarterly payments during the tax year.	Plan must be opened by end of business's fiscal year (usually December 31). For tax year 2004, Schwab must receive Funding Proposal Worksheet by November 1.
<u>401(k)</u>	Employer and employee contribution deadline based on employer's fiscal year	N/A
<u>Company Retirement Accounts (CRA)</u>		N/A