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Third Quarter Wrap-Up

The summer stock market recovered from a first half lassitude and proved resilient in the aftermaths of Hurricanes Katrina and Rita. High energy prices kept making headwinds for much of the market while also providing for the greatest sector outperformance (see table at right), with energy stocks rising almost 18%. Meanwhile the bond market fell prey to inflation fears, likewise a result of soaring energy costs, expectations of higher commodity demand due to hurricane rebuilding, and Washington DC's seeming defiance of financial physics in its ongoing promises to spend more while trying to tax less.

What did this mean for the assets we manage for you? On the equity side, our investments edged out the large cap indices (S&P 500 and DJIA) while coming close to the NASDAQ's performance. On the fixed income side, our

Third Quarter Performance, 2005	
Allen Trust Core Equities	4.30%
Allen Trust Total Equities	4.92%
Allen Trust Bonds	-0.43%
Dow Jones Industrial Avg	3.32%
S&P 500	3.61%
Nasdaq Composite	4.60%
Lehman Agg Bond	-0.67%

defensive tilt toward high quality bonds and short maturities proved rewarding relative to the Lehman Aggregate Bond Index, though our foreign bond positions

(minor allocations, typically) were a drag as the US dollar benefited from the Fed's steady rate hikes. Dollar strength this year has surprised us, but we remain skeptical, and we continue to maintain similar foreign bond allocations.

Let's talk more about the equities. The table at the top of the next column resembles those of the last two quarters in that Energy handily beat all comers, and Utilities hung on in second place. Anecdotally, however, we think a change in stock market leadership may be in the offing.

For the first time this year, no energy stocks made our top five, though Conoco Phillips was close with a 22.1% rise. Rather, our top Core performers were wireless chip maker Qualcomm (+35.6%), biotech Amgen (+31.8%), diversified miner Anglo American (+28.4%), bulk commodity

hauler Canadian Pacific Railway (+24.5%), and Check-Point Software (+22.6%). So in your portfolios at least, technology, health care and materials-related companies

S&P 500 Sector	3rd Qtr	Weight
Energy	17.8%	10.3%
Materials	1.3%	2.9%
Industrials	1.9%	11.1%
Consumer Discretionary	-1.1%	10.7%
Consumer Staples	2.5%	9.7%
Health Care	1.1%	13.3%
Financials	0.1%	20.1%
Information Technology	5.8%	15.3%
Telecommunications	-2.0%	3.1%
Utilities	6.4%	3.6%

came to the fore. We see more value in these sectors than we do in the year-to-date leaders Energy and Utilities.

Also, whereas home building stocks surged in the first half, they faltered in late summer. Core stock KB Homes lost 3.7% for the quarter, and mortgage lender Countrywide Financial, another beneficiary of the booming housing market (and the leveraging thereof), was the Core list's biggest Third Quarter loser, off 14.2%. In both stocks, we had already begun realizing long-term gains, though mainly to reduce concentrations resulting from earlier price appreciation rather than because of our bearishness on either company. Other Core losers were Dell (-13.3%, due foremost to revenue disappointments and fear of consumer spending declines), Sysco (-12.9%, commodity price exposure), and Abbott Labs (-12.9%, unfavorable legal and regulatory outcomes).

We continue to hold these laggards, though we are watching KB Homes for signs of operational deterioration. We like that Countrywide continues to reemphasize its loan servicing business, a lower volatility proposition than new loan origination; that Dell remains the low-cost brand-name computer hardware producer; that Sysco, as much as ever, has what we believe to be superb competitive positioning; and that Abbott Labs has high quality financials, a well-rounded product offering and decent growth prospects at a compelling value.

Bill Harris

Firm News

Amy Ekblad has joined Allen Trust Company as client services specialist. She will work closely with Stuart Allen in communicating with clients and tailoring our team's work to your needs. Welcome, Amy!