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1ST QUARTER COMMENTARY

Los Angeles, March 31 2006

Dear Fellow Investor:

As a registered investment adviser under the Investment Advisers Act of 1940, Bristlecone is required once a year to make available to clients upon request a copy of our Form ADV Part II. This form discloses important information about our firm, such as services, business practices, and potential conflicts of interest. It is available for download at www.bristlecone-vp.com, but we'll be happy to mail you a copy free of charge if you don't have access to the internet (please send a request to: Client Services, Bristlecone Value Partners, 10880 Wilshire Blvd., Suite 880, Los Angeles, CA 90024). We are also required to regularly communicate our Privacy Policy and our Proxy Voting Policy. You will find both following this letter. We also like to remind our investors that the portfolio's investment objective is to provide long-term capital appreciation. Therefore, it is important to let us, or your financial advisor, know of any material change in financial circumstances, investment objective, and special instructions or limits that might affect the manner in which Bristlecone makes investment decisions on your behalf (examples of such special restrictions would be any social, legal, moral or tax constraints that you may have).

Keeping up their momentum from the end of last year, stocks rose in the first quarter of 2006. Once again, shares of small companies led the charge. Among large companies, shares of energy and commodity stocks were the top performers during the quarter, a pattern reminiscent of last year. The long-awaited rotation into shares of large companies has not happened so far as most investors kept favoring, during the first quarter, the type of investments that have outperformed over the last few years.

The S&P 500 – a measure of broad market investment returns – was up about 4.2% during the first quarter of 2006. The Russell 1000 Value index, which tracks large and mid-cap value stocks, was up 5.9% during the same period. Net of fees, and based on preliminary estimates, the average Bristlecone Large Cap Value account¹ was up about 5.4% for the quarter. More relevant to long-term investors, the average Bristlecone account increased by over 22% (4% annualized) net of fees over the last five years². This is in line with a similar cumulative return of over 21% (also 4% annu-

alized) for the S&P 500. Since April 1, 2000, the inception of Bristlecone's investment performance, our portfolios have increased on average by approximately 34% (5% annualized) versus a decline of close to 5% (about minus 1% annualized) for the S&P 500 index.

Our investment activity increased from last year's fourth quarter. First, we took advantage of the current weakness in their stock price to initiate three new investments in equities of Apollo Group, Anheuser Bush and Intel. Although some of you may already be familiar with the last two companies since we owned their shares in the past, Apollo Group is probably unknown to you. Apollo is in the for-profit education business, and owns the University of Phoenix among others. It exhibits the characteristics of a terrific business. Apollo has no debt, very high returns on capital, and sustainable competitive advantages due to the fact that the accreditation process is long and difficult thereby keeping competitors at bay. The company's stock price recently declined on concerns about lower enrollment growth and the resignation of the CEO. Our opinion is that such concerns are more than reflected in the current price and will prove to be temporary. We reduced our investment in Electronic Data Systems as the stock price approached our assessment of the company's intrinsic value. We also sold our remaining investments in Discovery, Textron and Pepsico as we felt that their stock price reflected the value of the underlying business. More specifically, in the case of Textron and Pepsico, as long-term investors, we are thankful to these companies' management teams who delivered terrific returns for their shareholders over the past few years. Cash levels in the portfolio rose to about 7% during the quarter as sales exceeded purchases. Annual portfolio turnover³ ended the quarter slightly above 20%. In practical terms, this means on average that we hold stocks for about five years, a key element of our investment discipline to be long-term investors and minimize transactions costs and taxes.

The stocks that made the biggest positive contribution to the quarter's investment returns were Waste Management, DirecTV, and Keycorp. The companies that penalized returns the most were American International Group, Expedia, and Tyco.

Quarterly Activity:

- ◆ **New Investments:**
Apollo Group (APOL), Anheuser Bush (BUD), Intel (INTC)
- ◆ **Increases in Existing Investments:**
Apollo Group (APOL)
- ◆ **Reductions in Existing Investments:**
Electronic Data Systems (EDS)
- ◆ **Investments Sold:**
Discovery (DISCA), Pepsico (PEP), Textron (TXT)

"BECAUSE OUR FAMILIES'
 SAVINGS ARE INVESTED
 ALONGSIDE YOURS, OUR
 GOAL IS TO USE TIME AND
 COMPOUNDING TO OUR
 ADVANTAGE IN ORDER TO
 BUILD WEALTH".

¹ PAST PERFORMANCE IS NO GUARANTEE OF FUTURE RESULTS. Investment returns quoted are those of the Large Cap Value Non Wrap Composite net of fees. Benchmarks' performance numbers include the reinvestment of dividends.



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The Magic of Compounding: Slow and Steady Wins the Race

The rising popularity of hedge funds over the last couple of years once again highlights a common behavioral trap into which too many investors fall: the lure of outsized returns as the fast road to riches. Every few years, investors find a new fairy tale to latch onto: technology stocks, biotech stocks, gold stocks, real estate investment trusts, oil partnerships, etc. (the list goes on all the way to tulip bulbs in seventeenth-century Holland!). The unfortunate result is that, according to a study done in 2004 by the research firm Dalbar, the average mutual fund investor earned 3.5% annually over the previous 20 years, while the market returned 13%! The reason for this huge difference was that the typical investor purchased funds that had already gone up and sold funds that had gone down. Without going into too much detail about what they do (it is irrelevant to the point that we're trying to make), hedge fund returns in the coming few years will most likely disappoint investors, professionals and amateurs alike, for one simple, inevitable reason: past excess returns breed popularity, which in turn leads to reversion to the mean. What saddens us, though, is that most people do not need to earn outsized returns to reach the financial security they seek, but in the process of chasing the latest fads, they frequently end up failing miserably. Following is a much simpler, and more reliable, formula for wealth accumulation, based on two simple tenets: 1) spend less than you earn; and 2) use the magic of compounding.

The first one is obvious. In order to accumulate wealth, one needs to spend less than one earns. Simple, yet often ignored. The second tenet is more difficult to grasp because most people do not understand how dramatically compounding impacts wealth creation. We'd like to walk you through two examples. Whereas simple arithmetic might lead you to think that it takes 10 years to double your savings if it earns 10% a year in interest (a cumulative 100% return), it actually only takes slightly more than 7 years. The reason is the additional interest earned on interest: at the end of year 1, a \$100 investment turns into \$110 and the interest earned in year 2 increases to \$11. Each following year, the 10% interest payment represents a greater dollar amount. This is why Albert Einstein supposedly declared that compound interest was "the greatest mathematical discovery of all time." Unfortunately, the impact of losses is also magnified. If you were to lose 50% in year 1, your savings are now worth just \$50. To get even, you need to double your money – i.e. earn a 100% return! At 10% a year, it will take more than 7 years to recoup such losses. This is no hypothetical example here; there are some investors in technology stocks who suffered even greater losses from 2000

through 2002 and are still well below breakeven.

The lesson here is that the keys to successful compounding are putting time on your side and avoiding big losses. Time is important because, if one doubles one's savings approximately every 7 years (at 10%), the more 7-year periods one has to compound, the greater the wealth accumulation (tell your kids to start saving as soon as they enter the workplace). Compounding is the gift that keeps on giving: \$250,000 turns into \$500,000, which turns into \$1 million and so forth. The second important lesson is to minimize losses. As illustrated in our example, losing a significant amount of savings can set investors back years, frequently leaving financial security out of reach. Unfortunately, by constantly chasing outsized returns, a great number of investors end up in that situation.

Because our families' savings are invested alongside yours, our goal is to use time and compounding to our advantage in order to build wealth. It is now easier to understand why, as long-term investors, we view significant, permanent losses of capital as the biggest risk to wealth creation. Our goal is to limit the extent and occurrence of such losses in order to be able to compound your capital and ours at attractive rates over time. When investing in equities, we believe that one time-tested way to reduce the chances of a significant permanent loss of capital is by owning a diversified portfolio of shares of well-financed companies with sustainable competitive advantages, managed by competent executives, trading at a discount to a conservative appraisal of their value. Currently, your portfolio holdings trade at an average discount of about 25% to our assessment of the value of the underlying companies. This makes us feel optimistic about the long-term prospects of these investments, and if history is any guide, reasonably confident that the portfolio can weather more turbulent times without undue downside risk. In other words, like the tortoise in Aesop's fable, we believe that "slow and steady wins the race."

On a final note, we want to welcome Erik Luchs to Bristlecone. Erik joins us from Royal Bank of Canada, and will be our new Director of Business Development.

We thank you and appreciate your trust. As always, we welcome your comments or questions (email us at clientservices@bristlecone-vp.com or call 877-806-4141).

Sincerely,

Your Portfolio Management Team

² Performance prior to June 1, 2004 pertains to portfolios managed at a prior firm and includes both wrap and non-wrap accounts. For a description and complete list of composites, please contact Client Services at clientservices@bristlecone-vp.com or call (877) 806-4141.

³ Portfolio turnover is calculated on the model portfolio and is meant to estimate turnover induced by investment decisions only, rather than transactions induced by cash flows in or out of the portfolio.

CAUTIONARY STATEMENT

One of Bristlecone Value Partners' principles is to communicate frequently, openly and honestly. We believe that our clients benefit from understanding our investment philosophy and process. Our views and opinions regarding the investment prospects of the portfolio are "forward looking statements," which may or may not be accurate over the long term. While we believe we have a reasonable basis for our appraisals, and we have confidence in our opinions, actual results may differ materially from those we anticipate. Information provided in this report should not be considered as a recommendation to purchase or sell any particular security. You can identify forward looking statements by words like "believe," "expect," "anticipate," or similar expressions when discussing prospects for particular portfolio holdings. We cannot assure future results and achievements. You should not place undue reliance on forward looking statements, which speak only as of the date of this report. We disclaim any obligation to update or alter any forward looking statements, whether as a result of new information, future events, or otherwise. Our comments are intended to reflect trading activity in a mature, unrestricted portfolio and might not be representative of actual activity in all portfolios. Portfolio holdings are subject to change without notice. Current and future performance may be lower or higher than the performance quoted in this report.