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Happy New Year! Our client's portfolios continued to outperform in 2005, averaging 7%, which was more than twice the 3% return of the Standard & Poor's 500 (S&P 500) Index and better than the Lipper Balanced Fund Index, the Dow Jones Industrial Average, and the NASDAQ. Our fundamental approach to investing has consistently beaten the major market indices over the past three, five, and ten years (see table of comparative results). The challenges investors are facing and our investment strategy for this economic climate follow.

The U.S. economy continues expanding at a moderate, sustainable 3-4% per year. The Federal Reserve Board recently indicated that its campaign for raising interest rates is near an end. Although this removes some of the concern over rising interest rates, we remain concerned about commodities prices, the twin deficits (government and trade) and geopolitics.

Meanwhile, both stocks and bonds continue to be richly valued, despite these market risks. The stock market's high valuation is demonstrated by the Price/Earnings Ratio of the S&P 500 Index, which at 19 is 18% higher than the 50 year average of 16. The S&P 500 has been overvalued in this historical context since the mid-1990s. In addition, the difference between overnight and 30-year interest rates of less than one-half percent is very low historically. Thus, we see little reward for incurring the additional risk of buying longer-term fixed income securities. Bottom line -- this is a good time for extra caution with both equity and debt securities.

The market's performance over the past six years has strengthened our belief that investing requires: ongoing, fundamental analysis; careful valuation of potential investments; a consistent, conservative strategy; a long investment time horizon; and patience. Please let us know if we can provide you or someone you know with the same safe, superior investment management that our clients have enjoyed for over 31 years.