On the Horizon

Fall 2006

Horizon Notes

We're pleased to welcome Allison Crosswell to our team here at Horizon. Allison joins us from Lehman Brothers, where she worked in the private investment management group, here in Houston.

Allison is a native Houstonian and is married to Miller Crosswell. She attended college at the University of Texas at Austin, earning her BBA in Marketing. After working in the securities industry for several years in Atlanta, she returned to Houston and attended the Jones School at Rice, where she received her MBA before joining Lehman Brothers. She brings a great deal of securities knowledge and hands on client experience which should add to our growing capabilities. We know you'll enjoy getting to know Allison.

What does the new record for the Dow mean?

At this writing, the big news in the financial markets is that the Dow Jones Industrial Average (the "Dow") has reached a new all time high. Some commentators have also noted that the market, in general, is now four years into a bull market, recovering from the market lows reached in October 2002. See the following table.

Index	Oct 2002	Sep 2006	Pct Chg
S&P 500	777	1,336	72%
Nasdaq	1,114	2,258	103%
Dow Jones	7,286	11,679	60%

These are certainly strong and positive returns for the last four years. If you just look at this four year time period, you would think returns were fantastic (and they have been.) However, for those of you with only slightly longer memories, the following table indicates the markets' changes from a far different date – March 2000, when the technology-fueled bull market was still in full force.

Index	Mar 2000	Sep 2006	Pct Chg
S&P 500	1,527	1,336	(14)%
Nasdaq	4,963	2,258	(45)%
Dow Jones	11,722	11,679	0%

As you can see in this table, the percentage change for the past 6 ½ years is still negative for the S&P, down 14% and the tech heavy Nasdaq remains in shambles, 45% below its peak.

The point of showing these tables is to remind our readers to keep things in perspective and to not pay too much attention to all the noise and hullabaloo which the financial press provides about these sorts of market achievements. After all, reading the first table seems to indicate that we're in a four year bull market, when the second properly suggests that some markets at least, are still recovering from the bear market which began in 2000 with the bursting of the internet and technology bubble.

In fact, one interesting observation is that today's news is about an index, the Dow, which in the late 90s and 2000, was often ridiculed and considered a benchmark for the "old economy." During the technology boom, news was all about the "new economy" - and the financial well-being of this new economy was measured by the stunning performance of the S&P 500 and Nasdaq indices. Obviously, the tables have turned.

Of course, both tables are correct. The thing to keep in mind is that these periods of performance are just part of a much longer period of investment returns which have been, on average, very positive.

Finally, it reminds us that we shouldn't get too excited or disappointed by what we hear in the financial press. In fact, many of the best investors routinely ignore the majority of financial news. Often times, the things that really matter don't make the headlines. Slow and steady wins the race, but doesn't get any endorsement contracts.

COLLECTED THOUGHTS

"The foreseeable future, isn't." - Bowen White

Market Review

The following table shows market index returns for the 3rd quarter, trailing 12-months, and past 3 years.

Index	3rd Qtr	1-Year	3-Year
S&P 500 (Large Stocks)	5.17%	8.71%	34.13%
Russell 2000 (Small Stocks)	0.13%	8.65%	48.78%
EAFE (International Stocks)	3.42%	16.46%	70.86%
Lehman Bond Aggregate	3.46%	3.83%	8.56%

The third quarter began with declining stock prices, fears over rising energy prices, and Mid East tensions. But then, a ray of hope hit the market. Fed Chief Ben Bernanke hinted that the interest rate hikes might pause. His statements were then backed up by two Federal Reserve meetings without rate hikes and a steep decline in crude oil prices. Both acted as catalysts for rapid increases in stock prices that carried through to the end of September. Economic indicators have improved, inflation seems to have cooled off, and interest rates have stabilized. This has provided renewed hope that freshman Fed Chairman Bernanke can successfully guide the U. S. economy to a "soft landing" by creating an economic policy that will foster growth without fueling inflation.

The third quarter rally was led primarily by the large cap "Blue Chip" companies with the S&P 500 rising 5.2% and the Dow Jones Industrial Average increasing by 4.7%. The noticeable laggards were the small companies with the Russell 2000 Small Cap Index barely breaking into positive territory with a 0.1% increase. This may mark a shift in investor sentiment as small caps have led blue chips for the past three calendar years.

The result of the Fed's decision to leave interest rates unchanged has been a meaningful decrease in bond yields and consumer interest rates. The 10-year Treasury Note has declined from a high of 5.25% to 4.64% at quarter end. Similar declines were also realized for 30-year mortgage rates. Money market yields and similar savings yields have only declined slightly, but if the Federal Reserve decides to reduce interest rates, these short-term rates are sure to go lower.

Nervousness has now shifted from interest rates to the housing market where, despite declining mortgage rates, clear signs of a real estate slow down have begun to surface. Texas and most middle American markets will likely hold their ground due to strong local economies and only modest gains from the most recent housing boom. However, once-hot markets on the west and east coasts that enjoyed the colossal run up now stand to lose value as affordability has become a major issue for many households in those regions. Housing inventories are rising and homes are staying on the market much longer than they did 12 months ago. Additionally, those who purchased properties purely as investments are beginning to liquidate their properties to protect their capital.

Consumers were helped in the third quarter by sharp declines in energy prices. This benefits many areas of the economy such as manufacturing and transportation, but has hurt the stock performance of many energy related companies. There are some areas of the country where gasoline has declined to less than $2.00 a gallon. Even if the almost 30% decline in gasoline prices in the third quarter does not have a significant impact on household budgets, the psychological impact will likely increase consumer spending, which in turn helps retailers and eventually the economy as a whole.

So far this year, most of the major market indexes have realized high single-digit gains. We expect the market will add to or at least hang onto these gains in the fourth quarter, which would deliver an average year for U. S. equities. There are still many unknowns for the market, such as the impact of a weak real estate market and the mid-term elections, but there are a lot of positives as well. When you consider the enormous growth in corporate earnings compared to the fact that the market has basically moved sideways for the past six years, it is easy to make a case that equities are generally undervalued and that now is an appealing time to place money into the market.

Thank you very much for your continued confidence in our service and advice. If you have any questions, comments, or would like to schedule some time to come by and review your goals and objectives, or to just visit, please call.

Manager Spotlight— Growth Fund of America

At Horizon Advisors, we feel that the best way to reduce the risk in our clients' portfolios is to diversify both the *types* of investments our clients own, as well as the *styles* of the different managers we use. We recently visited the headquarters of the American Funds, which are managed by the Los Angeles based Capital Research and Management. They have a very unique style for managing money.

Most investment funds have a structure of one or two senior portfolio managers who make the buy and sell decisions for the fund with the support of a dedicated group of analysts to do most of the detailed research. The American funds are run in a very different manner.

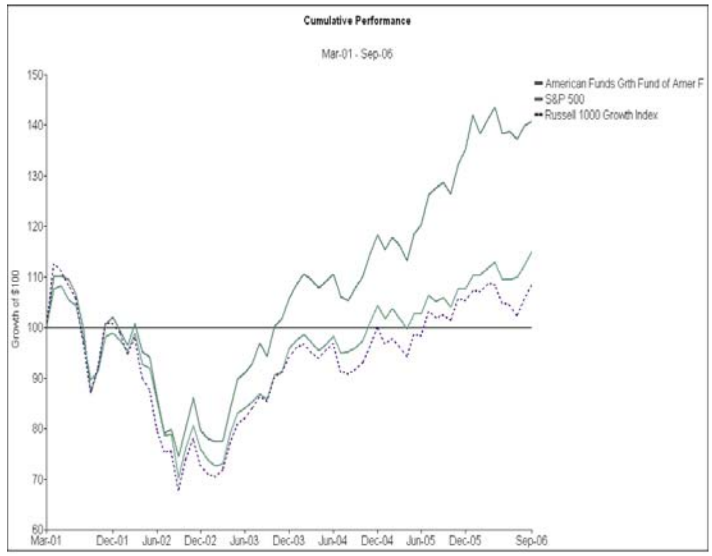
The most important difference is that there is no single Portfolio Manager or individual that has complete control over any of their funds. Instead, the American Funds employs a "Multiple Portfolio Counselor" system where each Portfolio Manager is given a slice of the total fund assets to run independently. With this structure, each of the American funds can be thought of as a combination of several different and independently managed portfolios.

Another major difference is that the size of the firm is enormous. The American Funds have more than $940 billion in assets under management. The firm's considerable size allows them to support a very large and talented research staff of more than 100 analysts covering every corner of the investment universe from offices all over the world. The research department is structured to support the Portfolio Managers in the management of the assets and, despite its size, employs a very effective system of disseminating that information so that decisions can be made quickly and seamlessly.

There are many benefits to this unconventional structure. First, it allows each of the funds to benefit from the different styles of each of the Portfolio Managers. Second, it lessens the risk of any one individual negatively impacting the overall portfolio. This system also minimizes the impact when a Portfolio Manager retires or leaves the firm. Additionally, this structure has proven to be an effective way for the American Funds to manage the growth in their portfolios by adding new portfolio managers as assets in those funds increase.

Each fund also reserves a portion of the portfolio for the analysts to manage without the input or oversight of a Portfolio Manager. This policy ensures that the analysts' best ideas are incorporated into the fund.

Capital Research and Management was the innovator of this "Multiple Portfolio Counselor" system and has used it with great success for more than forty years. As you can see from the following graph, the Growth Fund of America has greatly outperformed the S&P 500 and the Russell 1000 Growth.



Source: Markov Processes International

We have selected the American Funds Growth Fund of America for our clients because of their unique approach, depth of research, and long track record of superior returns. As with all of our recommended investment managers, we will continue to monitor the performance and process of this fund to assure it delivers the quality we expect for our clients.

Disclaimer: This manager (The American Funds) is responsible for managing one or more investments recommended in the past by Horizon Advisors. A complete list of all investment recommendations Horizon Advisors has made in the past 12 months is available upon request.

COLLECTED THOUGHTS

"Carry one thing with two hands, rather than two things in one hand." - Anon

Making Cents—Year End Planning

Each year at this time, we turn our thoughts to year end planning.

Investment and Portfolio Matters

We suggest a "pre" year-end review of your portfolio holdings. This may identify securities with losses which can be sold to offset gains already recognized during the year. This will reduce your 2006 tax liability. We also recommend that this review be coordinated with an estimate of 2006 and 2007 income taxes, so that any planning opportunities can be identified while there is time to act on them.

Estate and Gift Tax

Beginning this year and continuing through 2008, the first $2 Million of a decedent's estate is exempt from estate tax. As the law currently exists, the exempt amount is to increase in 2009 to $3.5 million and then in 2010, all estates are exempt, but only until 2011 when the exemption declines to $1 Million.

It is widely expected that Congress will change these scheduled exemptions in the future, but they've been unable to pass any legislation to date. We will keep an eye on this and let you know if changes are made.

If you are not certain how your estate plan operates, now would be a good time to perform a thorough review and projection of how your will and related documents are currently structured and make sure that your estate will be settled as you intend. Please let us know if you have questions—we'll be glad to discuss this and help you if necessary.

The annual gift tax exclusion, or tax free gift amount is $12,000 per person for each donor. Thus, a husband and wife can give combined gifts of $24,000 to each child or grandchild each year. Additional tax free gifts can be made for direct tuition or medial expense payments to providers on behalf of children and grandchildren.

Income Tax

We recommend a year end estimate of your 2006 tax liability, as well as a projection of your 2007 taxes. This review can provide certainty that you've adequately provided for your tax payments, identified opportunities for current tax savings, and generated ideas for future tax savings.

Closing Thought

Finally, as the year end brings the holiday season, we remind all of our clients and friends to "count your blessings!"

COLLECTED THOUGHTS

May the road rise up to meet you.
May the wind be always at your back.
May the sun shine warm upon your face;
the rains fall soft upon your fields and until we meet again,
may God hold you in the palm of His hand.

-Traditional Gaelic Blessing