Investment Report and Market Commentary

BRAGG
FINANCIAL ADVISORS

First Quarter 2005

We are pleased to enclose your Investment Report for the First Quarter of 2005. This report provides you with a concise accounting of your investment with Bragg Financial Advisors. We hope you find the format to be informative and easy to read. As always, we appreciate your feedback as we strive to provide you with pertinent information and quality service.

Market Index Total Returns as of March 31, 2005

Market Index	First Quarter	1 Year	3-Year Annualized	5-Year Annualized
Standard & Poors 500 (Large Cap)	**-2.15%**	**6.69%**	**2.75%**	**-3.16%**
Standard & Poors 400 (Mid Cap)	**-0.41%**	**10.43%**	**8.02%**	**6.87%**
Russell 2000 (Small Cap)	**-5.34%**	**5.41%**	**8.05%**	**4.01%**
MSCI EAFE (Foreign)	**-0.17%**	**15.06%**	**11.64%**	**-1.15%**
Lehman Brothers Aggregate Bond	**-0.48%**	**1.15%**	**5.99%**	**7.14%**
Lehman Brothers 3-Year Municipal	**-0.75%**	**.09%**	**3.27%**	**4.41%**

Stocks declined in the first quarter as investors worried about higher oil prices, the expanding trade deficit and rising interest rates. Large company stocks as measured by the S&P 500 were down 2.15% for the quarter while small company stocks as measured by the Russell 2000 were down even more, losing 5.34% for the quarter. Medium-sized company stocks and foreign stocks fared better but still posted negative returns as shown above. **The best performing asset class for the last three years has been foreign stocks, with an annualized return of 11.64%.** However, most of that return is attributable to the weak US dollar. Specifically, in local, non-dollar currency, the three-year return of foreign stocks is only 0.52% (much less than the return of US stocks for the three-year period). It is only when you convert that foreign currency return into the now cheaper US dollar that you get an 11% boost in return. If you wondered how you could benefit from the weak dollar, rest assured that you already have through your exposure to foreign stocks or foreign stock funds. In addition to owning foreign stocks, simply owning shares in large American firms delivers a great hedge to a falling dollar as so many of these firms derive a large percentage of their revenues from markets outside the US.

S&P Sector	Weighting in Index	Year to Date Return
Energy	**9%**	**17.07%**
Utilities	**3%**	**4.44%**
Materials	3%	1.27%
Consumer Staples	10%	0.15%
Health Care	13%	-1.02%
Industrials	12%	-2.04%
S&P 500	**100%**	**-2.59%**
Consumer Discretionary	11%	-5.90%
Financials	20%	-6.96%
Info. Technology	15%	-7.47%
Telecommunications	3%	-8.61%

Oil Prices: **The other big story has been the rising price of oil.** At the end of March oil was trading for about $55 per barrel. While this is still below the inflation-adjusted price of 1981, it is about twice the price of only three years ago. This increase has been driven primarily by fast growing economies in the US, India and China; demand has simply outpaced supply and distribution. These higher prices have served as a brake on the global economy but fortunately the U.S. now spends a much smaller percentage of its income on oil than it did during the oil crisis era. In 1981, the U.S. was spending 13% of gross domestic product on energy, according to the U.S. Energy Information Administration. Energy costs could be around 8% of gross domestic product this year. This should reduce the impact on the economy. **The chart to the left** shows you where the action has been so far this year. Obviously **energy and utility** companies have benefited from higher prices as more of their revenue hits the bottom line. Technology and telecom have continued to lag the rest of the market. Please remember that these trends of the last 12-18 months could reverse themselves in the months ahead. **Stay diversified.**

Bonds had a poor quarter as well with the Lehman Aggregate Bond Index losing 0.48%. Investors drove prices down slightly (and yields up) as they reacted to higher inflation numbers released by the Bureau of Labor Statistics at the end of March. Interest rates have risen across the board this year but the increase in longer term yields has been slight relative to the increase in short term yields. Specifically, the yield on the 10-year Treasury bond was 4.22% at the beginning of the year and at the end of March it was only slightly higher at 4.49%, little changed from the level when the Federal Reserve Board began raising rates last June. In contrast to these long-term yields, short-term yields have risen dramatically as the Fed has raised the overnight lending rate (read short-term interest rates) to 2.75% from a low of 1% through a series of quarter-point increases beginning last June. The Fed has signaled that it will continue to raise the cost of short-term borrowing as needed to keep the economy growing without inflation.

BRAGG
FINANCIAL ADVISORS

How high will interest rates go? It's risky to try to answer that question but we can make an attempt if we make an assumption about the expected level of inflation. On average, the yield on the 10-year Treasury has historically been about 3% above the expected rate of inflation. Therefore if inflation is expected to be about 2% (and 2% is the target of central banks all over the world), then the 10-year should yield about 5%. We are not far from this level now.

The economy is doing extremely well despite the drag from higher interest rates and higher energy costs. On February 16th, the Federal Reserve released data showing that industrial production began 2005 at an all time record level. On March 30th, The Bureau of Economic Analysis released final figures showing that real Gross Domestic Product grew at 3.8% in the fourth quarter of 2004 and at 4.4% for all of 2004. In addition to these total output measures, unemployment is down to 5.2%, home ownership is at an all-time high of 69%, corporate earnings remain strong, interest rates are still low, inflation is in check and consumers are spending more than ever. **Is there anything to worry about?** Absolutely! There will always be a list of things to worry about. Today they include terrorism and the general threat of failed states around the globe, rising oil prices, higher interest rates, rising health care costs, the rising trade deficit, outsourcing of jobs, the federal budget deficit, and global warming. I am sure I have left some worries off the list. If you find yourself worrying too much, the following table may give you some perspective. We hope you enjoy it.

	What we were worried about then… **Column to right shows the value of $1000 invested in 1929 in S&P 500 with dividends re-invested. S&P 500 is an unmanaged index, taxes ignored, not an offer to buy or sell security.**	**End of Period Value of $1000 invested 1929**
4th Quarter 2004	Kerry vs. Bush 2004, oil prices, Iraq violence, inflation, deficits	$2,533,319
1st Quarter 2004	The "jobless recovery," manufacturing jobs, bonds, inflation, deficits	$2,323,527
3rd Quarter 2003	Mutual fund scandals, violence in Iraq, deflation, China economy	$2,036,984
1st Quarter 2003	Iraq…Bush vs. UN…case for WMD, stocks fall 15%, deflation, bonds	$1,719,858
4th Quarter 2002	Corporate scandal, unemployment 6%, stocks down 22% in 2002, corporate earnings lousy	$1,775,795
3rd Quarter 2002	Anniversary of 9/11, S&P 500 47% off peak, Nasdaq off 77%, stocks falling, Worldcom	$1,673,810
1st Quarter 2002	Enron fallout, deflating tech bubble, oil prices, Middle East	$2,285,714
4th Quarter 2001	Anthrax, waiting for "other shoe to drop"	$2,279,446
3rd Quarter 2001	9/11, stock exchange closed for four days…are things different now?	$2,059,399
1st Quarter 2001	Bear Market …Stocks off 22% from peak, profit warnings	$2,280,192
2nd Quarter 2000	S&P 500 peaks at 1527, bubble, Fed rate hikes begin.	$2,833,522
1st Quarter 2000	Inflation, market bubble, Dow peaks at 11722	$2,910,864
1999	Y2K, jobless rate low, market up over 20% for 5th straight year.	$2,845,697
1997-1998	Asian currency crisis rocks world financial system, Russian debt default, market off 20%	$2,351,039
1994-1995	Fed raises rates six times….bonds…"party over? " Dow tops 4000, then 5000…"too high?"	$1,114,060
1991	Recession in US, Soviet Union dissolves, chaos in Eastern Europe	$675,658
1990	Iraq invades Kuwait, first Gulf War	$517,547
1988-1989	Bank failures (S&L's) peak, junk bond debacle rocks Wall Street	$534,490
1986-1987	Black Monday…Dow declines 22% in single day, bombing of Libya	$347,990
1981-1982	Reagan shot, pope shot, worst recession in 40 years	$162,232
1979-1980	Three Mile Island disaster, prime rate 20%, home ownership "out of reach," Reagan elected	$140,523
1975-1978	Energy crisis, oil embargo, massacre in Cambodia, US exits Vietnam	$89,597
1971-1974	Watergate, oil embargo, wage-price freezes, stocks off 48% from peak, Nixon resigns	$53,314
1965-1968	Civil Rights marches, M.L. King and R. Kennedy assassinated, Vietnam War escalates	$65,641
1962-1964	Cuban missile crisis, J. Kennedy assassinated, Gulf of Tonkin	$47,136
1958-1961	Recession, Castro seizes power in Cuba, Soviets down U-2 plane, Berlin Wall erected	$36,106
1956-1957	Suez crisis, Soviets launch Sputnik	$17,645
1952-1954	US seizes steel mills, Soviets explode H-bomb, Dow tops 300	$14,107
1947-1949	Cold War begins, Berlin blockade, Soviets explode A-bomb, Korean War	$4828
1945-1946	Post war recession predicted, Dow tops 200… market "too high"	$3645
1939-1941	War in Europe, France falls, Pearl Harbor, WWII	$1602
1929-1937	Great Depression, stock market collapse	$1538

Thank you for letting us help you with your planning and investing. Please let us know when you would like to review.

Benton S. Bragg, CFP, CFA
President, Bragg Financial Advisors, Inc.