Investment Report and Market Commentary

BRAGG
FINANCIAL ADVISORS

Fourth Quarter 2005

Stocks managed to pull out a positive year despite serious headwinds from rising interest rates, soaring oil prices and massive hurricane destruction. Large Cap US equities as measured by the Standard and Poor's 500 were up 4.91% for the year, while Mid Cap and Small Cap stocks were up 12.56% and 4.55% respectively. Foreign stocks won the prize for 2005 with a return of 13.54%. That market returns were positive in 2005 demonstrates the continued resilience of the US economy. We would have been hesitant to invest in stocks at the beginning of 2005 had we known that a gallon of gas would cost over $3 by September and that a major US city with a population of over 1.3 million people would be rendered uninhabitable due to flooding and hurricane damage. These events, coupled with higher borrowing costs for consumers and corporations, certainly put the brakes on a fast-moving economy last year but nevertheless, the economy grew, unemployment dropped and the stock market managed a positive return for the year.

Once again, look at the table below and take note of the great returns stocks have posted over the last three years. While the market is still below the peak reached in March of 2000, it has made great strides lately. Although the numbers below don't lie, the gloomy reports we hear in the mainstream media may have given you a different impression of the economy and the stock market over the last few years. Despite what you have heard, the news about your money and the health of the world economy is very positive. Set aside this commentary and take a look at your three-year return on your investment report. I hope you will agree that the real news - and your numbers - have been quite good!

Market Index Total Returns as of December 31, 2005

Market Index	4th Quarter	1 Year	3-Year Annualized	5-Year Annualized
Standard & Poor's 500 (Large Cap)	2.09%	4.91%	14.39%	0.54%
Standard & Poor's 400 (Mid Cap)	3.34%	12.56%	21.15%	8.60%
Russell 2000 (Small Cap)	1.13%	4.55%	22.13%	8.22%
MSCI EAFE (Foreign)	4.08%	13.54%	23.68%	4.55%
Lehman Brothers Aggregate Bond	0.60%	2.43%	3.62%	5.87%
Lehman 3-Year Municipal	0.28%	0.87%	1.78%	3.70%

Obviously Large Cap Stocks have lagged other equity asset classes over the last three years. The 14.39% three-year annualized return of the S&P 500 Index you see in the table above is nothing to sneeze at but it pales in comparison to the returns of Mid Caps, Small Caps and Foreign stocks for the same period. Before you give up on Large Caps, take a look at the table below. It compares the 3-year annualized returns for the period ending 12/31/2005 to the 3-year annualized returns for the period ending 12/31/1999. As you can see, Large Caps were dominant during the earlier period relative to other asset classes.

Market Index	3-Year Annualized Year Ending 12/31/2005	5-Year Annualized Year Ending 12/31/1999
Standard & Poor's 500 (Large Cap)	14%	28%
Standard & Poor's 400 (Mid Cap)	21%	22%
Russell 2000 (Small Cap)	22%	13%
MSCI EAFE (Foreign)	24%	18%
Lehman Brothers Aggregate Bond	4%	6%

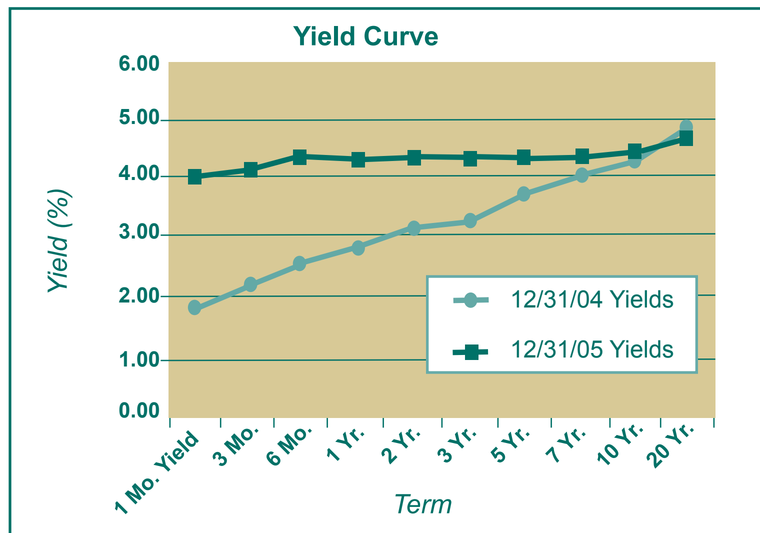
This is a good illustration of the cycles the market regularly goes through and it makes a great argument for portfolio re-balancing. Disciplined re-balancing forces us to "sell high" and "buy low" thereby reducing exposure to those asset classes that have done well lately and increasing exposure to those asset classes that have lagged. As simple and intuitive as re-balancing sounds, human nature, emotion, fear and greed often lead investors to do the opposite.

BRAGG
FINANCIAL ADVISORS

Bonds had a positive return in both the fourth quarter and for the full year but rising interest rates definitely had a negative impact on returns in 2005. The Lehman Aggregate Bond Index finished the year with a total return of 2.43%. This return reflects the combination of an interest coupon payment of about 3.80% and an approximate 1.27% loss to principal. Bond values fell slightly during the year as the Federal Open Market Committee of the Federal Reserve Board (the Fed) continued to raise short-term interest rates. Remember that as rates rise, bond values fall.

Treasury Bond Yields 12/31/2005 and 12/31/2004

Date	1-Month Yield	3 mo.	6 mo.	1 yr.	2 yr.	3 yr.	5 yr.	7 yr.	10 yr.	20 yr.
12/31/04 Yields	1.89	2.22	2.59	2.75	3.08	3.25	3.63	3.94	4.24	4.85
12/30/05 Yields	4.01	4.08	4.37	4.38	4.41	4.37	4.35	4.36	4.39	4.61



The table above compares Treasury bond yields today to yields one year ago. The chart to the left simply plots these bond yields against their respective maturities resulting in the yield curve. As you can see in the chart, the curve is now quite flat; short rates are almost as high as long rates. The **yield curve** is said to be inverted when short-term rates are higher than long-term rates. While the Fed has significantly increased short-term rates, its actions have had less impact on the yields of intermediate and longer-term bonds. Illustrating this pretty well is the fact that in the face of significant yield increases on short-term bonds, the longer-term 10-year Treasury bond yield only rose to 4.39% by 12/31/2005 from 4.24% on 12/31/2004.

Historically, an inverted yield curve has been a good forecaster of an economic slowdown in future months. In the last 40 years, inverted yield curves have preceded six out of eight US economic recessions. There is much debate among economists today about whether the current flat yield curve and slight inversion is forecasting a recession or a slowdown in the coming months.

Arguments for a slowdown include the lagging effect of higher borrowing costs. The Fed's rate increases will not be fully felt until the middle of 2006 at which point the higher borrowing costs may have significantly slowed the economy. There is also the general argument that the yield curve reflects the true expectations of investors betting real money on the future. But most economists feel that the economy will not slip into recession in the near future; they believe the inversion is a result of the low level of long-term U.S. interest rates, which can be partly explained by the low rates of inflation, a global savings glut, an insatiable appetite for US bonds on the part of foreign central banks and demand by pension funds for longer-term securities. In addition to these arguments against a recession, the economy has continued to grow at a good pace, inflation appears to be under control, unemployment is under 5% and corporate balance sheets are relatively healthy. As for the stock market, valuations at this point seem reasonable relative to history, with the trailing and forward price-to-earnings ratio of the market (especially Large Caps) very close to long-term historical averages.

The greatest threats to continued progress remain the uncertainty created by the geopolitical situation and the failure of our elected representatives (national, state and local) to make tough decisions to rein in spending and make changes to reduce the ballooning obligations resulting from programs like Medicare, Medicaid and Social Security. These will require leadership and tough choices but a failure to act soon may jeopardize our healthy economy and our continued prosperity.

Thank you for letting us help you with your planning and investing. Please let us know when you would like to review. We hope you have a safe and prosperous 2006!

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

Bragg Financial Advisors Inc. *is a Registered Investment Advisor Firm offering securities through an affiliate, Queens Road Securities, LLC, Member NASD/SIPC. The S&P 500 Index and other indices are unmanaged measures of performance. Past performance is no indication of future performance. Investors cannot invest directly in an index. Opinions expressed here are subject to change.*