Investment Report and Market Commentary

BRAGG FINANCIAL ADVISORS

First Quarter 2006

The stock market finally got down to business in the first quarter of 2006 and scored some welcome returns. The Standard & Poor's index of 500 major U.S. corporations returned 4.21% in price appreciation and dividends in the first quarter, and a healthy 11.73% in the twelve months ending March 31. Even more impressive were the gains racked up by mid- and small-size companies and foreign firms. Small cap companies fared the best, with an eye-popping total return of 13.94% for the quarter and 25.85% for the twelve months as measured by the Russell 2000 Index. Among the best performers were energy, basic materials, and real estate companies.

Underpinning the strong investment performance is an economy that has proved surprisingly robust in the wake of last year's devastating hurricanes. Productivity gains have helped corporate profits hold up very well in the face of rising interest rates and higher energy costs. Nevertheless, many economists expect that dreadful duo could erode profits somewhat, as the year wears on, restraining economic growth and clouding the investment outlook.

Market Index Total Returns as of March 31, 2006

Market Index	1st Quarter	1 Year	3-Year Annualized	5-Year Annualized
Standard & Poor's 500 (Large Cap)	**4.21%**	**11.73%**	**17.22%**	**3.97%**
Standard & Poor's 400 (Mid Cap)	**7.63%**	**21.62%**	**26.04%**	**12.75%**
Russell 2000 (Small Cap)	**13.94%**	**25.85%**	**29.53%**	**12.59%**
MSCI EAFE (Foreign)	**9.40%**	**24.41%**	**31.13%**	**9.63%**
Lehman Brothers Aggregate Bond	**-0.65%**	**2.26%**	**2.92%**	**5.11%**
Lehman Brothers 3-Year Municipal	**0.12%**	**1.76%**	**1.53%**	**3.19%**

Rising interest rates are generally unwelcome news for investors but especially for bond investors and that was true in the first quarter, when the Lehman Brothers Aggregate Bond Index declined by 0.65%. On March 28 the Federal Reserve Open Market Committee was sufficiently concerned by rising prices for energy and other commodities that it boosted the federal funds rate, charged on overnight loans between banks, by a quarter point to 4.75%. The move marked the Fed's 15th consecutive quarter-point increase since June of 2004 when it first starting raising rates from a 45-year low. The yield on the ten-year Treasury increased nearly a half point during the quarter, to 4.857%, pushing down bond prices. Many market watchers are anticipating a further increase when the Fed committee convenes again May 10.

On the positive side, the March meeting marked the debut of new Fed chairman Ben Bernanke, following in the formidable footsteps of Alan Greenspan, who served in the post for 18 years. So far the new chairman earns plaudits for effecting a smooth transition, signaling no radical departures from past policies and indicating that, just possibly, his comments may prove more transparent than Greenspan's legendarily opaque pronouncements.

Bernanke has his work cut out for him as the Fed will attempt through judicious interest rate adjustments to encourage a "Goldilocks" economy, growing not to fast, not too slow, but at just the right pace. It is a delicate balance. The economy has delivered more than 2 ½ years of unbroken monthly job gains, driving unemployment down to 4.7% in March. Tight employment combined with high energy costs contribute to the risk of higher inflation. This keeps the Fed on watch in its effort to keep inflation under control while not choking off continued economic growth. The usual imponderables apply – the difficult war, an unstable Middle East, volatile energy prices, upcoming congressional elections, and another hurricane season nearly upon us. There's always a list. But this past quarter reminds us again of the depth and resilience of the U.S. economy. We feel good about its prospects over the long haul.

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With April 15th around the corner and taxes weighing heavily on our minds, we thought it might be helpful to share a few thoughts about taxes and other planning issues that might benefit you.

- **Consider a Roth IRA for yourself or for your working-age children**. Roth IRAs offer some powerful benefits, including tax-free appreciation and withdrawals, but only under certain circumstances. They may be right for you if you anticipate being in a higher tax bracket when you retire, or as an estate planning tool if you will not need those funds for retirement. There are income restrictions, however.
- **Investigate a Roth 401(k).** Starting in January 2006, retirement plans may now offer a Roth option. Unlike the Roth IRA, there are no income restrictions on eligibility. These may be especially appealing to younger workers in lower tax brackets or for individuals who already have more than enough in pre-tax qualified plans (401ks, IRAs, etc). If your company does not yet offer this option, inquire with your human resources department. For some folks, the Roth is not the best option; let us help you decide if you are not sure.
- **Consider a Health Savings Account coupled with a high-deductible health policy.** For some folks, this is a great way to save on health insurance premiums while enjoying the triple-tax-free benefits of a Health Savings Account. Contributions to these accounts are tax-deductible, earnings accumulate tax-free and distributions are tax-free when used for health expenses. Plus, your balance rolls over from one year to the next and can be invested like your other investment accounts. Ask your employer about this or consider it for your small business.
- **Lock in your mortgage rate.** If you have an adjustable-rate mortgage, you may want to lock it in while you can still get a rate around 6%. If you are like most folks, you probably don't have enough cash sitting around to pay off your mortgage if your adjustable rate soars and takes your monthly payments up with it. If you plan to be in your home more than five years, eliminate this risk by locking in with a traditional 15- or 30-year mortgage. Be sure to shop carefully for favorable interest rates.
- **Give yourself a debt check-up**. Are you carrying too much debt? As interest rates rise you could feel the squeeze. Consolidating debt, for example in a home equity loan, and reducing credit card debt can lower your expenses considerably. Remember, "good debt" is low-interest debt and preferably debt that offers tax-deductible interest like your mortgage or home equity loan. How much "good debt" should you carry? Only the amount that you can easily service; don't subject yourself to a cash crunch each month.
- **Give appreciated stock to charity.** Let the IRS subsidize your charitable giving. If you own stocks in your non-IRA account with significant capital gains and you normally give cash to charity, you are missing out on a great tax-saving opportunity. When you give appreciated stock that you have owned for at least 12 months to a qualified charity, the charity receives the entire value of the gift, you receive a tax deduction equal to the full amount of the gift and you and the charity avoid the capital gain tax.
- **Contemplate a partial conversion of your Traditional IRA to a Roth IRA.** This is often a good idea for folks currently in low tax brackets who expect to be in higher tax brackets in the future. It also can be a wonderful estate planning tool for folks who have accumulated more money than they will need during their lifetime. Timing is always important with a Roth conversion. Let is know if we can help you decide if this makes sense for you.

As always, please let us know when you would like to review your planning and investments. Thank you for your confidence in Bragg Financial Advisors.

Sincerely,

Benton S. Bragg

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