

December 31, 2005

2005 Year End Review

Despite a major natural disaster and record high energy prices, the stock and bond markets ended 2005 much as we expected them to. The stock market ended the year with positive, if unspectacular gains, while for the second straight year bonds were flat as rising interest rates lowered total returns. In short, this year was much like last year.

The U.S. economy continues to be very resilient despite the hurricanes and energy prices. Corporate balance sheets look good while employment and capital spending remain low relative to profits and revenues. This bodes well for the coming year. Consumer spending also remains strong. The wealth effect from stock market gains that fueled consumer spending in the 1990's seems to have been replaced by housing gains over the past several years. In certain parts of the country the behavior of the housing market has been eerily similar to the tech bubble of the late 1990's. While a major housing collapse seems unlikely, it does appear that the housing market is beginning to cool due to rising mortgage rates. How this will affect consumer spending remains to be seen.

In our last letter to you we felt that there was a strong likelihood that the yield curve would invert, with short term interest rates rising above longer term rates. This did indeed happen during December, causing a late sell off in stocks. A yield curve inversion is often a signal that a recession is on the way. While this may happen, we feel that if a recession does occur, it will likely be a mild one. It is important to remember that our last recession ended in late 2001, so this expansion, while less robust than many, has also been longer than most. Because the business sector is in good shape and stocks are not overvalued relative to earnings, at this time we expect we could see a pretty good year ahead for stocks.

We also think 2006 will be a better year for the bond market as interest rates level off. The Federal Reserve has given indications that the tightening cycle is nearing an end. This is good news for bond investors after two years of low returns. We continue to focus our bond purchases in the intermediate sector of the market.

If you would like to see an updated copy of our Form ADV, which is on file with the SEC and contains information about Wabash Capital, please let us know. We here at Wabash Capital wish all of you a safe and healthy 2006.

Wabash Capital