

# BEACON STREET CAPITAL, LLC

INVESTMENT MANAGEMENT

## *Separately Managed Accounts*

January 1, 2007

### Highlights

- The bullish tone in the U.S. equity markets that began in the third quarter extended into the fourth quarter. Lower oil prices, stable interest rates and higher employment were the over riding factors.
- Volatility for our portfolios remains significantly less than their benchmark indices, and this dramatically improves the impact of compounding on long-term returns.

### Fourth Quarter 2006 Newsletter

Oil prices began a long awaited correction in the fourth quarter, giving the equity markets a boost as inflation fears diminished. Economic data was also positive for the markets during the quarter as expectations are for a “soft landing” rather than a recession for 2007. As a result, our performance, net of fees, for the quarter was positive with our DowJones/*Select* strategy being up 5.62% and our S&P500/*Select* strategy being up 5.35%.

However, both strategies trailed their benchmarks by over 100 basis points due partly to our high cash levels (15%), partly to some individual stocks, such as United Technologies (-4.9%), Intel Corp. (-5.1%) and Wal-Mart Stores Inc. (-6.3%), but mostly due to the fact that “growth” strategies underperformed “value” strategies by a wide margin in all size categories. According to *Lipper Analytical Services* and the *Wall Street Journal*, fewer than 20% of U.S. fund managers (most of which are “growth” managers) running diversified stock funds attempting to beat a broad market index were successful in 2006. In contrast, 61% of diversified managers, including Beacon Street Capital, were able to beat a broad market benchmark in 2005.

The fact that “value” stocks lead in some periods and “growth” stocks lead in others is part of the mystery of the stock market, but “growth” strategies tend to do well over the long-term as our long-term performance indicates. Since its July 1, 1997 inception<sup>1</sup> the DowJones/*Select* portfolio composite has returned a cumulative +246%, outperforming the DJIA (+62%) by a cumulative margin of 184 percentage points. Over the same period the S&P500/*Select* portfolio composite has returned a cumulative 238%, outperforming the S&P 500 (+86%) by a cumulative margin of 152 percentage points. We expect growth strategies to get back on track in 2007.

Best Regards,

*BEACON STREET CAPITAL, LLC*

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<sup>1</sup>All results are un-audited and net of fees. Composite returns began November 2001 for the S&P500/*Select* and March 2002 for the DowJones/*Select*, are asset weighted and net of fees. Returns prior to November 2001 and March 2002 are total returns for model portfolios managed by Beacon Street Research, Inc., an affiliated company, on a real-time basis using the same methodology and manager, with stocks selected from those comprising the Standard & Poor's 500-Stock Index and Dow Jones Industrial Average. Past performance is no indication or guarantee of future performance.

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## Market Review

The U.S. equity markets moved relentlessly higher in the fourth quarter of 2006 with the Dow Jones Industrial Average setting 22 new records before settling in at 12,463.15 at year-end for a gain of 6.71% for the quarter and 16.29% for the year. The high point was hit December 27 at 12,510.57. The Standard & Poor's 500-Stock Index still has not set a new record high but did move higher in the quarter by 6.70%, and by 15.79% for the full year, both including dividends. Investor hopes were buoyed in the quarter by the belief that the Fed is done raising rates; by the benign reports on consumer inflation in the quarter; by the results of the mid-term elections that many translate to gridlock in Washington; and the belief that despite the difficulties in the housing market, that the economy will somehow dodge a recession in 2007 and come in for the soft landing many are projecting.

### Exhibit 1: DowJones/Select

#### Top Ten Holdings

Microsoft	9.2%
McDonalds	8.9%
United Tech.	8.4%
Procter & Gamble	8.2%
Honeywell	8.0%
IBM	8.0%
Boeing	7.9%
AT & T	7.6%
Caterpillar	7.1%
Home Depot	7.0%

### Exhibit 2: S&P500/Select

#### Top Ten Holdings

Apple Computer	2.7%
Coach	2.0%
Cisco	1.9%
Lab Corp. Of Am.	1.9%
Lockheed Martin	1.9%
Nordstrom	1.9%
Penney, J.C.	1.9%
Microsoft	1.8%
General Dynamics	1.7%
McDonalds Corp.	1.7%

Many of these same factors will weigh on equity prices going forward. The weaker trend in economic growth has been pronounced with GDP growth slowing from 5.6% in the first quarter of 2006 to 2.1% in the third quarter; and growth projections for the fourth quarter are in the range of 1.5-2.0%. The housing slump has had a major hand in the economic downtrend and we are also seeing softness in manufacturing, auto production and consumer spending. Due to the softness in housing consumers will have more difficulty using their homes as piggy banks by tapping their home equity. The flip side of this coin is that non-manufacturing activity remains strong, personal income is rising at a healthy pace, non-farm payroll growth is brisk, and the jobless rate is at a five year low. The major question in the minds of investors seems to be whether the housing slump will be great enough to push the economy into recession. The recent sharp decline in oil prices, if they hold or move lower, should provide a decent offset to the housing situation. Unless consumer spending falters or the Federal Reserve Board blunders on the interest rate front, the odds continue to build that we will avoid a recession in 2007 and that the Fed just may be successful in navigating the soft landing that the stock market appears to be predicting.

On balance all of this seems to favor higher equity prices going forward absent a major surprise. Corporate profits should continue higher, although at a moderating pace; oil and commodity prices are lower and should remain so, leading to moderate inflation readings going forward; and the Fed's next move

### Exhibit 3: S&P500/Select Sector Weighting

	<u>4Q06</u>	<u>3Q06</u>
Information Tech	20%	23%
Industrials	20%	17%
Cash	16%	13%
Health Care	12%	15%
Consumer Disc	12%	12%
Consumer Staples	10%	11%
Energy	7%	6%
Financial	0%	2%
Materials	2%	1%
Telecomm Services	1%	0%

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appears to be a reduction in rates. However, we believe fourth quarter earnings and financial data being reported over the next several months will be critical to understanding the expectations for 2007 and we will be analyzing this data carefully.

*Herron P. Weems  
Managing Director*

**Performance Summary**

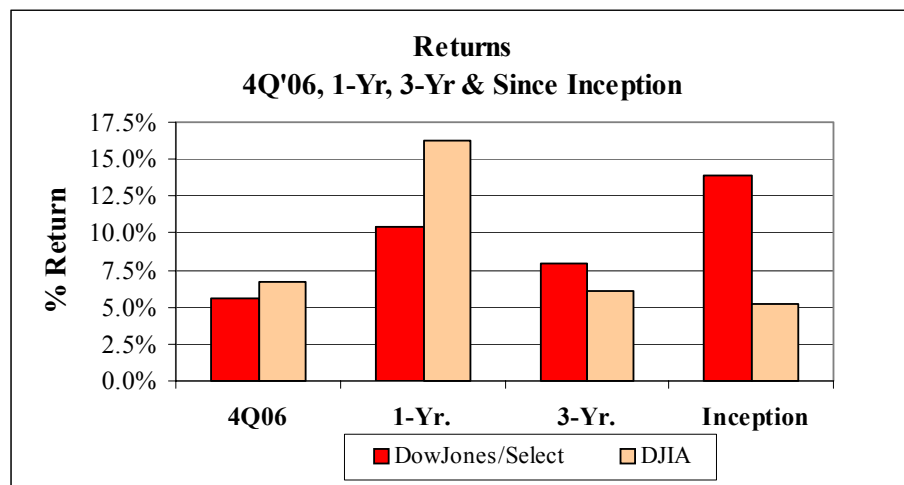
**DowJones/Select:** During the quarter we made only one change to the portfolio composite purchasing AT&T (T) at \$34.20 per share. T closed the quarter at \$35.75, improving by 4.5% since the purchase. We currently own 12 stocks in this strategy and are essentially in a fully invested position.

In the quarter the top five performers in the Dow Jones Industrial Average included International Business Machines Inc (IBM, +18.6%), McDonalds Corp (MCD, +13.3%), and Boeing Co (BA, +12.7%). Other positive performers were Home Depot Inc (HD, +10.7%), Honeywell International Inc (HON, +10.6%), AT&T Inc (T, +9.8%), Microsoft Corp (MSFT, +9.2%), and Procter and Gamble Co (PG, +3.7%). Negative performers were United Technologies Corp (UTX, -1.3%), Intel Corp (INTC, -1.6%), Wal-Mart Stores Inc (WMT, -6.4%), and Caterpillar Inc (CAT, -6.8%). Unfortunately the four losers, particularly WMT and CAT, ate into the returns of the eight winners to a significant extent.

Our DowJones/Select portfolio composite had a gain of 5.62%, under performing the Dow Jones Industrial Average which improved by 6.71%. However, as Exhibits 4 & 5 show, over the past three years the Dow Jones/Select has returned 7.99% annually compared to 6.04% for the DJIA.

<b>Exhibit 4: DowJones/Select Net Return versus Benchmark</b>				
	<b>4Q06</b>	<b>1Year</b>	<b>3Yr. Avg.</b>	<b>Inception</b>
<b>DowJones/Select</b>	5.62%	10.37%	7.99%	13.95%
<b>Dow Jones Ind. Avg.</b>	6.71%	16.29%	6.04%	5.24%

**Exhibit 5:**



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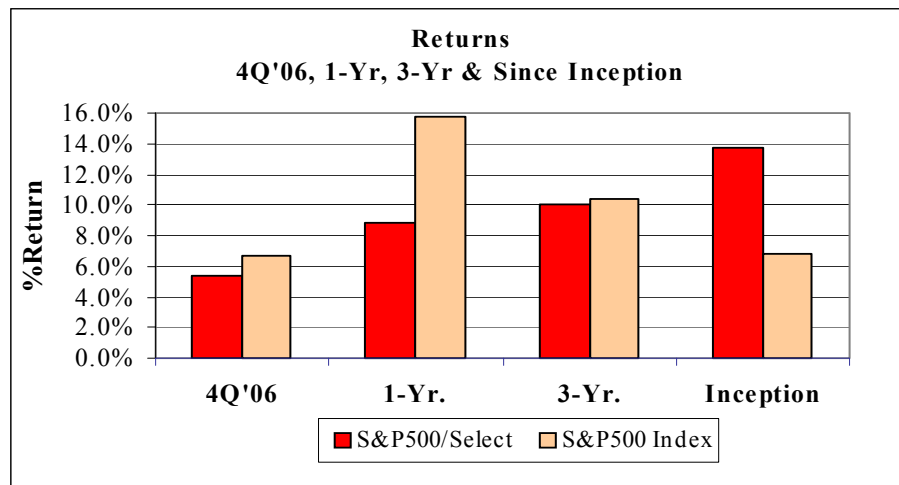
**S&P500/Select:** During the fourth quarter we purchased four new stocks and sold five, and now hold a total of 56. Of the new purchases in the quarter, AT&T Inc (T, +4.5%), Baker Hughes Inc (BHI, +5.1%) and Norfolk Southern Corp (NSC, +3.1%) have performed the best from the date of purchase through the end of the quarter while W.W. Grainger Inc (GWW, -2.4%) underperformed.

Our S&P500/Select portfolio composite gained 5.35% in the quarter as the table in Exhibit 6 shows, underperforming the S&P500-Stock Index which gained 6.70%. The primary reason was the surge in “value” stocks compared to the “growth” stocks in which we concentrate.

From a broader perspective, over the past three year period the S&P500/Select has returned 10.04% annualized compared to 10.44% for the S&P500-Stock Index. The following table in Exhibit 6 provides additional comparisons.

<b>Exhibit 6: S&amp;P500/Select Net Return versus Benchmark</b>				
	<b>4Q06</b>	<b>1Year</b>	<b>3Yr. Avg.</b>	<b>Inception</b>
<b>S&amp;P500/Select</b>	5.35%	8.84%	10.04%	13.70%
<b>S&amp;P 500-Stock Index w/ dividends</b>	6.70%	15.79%	10.44%	6.76%

**Exhibit 7:**



But return is only half of the story. Risk, or volatility, is another factor that is important to consider because of its major impact on the compounding of returns. As Exhibit 8 shows, the volatility for the DowJones/Select and the S&P500/Select composites over the past five years, as measured by standard deviation (SD) of returns, continues to be well below that of their respective benchmarks although returns have been similar.

Exhibit 8: 5-Year Risk Reward Characteristics: 1Q'02 – 4Q'06

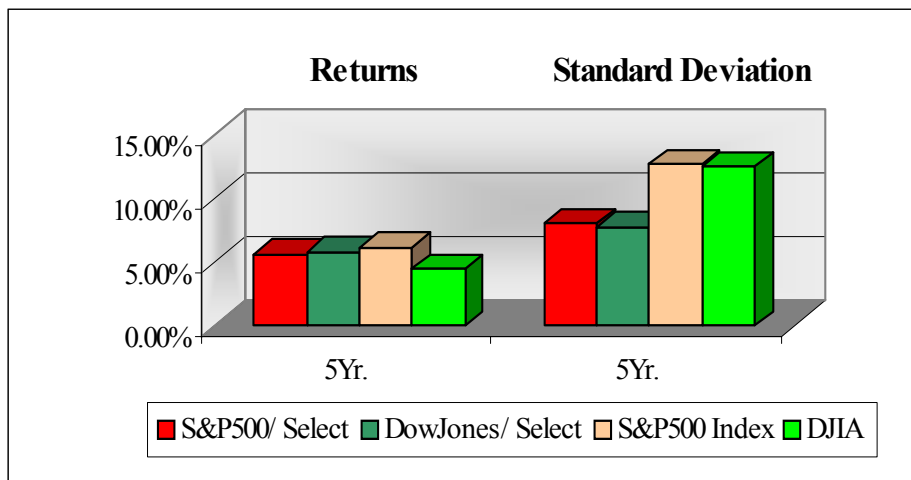


Exhibit 9 compares the risk and reward characteristics for the past five years of our DowJones/*Select* and S&P500/*Select* composites with both the DJIA and the S&P 500 Index.

Exhibit 9: Risk Statistics	DowJones/ <i>Select</i>	DJIA	S&P500/ <i>Select</i>	S&P 500 Index
Annualized Std. Deviation (5 Yr.) <sup>1</sup>	7.72	12.50	8.05	12.74
Sharpe Ratio (5 Yr.) <sup>2</sup>	0.46	0.22	0.43	0.36
Information Ratio (5 Yr.) <sup>3</sup>	0.09	N/A	-0.12	N/A
Beta <sup>4</sup>	0.85	1.00	0.44	1.00
Alpha (5 Yr. Average) <sup>5</sup>	2.91%	N/A	1.99%	N/A
Correlation <sup>6</sup>	.67	N/A	.75	N/A
Annual Turnover (5 Yr. Average)	32%	N/A	64%	N/A

## Benchmark Update

Because our investment strategies are large cap “growth” oriented and our current benchmarks include both growth and value stocks, we are making a change going forward regarding our performance reporting for both the Dow Jones/*Select* and S&P500/*Select*. Rather than comparing our investment results to the DJIA and the S&P500 Index, which we have outperformed handedly since inception, beginning first quarter of 2007 we will be using the Russell 1000<sup>®</sup> Large Cap Growth Index as our benchmark for both strategies.

This Index is more representative of the overall large capitalization market and thus more representative of our investment style. It is also widely used by institutional consultants, such as *Informa Investment Solutions Inc.*, which tracks and reports our performance through its *PNS Manager Database*, when seeking investment managers for their clients.

Below is a comparison of our performance with both the old and new benchmarks for the past five years:

Exhibit 10:

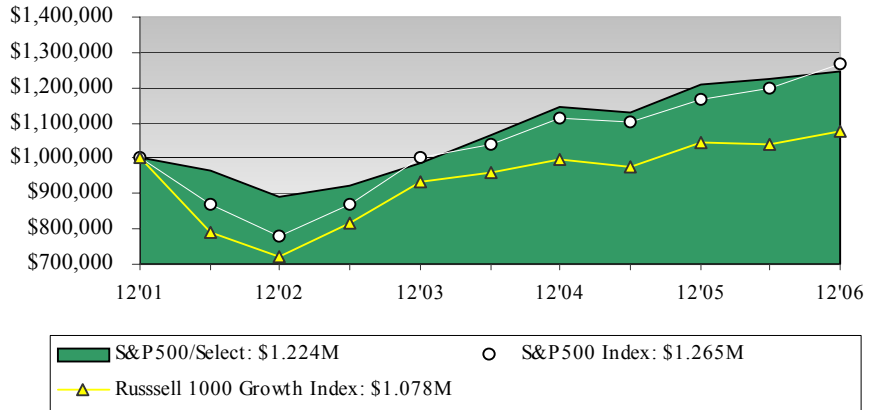
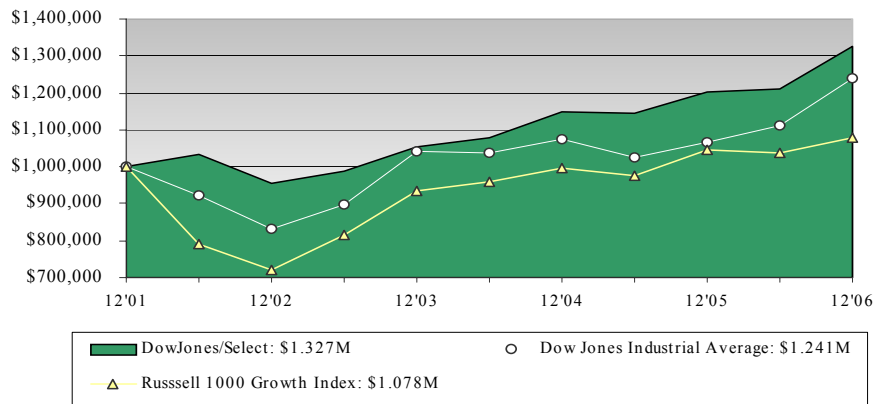


Exhibit 11:



## About the Firm

Beacon Street Capital provides affluent business professionals in the Southeast with a conservative, consistent, long-term approach to managing money that has generated excess returns with reduced volatility. Our strategy reflects sound investing principles, delivered with a sophisticated level of financial services. Our clients deserve nothing less.

We select for our clients individual equity securities that show positive internal growth potential and financial strength. These securities are held and actively monitored in a Separately Managed Account held by an independent custodian, and we provide detailed quarterly updates.

Whether growing assets for retirement or building a family estate, we believe that wealth properly managed is wealth with a future. Please contact us to explore how we can help you with this process.

*Terry E. Burke*  
Chief Executive Officer

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### Definitions:

<sup>1</sup> *Standard Deviation*: A measure of volatility, or the range of a portfolio's performance. The more an investment's return varies from its average, the higher the standard deviation. Unlike *beta*, which measures volatility relative to the market, standard deviation is a measure of total risk, or the total variation of the return. The lower the standard deviation the lower the risk, or volatility of the portfolio.

<sup>2</sup> *Sharpe Ratio*: A measure of risk-adjusted return. The Sharpe Ratio incorporates the standard deviation and the excess returns over 90-day Treasury bills to measure the reward per unit of risk. The higher the ratio over 0.0 the better the investment's historical risk-adjusted performance.

<sup>3</sup> *Information Ratio*: One of the most important tools for measuring the performance of an active manager against an appropriate benchmark. It is the ratio of excess returns to standard deviation of excess returns of the portfolio, and is used to estimate the return added by the manager for each 1% of risk added by the manager. A 5-year average *Information Ratio* over 0.50 is considered "good", over 0.75 "very good", and over 1.00 "exceptional".

<sup>4</sup> *Beta*: Measures volatility in relation to the benchmark (or market). A portfolio with a *beta* of 1.5 means that the portfolio return is expected to move 1.5 times the benchmark return. If the benchmark return is 10%, the portfolio return is expected to be 15%. If the benchmark return is -10%, the portfolio return is expected to be -15%. A low *beta* represents lower volatility, which is often associated with low returns; a high *beta* represents higher volatility, which is often associated with high returns. It is unusual to have a combination of high returns and low volatility. However, a good manager picking outstanding stocks can provide excess returns without adding excess risk. This is call "adding *alpha*".

<sup>5</sup> *Alpha*: Measures the return added by the manager. It is the excess return over the benchmark return, adjusted for volatility.

<sup>6</sup> *Correlation*: Measures the correlation between the portfolio return and the benchmark return, or how well they fit from a statistical standpoint. A correlation of a 1.00 means a perfect fit and any number over .70 means the *Alpha* and *Beta* measurements are meaningful.