

J.L. BAINBRIDGE & COMPANY, INC.

◆ PROFESSIONAL MONEY MANAGEMENT ◆

2006 MID-YEAR REPORT

INVESTMENT RESULTS

For the first half of 2006 J. L. Bainbridge & Company, Inc. achieved a -.1% rate of return on all monies managed in its equity investment program. In conjunction with returns in its equity program for 1994, 1995, 1996, 1997, 1998, 1999, 2000, 2001, 2002, 2003, 2004 and 2005 returns of 10.2%, 38.4%, 20.3%, 23.2%, 29.9%, 5.6%, 16.9%, -3.2%, -8.5%, 13.8%, 14.6% and 5.0% respectively, a January 1, 1994 investment of \$250,000 has grown to a June 30, 2006 value of \$1,098,136. This equates to an increase of 339% over the past twelve and one half years or 12.6% compounded annually. These results assume reinvestment of dividends and are after transaction costs and our management fee.

INVESTMENT REVIEW

Our results for the first half of 2006 were affected by the investment community's lack of interest in high quality blue-chip companies as another bout of speculation and unrealistic expectations of short-term returns gripped the market. This speculation is surprising considering the catastrophic losses incurred only six years ago, as the Internet/technology bubble burst, have not yet

been recovered. The current speculation has been widespread and includes commodities, emerging markets and real estate. It will be interesting to see how investors holding empty condos react to falling prices while concurrently facing mortgage, property tax, insurance and maintenance payments. The current speculative bubble has burst and significant losses have been incurred over the past six weeks which bodes well for our program as investors come back to earth and seek more conservative investments. This is exactly what happened in 2000 when the market suffered a devastating decline and our portfolio produced a return of 16.9%.

The past six and one half years have been the most challenging in our twenty-five years as investment advisors. This period experienced the devastating end of the almost unimaginable Internet/technology speculative bubble, the September 11, 2001 terrorist attacks, a recession and major accounting scandals such as the bankruptcy of Enron and WorldCom. As a result the market remains well below the levels reached in early 2000. In this environment our program not only preserved clients' assets, but achieved a total return of 41.8%.

INVESTMENT STRATEGY

Since our founding in 1981, our objective has been to build and preserve our clients' wherewithal for an enhanced retirement. In order to achieve this objective requires our clients' assets, less home equity, reach a level sufficient to meet their annual expenses for as many as forty or more years. This amount of money is often referred to as "The Number." Calculating the number is relatively easy. For our program, we recommend withdrawals of no more than 7% of the number each year which equates to a number 14.29 times the amount withdrawn annually. To determine the amount to be withdrawn annually from the number, subtract annual social security and pension payments from the annual pretax budget. For example assume a pretax budget of \$100,000 and social security of \$20,000 and no pension, the number is $\$80,000 \times 14.29$ or \$1,143,000. If one decides to allocate a portion of the number to income investments, the number increases because these investments return only 3% annually after inflation. Therefore withdrawals should be limited to 3% annually from the income portion of the number because any amount greater than 3% would result in an erosion of principle. Thus with an allocation of half income and half growth, the amount withdrawn annually must decline to 5% of the number. With the same \$80,000 withdrawal as above, the number increases to $\$80,000 \times 20$ or \$1,600,000. This does not mean this allocation is wrong, but simply demonstrates a more conservative allocation results in a larger number. The challenge is to both accumulate the number and earn a sufficient return to fulfill retirement expenses and at least cover inflation. If the return is less, one faces the real possibility of outliving one's money.

There are four investment mistakes that either result in not reaching the number or depleting the number after retirement:

Too conservative. CDs and other quality low risk income investments return so little that achieving the number is unlikely except for the most frugal of people. However the biggest downfall is most investors are not satisfied with low returns and get drawn into various products that appear safe. Many investors in bond mutual funds experience losses because the fund managers invest in high risk offerings seeking to satisfy investors' appetite for higher yields.

Speculation. The losses of 50% or more incurred after the Internet/technology bubble burst in 2000 and the recent speculation in emerging markets, commodities and real estate, which have seen major losses in the past six weeks, are typical examples how to miss your number via the desire for quick riches. It takes several years to make-up losses like these, leaving fewer years to reach the number.

Bad investments. Enron and WorldCom are examples of bad investments purchased purely because the price was going up. There is no substitute for investing only in companies researched extensively to the point a comprehensive understanding of their business, financial position and the trends driving earnings growth is achieved.

Short-term focus. This is by far the biggest reason for failure. Patience and a sound long-term investment approach are the keys to success. The lack of patience usually leads to chasing whatever has recently produced the greatest returns. For

example over the past two years many investors have been selling large cap stocks and buying small cap stocks because small caps have outperformed large caps over this period. This jockeying from low valued large caps to higher valued small caps investments logically increases risk and lowers potential returns. In addition not adhering to a long-term program often results in selling when the market is in decline. Dunbar Inc.'s "Quantitative Analysis of Investor Behavior" study found aversion to loss as the primary cause of losses. Fear of loss causes investors to sell when prices are so low to the point that attempting to avoid loss actually achieves the opposite result. This study found that investor behavior of chasing short-term winners and striving to avoid losses resulted in an average return of just 3.9% annually over the twenty year period 1986 to 2005.

CONCLUSION

While the media constantly bombards ones senses with doom and gloom, the economy is in good shape with moderate inflation, moderate interest rates and reasonable economic growth that is sustainable. In addition the positive long-term trends of the aging of the population, globalization of trade and productivity gains resulting from the application of technology will be beneficial for decades. Importantly our portfolio has been designed to reap the full benefit of these trends, and the companies we own continue to generate double digit earnings and dividend growth. The companies chosen for investment also generate substantial excess cash flow that in the current investment environment is being utilized to aggressively repurchase shares which has a positive impact on future earnings per share growth. For example American Express recently announced a

200 million share repurchase that equates to 17% of shares outstanding. The keys to reaping the financial rewards from the compounding of growth at a double digit rate are patience and confidence in a logically based investment program from which we will not deviate. The current low evaluations of blue-chip stocks coupled with continued strong earnings growth causes us to conclude that several years of excellent investment returns lay ahead. This will enable our clients to achieve their "Number" and preserve it during many years of enhanced retirement.

PRIVACY POLICY: J.L. Bainbridge & Company, Inc. policy is client information is private and is not shared with any individual, organization or firm.

ENHANCING CLIENTS' LIVES

At J.L. Bainbridge & Company, Inc. our business is dedicated to “enhancing client’s lives” by providing long-term professional money management service totally focused on helping clients finance their children’s education, build and preserve the resources for an enhanced retirement and achieve a meaningful higher standard of living.

The foundation of J.L. Bainbridge & Company, Inc.’s business philosophy is based on the full understanding that our future and success is completely dependent on client satisfaction and delivering to clients a consistent long-term investment service of the highest level of quality, competence and integrity.

Our commitment to “enhancing client’s lives” is a guiding light that governs our professional daily activities and demands every decision and action be assessed as to exposure to investment risk as well as the long-term benefit to clients.

J.L. BAINBRIDGE & COMPANY, INC.

Managing over \$350 million for more than 900 clients nationwide.

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