

J. L. BAINBRIDGE  
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& C O M P A N Y, I N C.

April 3, 2006

Dear Mr. & Mrs. Client:

The most unexpected and positive economic development this year is the revival of Japan's economy that appears to be sustainable for several years. Japan, whose economy is the second largest in the world, has suffered from both recession and deflation for almost two decades, and during this period has experienced many tepid recoveries followed by another recession and continued deflation. However today asset values are increasing, and the growth of their economy is being driven by consumer spending rather than exports. Hence the recovery most likely has strong legs. Most importantly since the current expansion is driven internally via consumer spending, Japan's contribution to the world economy is much greater than previous periods more than twenty years ago when growth was based on flooding world markets with exports. In addition in the past consumer spending was discouraged by high taxes and trade barriers which were designed to keep consumer prices high and export prices low. After many years of pressure from their trading partners, Japan has removed many of their trade barriers which foster lower consumer prices and more foreign investment. All of these developments have positive long-term implications for the world economy.

For many years a fundamental aspect of our investment strategy has been an emphasis on the higher growth in emerging international markets. Japan's return to vitality makes this strategy even more relevant in that the primary beneficiaries are their close neighbors in the emerging markets China, India and the remainder of Southeast Asia. However in our view investing directly into these markets carries the risk of currency fluctuations as well as direct involvement in more speculative, relatively unregulated stock markets and lower accounting standards. Does anyone remember the collapse of the Southeast Asian markets in 1998 or the devaluation of the Russian currency three years earlier which caused major market declines not only in Russia but throughout Eastern Europe? In order to reap the rewards of faster growth in international economies but avoid the risk, our approach is to own American companies with substantial international business.

This approach led us to adding 3M Company to our clients' investments last year. 3M has been expanding internationally for many decades. Consequently, 61% of their sales are derived internationally which is most likely a surprise to most investors. In addition, years ago 3M targeted Southeast Asia as an area for rapid expansion. As a result they have well established, very large businesses in China, India and most countries in the region. These businesses are growing more than three times their United States business which makes 3M an attractive investment. If 3M operated only in the United States, they would be growing at a single digit rate and would not meet our investment objective. Fortunately because their revenue growth was slightly below expectations early last year, 3M's stock price declined last year despite the fact earnings exceeded expectations. Accordingly the current price is only 16.4 and 14.9 times this year's and next year's earnings respectively. In our view this represents an attractive international investment.

Jerry L. Bainbridge, President