



MANCHESTER CAPITAL MANAGEMENT LLC

March 10, 2006

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Market Outlook

By Ted Cronin, CIO

The markets of 2006 are starting out much like those of the last six years. International stocks are out-performing domestic stocks. Smaller stocks are doing better than their larger brethren. In fact, allocations to the international and smaller stocks are adding notable performance over portfolios of just domestic large stocks and bonds.

Year-to-date through February 28th, the Dow Jones Industrial Average, which is a measure of the stock returns from large domestic companies, was up 2.57%. The Russell 2000, however, which measures stock performance of smaller companies, was up 8.53%. International stocks, as measured by the MSCI EAFE that includes Europe, Japan, and Australia, were up 5.93%. Many emerging market managers were up over 12% in the first two months.

At some point this trend of smaller and international stocks out-performing larger domestic stocks will reverse. Similarly, the recent trend of “value” investment styles out-performing “growth” investment styles will also revert. We don’t know when, but the history of the markets teaches us that it will happen. In the meantime, we are pleased to enjoy the added performance that comes from having made allocations in the right place at the right time.

Clearly, the economy is rebounding nicely from the fourth quarter, when the Katrina Hurricane threatened to interrupt energy supplies and slow the economy. However, unusually warm winter weather has helped retail sales return to record levels. Capital spending has accelerated. Corporate profits are surprisingly strong, cash flows are robust, unemployment has fallen to 4.7%, and productivity remains high. The first quarter Gross Domestic Product will probably be above 4%, demonstrating a very healthy economy.

Part of the US success comes from global economic strength. Germany, with its export-oriented economy, is doing fine and serves as the driving force of the European economy. In Asia, Japan has

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turned a strategic corner after more than a decade of deflation, poor growth, and declining markets. Japanese consumers are buying, prices are rising modestly, the stock market is advancing. All of these factors are a huge positive for the region. We like Japan.

Our outlook for 2006 continues to be positive despite national and international concerns.

Our outlook for 2006 continues to be positive despite the many problems that we have identified in prior newsletters. Oil and commodity prices remain high and could go higher as a result of global demand and geopolitical risks. Iraq is going through new agonies, Iran and Palestine are more problematic, and Nigeria and Venezuela are wrestling between the need for oil revenues and internal political strife. Current oil prices reflect these threats to supply, and could advance or decline dramatically depending on what happens.

Even if you calculate that the current budget and trade deficits are not onerous as a percentage of GDP or the global economy, these deficits are undermining the strength of the dollar. The Social Security and Medicare shortfalls are very dark clouds on the horizon. Party politics have preempted any serious resolution. The 2006 elections could see a change in players, but we are unlikely to see any progress in addressing these issues.

The yield curve is close to flat, thereby tempting investors to buy short-term fixed income securities yielding 4% plus rather than accept the risk of the stock market or longer-term bonds. There could be a tipping point, accelerated by any decline in the markets, that causes a wholesale shift in investor focus to short-term safety rather than their long-term goals.

When any asset class is under-priced or over-priced, it will eventually revert to the mean.

We expect the markets to pause after the early success of the first two months. We also expect our portfolio designs to provide solid rates of return this year. We continue to like our emphasis on international allocations, our defensive long bond and high yield position, our over-weight in energy, and commitments to alternative strategies. At some point, large cap growth will assume leadership, but it could take months or years.

Market trends usually continue for longer than anyone would expect or that reason would support. Nonetheless, there is an invisible but well-documented self-correcting mechanism in the markets. When any asset class is under-priced or over-priced, it will eventually revert to the mean.

Zephyr Associates

As part of an effort to continually strengthen our investment process, we have ended our relationship with Callan Associates and have begun working with Zephyr Associates. Zephyr is a global leader in the development of analytical software tools for the financial management industry. Zephyr enables us to channel manager information from the most established data providers in the business through one powerful software tool. Using Zephyr's manager screening tools, Manchester Capital has the ability to run a thorough statistical analysis on thousands of managers across the globe. This broad scope enables us to continue to identify the finest managers, wherever they may be. Zephyr's tools are world class and bring our investment process just that much further along in providing strong investment results for our clients.

Estate Planning

Recently several clients have requested that we reprint our earlier article on estate planning. There is no doubt that the subject of estate planning can cause some significant emotional issues. Unfortunately, if you ignore those issues now and fail to plan for the future, you may cost your family thousands, or even millions, of dollars after your death. Sufficient estate planning takes far less time and effort than most people imagine, and it can offer you remarkable peace of mind. If you fail to plan ahead, assets may not pass to your heirs according to your wishes and your family could suffer many unnecessary inconveniences in attempting to settle your estate. Even worse, the federal government and the state in which you live could end up collecting much of what you own. Though the specifics involved in settling an estate have easily filled many books, the following checklist highlights the most important documents and activities involved in preparing an efficient estate plan.

Estate Planning Documents

- Review your will to be sure that it describes your current situation. If you amend your will or prepare a new one, be sure to destroy copies of all previous wills.
- Assign durable power of attorney in the event you become incapacitated. Durable power of attorney lets you transfer legal authority to another person to handle your personal affairs. Of course, this is a very powerful document, so you should be certain that you have absolute trust in the person to whom you delegate this authority. You may revoke this power if you later change your mind and want to designate someone else.
- Create a living will and durable power of attorney for health care where you describe the type and extent of medical treatment that you prefer. These instructions are invoked only if you are unable to make your preferences known in the future. Be sure to store these documents in an accessible location and provide copies to family members and your doctor, who can file them along with your medical records.
- Catalog your personal possessions and who the recipient of each item should be in the event of your death. Be very specific in your instructions to avoid the possibility of misallocation among siblings or others to whom you wish to leave personal items.

Estate Planning Checklist

- Document your preferences regarding funeral arrangements including burial site, content and site of memorial service, etc.
- Review the terms of your life insurance contracts periodically to make sure they accurately reflect your intentions. This is important because life insurance proceeds are transferred by contract – they go to whoever is listed as the beneficiary on the policy – regardless of what your will says.
- Arrange a list of insurance policies that should include each company's name, policy number, contact name and phone number, and location of policy documents.
- Develop a list of all bank accounts held in your name including the name of financial institution, account number, and location of documents or statements.
- Record the location of the following:
 - Safe Deposit Box
 - Tax Returns
 - Will
 - Trust Agreements
 - Living Will
 - Durable Power of Attorney
 - Birth Certificate
- After your death the executor should keep track of any money spent on activities associated with the closing of the estate. This could be important for tax purposes.

Inside MCM

We are pleased to welcome Wright Cronin to MCM!



Wright works at our Manchester office where he manages the charitable guidance efforts and philanthropic projects of our clients. He graduated with a BA from Reed College in 2004.

Please feel free to contact us if your accountant requires any additional information to complete your 2005 tax return.