



MANCHESTER CAPITAL MANAGEMENT LLC

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*Never has there been
more choice and
information on the
investment landscape.*

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Notes on the Investment Process

By David Brigham, Chief Strategist

Manchester Capital Management's investment process is carefully considered to assess the risk tolerance of each client relative to expected returns from various asset classes and actively engages the client in that discussion from the very beginning.

The implementation of this process is generally known as 'portfolio construction'. Sound investment theory suggests that the resulting array of asset classes selected within the portfolio construction will determine more than 80% of future investment returns. This array, or diversification, dominates the return of any individual securities chosen within the asset classes. Portfolio construction has become more complex in the past several years due to the proliferation of asset classes both domestically and internationally with the increasing globalization of our markets. The acceptance of more nations into the mainstream of worldwide economic activity has offered up more possible asset classes and sub-asset classes for investment opportunity.

Never has there been more choice and information. Our task at Manchester Capital is to constantly analyze and sift through these options and data in a dynamically changing investment landscape. We have to ascertain what types of investments deserve a more permanent part in client portfolios versus those that provide short-term opportunity. We have regularly scheduled meetings attended by all of our investment professionals to discuss these issues. However, the process is truly a continuum, with the formal meetings for the most part serving to validate or change our on-going assumptions relative to risk and return, and then to implement whatever changes should be made in client portfolios. The heavy work is in the selection of each part of a diversified portfolio so that the result for each client will be a portfolio that optimizes an expected return with the least risk.

The two most critical aspects of the investment process are to recognize change and prevent distraction. Change can be friend or foe, highly dependent on the consistency of the way data is provided and analyzed. Consistency of application has a better chance to succeed in spotting significant inflection points in markets and valuations. Random selection of data, and uneven analysis of it, has the potential to make things stand outside, and independent of, any previous pattern.

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Oftentimes decisions will be made that are influenced by the dominant news of the moment divorced from a longer perspective of more serious observation. Selection of data for decision making, such as earnings reports, interest rates, GDP, inflation, company valuations, etc., can be arranged and quantified in many valid ways by different managers to reach good conclusions, but invariably successful investment professionals will have a rigorous consistency to their approach.

A constant focus on the investment process is as important as the elements of the process itself. External or internal distraction is a powerful enemy of superior investment results. We believe that ownership by those doing the investing is an excellent pre-requisite for preventing distraction. We at Manchester Capital have only one master, our clients.

International Investing

By Brian Jandrucko

The idea of adding international equities as part of an investment portfolio has its roots in the extensive analysis of historical returns and volatility in all investable markets. Developed international equities have been attractive over time as a diversifier because they have return patterns that are unlike those of U.S. equities, and because of that we call them non-correlated returns. The product of this analysis has led to diversification into foreign equity markets for equally competitive returns which are also uncorrelated, to render the total portfolio return less volatile over extended periods of time.

Diversifying out of U.S. equities into developed international ones during the 1990's however proved painful as U.S. markets outperformed most global markets. Monies invested overseas did reduce overall portfolio risk, but at the cost of decreasing total portfolio return. Furthermore, correlation benefits have gradually begun to erode, leaving investors to question the continued diversification benefits of international investing.

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At Manchester Capital we take a long-term approach to asset allocation, observing that developed international equities deserve a consistent allocation in portfolios where equity represents greater than 50% of total assets. Market observers will note that developed international, as measured by the MSCI EAFE Index*, outperformed U.S. markets, as measured by the S&P 500, from 1970 – 1980, 1980 – 1990, and from 2000 to the present. In fact, the only decade in the last four and a half where the EAFE index underperformed was in the 1990's.

A large part of this underperformance can be attributed to the dramatic rise and subsequent fall of the Japanese economy, which by 1995 represented 41% of the EAFE Index. During the 1990's, Japan's economy fell into a prolonged period of stagnation. Since the beginning of the new millennium however, Japanese employment has stabilized, real estate pricing has firmed-up, corporate profitability has improved, and consumers

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	1970 - 1980	1980 - 1990	1990 - 2000	2000 - present*
S&P 500 Index	5.77%	17.40%	18.21%	0.67%
MSCI EAFE**	8.80%	21.99%	7.01%	-0.22%
MSCI Japan Index	na	na	-0.69%	-0.05%

We believe there is still diversification benefit to investing internationally.

* Through April 30th, 2006

** EAFE returns are expressed in dollars.

have begun to once again spend. With the outlook for Japan as good as it has been in years, as well as strong growth throughout Asia, we continue to be comfortable with our developed international equity exposure.

Another headwind commonly discussed for not investing internationally is that the correlations between U.S. and foreign assets have gradually risen, eroding the diversification benefits. The development of global trade has made capital more mobile, able to move freely across international borders, contributing to higher correlations between U.S. and foreign equities. Many argue that by purchasing U.S. multinational companies doing business throughout the world, they are able to achieve the same diversification benefits of buying foreign companies.

At Manchester Capital we believe there is still diversification benefit to investing internationally. While correlations have risen, they remain less than perfect and thereby still offer value. Furthermore, we do not invest in developed markets through the EAFE Index, which are what most correlation statistics are based on. Instead, we find superior managers who outperform the EAFE Index by being different than the index, thereby maintaining diversification benefits. We also search for opportunistic investments outside the mainstream, where we uncover a specific investment thesis with compelling diversification and return potential. In both these ways we feel we overcome the correlation problem.

Developing International Equity

Developing or emerging markets are economies made up of countries whose economic and political infrastructures are developing and building, working toward structural improvement, driving economic and political stability. Examples of emerging markets include China, India, Brazil, Malaysia, countries in Eastern Europe, and parts of Africa. One must find seasoned managers in this space, as emerging market currencies and stock markets can be highly volatile, reacting to economic and political changes and to changes in global sentiment. Much less research has been done in many of these markets, and therefore opportunity exists for the shrewd investor.

We have found that for portfolios with greater than 50% of total assets in equity, emerging markets can add value. Currently, just less than half of global GDP can be attributed to emerging markets yet about 85% of the world's population is in these same markets. It has been

At Manchester Capital, we diversify internationally, not out of concern for our economy, but rather to lower portfolio risk.

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projected that over the next decade, China alone could contribute as much to global GDP as Europe or the United States. As China continues to grow, broader Asia should positively benefit from its economic influence. Emerging market investments have appreciated significantly over the past three years as the world has become aware of these trends. While a short-term correction is likely inevitable, we would expect emerging markets to continue to contribute to overall portfolio returns over the long-term.

While it is not clear exactly how future international markets will develop, we are somewhat confident that international equities will continue to play an important role in our more aggressive portfolios. As such, we continue to explore the more recent development of country-specific, region-specific, and capitalization-specific investment opportunities, which not only offer diversification opportunity, but return opportunity. Acknowledging that a significant portion of the future's economic growth will likely come from outside of the United States, we continue to explore the best way to form a coherent strategy for our clients' portfolios to participate.

* EAFE is an acronym for Europe Australasia Far East, and is widely used internationally as a large cap equity benchmark, much like the S&P is used domestically.

Inside MCM

We are pleased to welcome Leslie Burkemper to MCM!



Leslie Burkemper has joined our Montecito office as the new Office Administrator. Her responsibilities range from client communications to producing reports. She previously worked for Wendy Foster, where she oversaw the shipping and receiving department. She is a graduate of the University of California with a B.A. in Psychology.

New Trade Confirmations Available

Schwab now offers consolidated trade confirmations on a quarterly basis. This report replaces the confirmations which are mailed every time a trade is placed. The advantage of this consolidated report is reduced mail and an overview of all trades placed throughout a single quarter. If you would like to receive this report please ask your advisor for more details.

MCM is Carbon Neutral!

We are proud to announce that we have enlisted TerraPass to help the firm and its employees offset our entire carbon footprint. Every year MCM and its employees emit about 120 tons of Carbon Dioxide through heating, electricity, commuting and travel. TerraPass funds clean energy projects that reduce industrial carbon dioxide emissions relative to the amount that we emit. Please contact us with any questions.