



# RHOADS LUCCA CAPITAL MANAGEMENT QUARTERLY UPDATE

First Quarter 2006

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## Market Commentary

Much of our time is spent trying to make money for you, but we also spend a lot of time trying to protect your money. In a recent investment committee meeting we discussed these particular issues in depth. We think 2006 holds good promise for returns but we also believe there is a high degree of *potential* risk at this time.

First, let's look at the opportunities.

It is a fact that many of the major indexes have been moving sideways for about a year and a half now. This is not the first time they have done so and it is unlikely that it will be the last. One characteristic of similar periods in the past is that they generally have resulted in significant moves out of the sideways behavior. While we do not have a crystal ball, we believe such a move will follow the present sideways behavior and the majority of our indicators and models suggest that the market will move higher. If it develops this way, we anticipate better returns than we have for several years.

Now, let's take a look at the risks.

While our models do suggest a productive year overall, they also suggest there is a high probability of a 5-10%, short term correction in the near future. We note two particular items that highlight the potential risks facing the markets: 1) there are fewer stocks advancing on each new market advance. Twelve weeks ago market rallies would have 85% stock participation. The most recent advance had only about 60% stock participation. Historically this has led to significant market corrections. 2) There is currently a historically low level of risk premium in the stock and bond market. This means investors are very optimistic right now and they have no expectation of bad news, let alone a shock of any kind. What this means is that investors have already anticipated the good news and simultaneously made no provision for any bad news. Therefore, good news will tend to move the market little if at all since it has already been factored in and bad news will have a disproportionately large negative impact on prices should bad news develop.

Putting this all together into an action plan, we remain modestly invested since prices have been moving up. However, we are taking two steps to protect your capital and your profits. First, we have moved some money to the safety of the money market fund and second, we have tightened our stops to move more capital to the safety of money funds if a correction does develop.

Remember, we work for you so if you have any questions, please call us at 888-895-1212.

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## Is My Information Safe?

This is a topic of great concern for everyone. Especially with the hacking of databases at major data-storing firms.

At RLC, we do not take our responsibility to protect your information lightly. We have in place various security measures to ensure that your information is not accessible. Some of these precautions include the cross-shredding of hard copy information before disposing of it, all computers are password protected, documents that are transmitted electronically are password protected and our firewall uses high level encryption. We also have our office in a security building and all paper client records are locked up every night.

Also, as stated in the RLC Privacy Policy: We keep confidential all information concerning client identity, financial affairs, and investments, except as the client otherwise agrees or is as required by law.

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**Rhoads Lucca will be closed**  
**Monday, May 29<sup>th</sup>**  
**in observance of Memorial Day.**

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## Form ADV-I and ADV-II Available

As always, the current version of Form ADV-II is available to you on request. This is the document we file with the Securities and Exchange Commission (SEC) as Registered Investment Advisors. Please let us know if you would like a copy.

ADV-I and ADV-II may also be viewed as Adobe Acrobat .pdf documents from our website at [www.rhoadslucca.com](http://www.rhoadslucca.com). In addition, you may also view our Proxy Voting Policies and Procedures and our Code of Ethics and Privacy Policy on our website, or you may request to have a copy mailed to you.

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## We Appreciate Your Trust!

A big thank you again to all of you who have been referring us to your friends and family. There is no better feeling than having satisfied clients refer others, especially when those referrals happen during down times in the market.

We will talk to any of your friends and family, at no cost or obligation, who are troubled by their current investment portfolios. For more information they can view our website at [www.rhoadslucca.com](http://www.rhoadslucca.com) or call either office.

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## What are redemption fees?

Occasionally mutual funds will charge a small exit fee if your money is moved to another fund in less than 90 days (sometimes more, sometimes less). More and more mutual funds have added these charges. Most times we screen out funds like this, but sometimes the best place to invest is in a fund that may carry one of these charges.

We try to avoid this charge by holding through the required time period, but there are times we must get out of the market to protect you. Volatile markets can produce quickly changing market conditions. We would rather not incur these charges - ever, but they occasionally are the cost of using a great fund. We earn none of this fee. It is kept by the fund.

Even though the occurrence of redemption fees is infrequent, we want you to be aware of what they are and why they happen.

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## Year to Date Returns

Through 3/31/2006, year to date returns on the portfolio models, after maximum management fees, were:

|                  |        |
|------------------|--------|
| Sleep Easy:      | 1.92 % |
| Solid Oak:       | 2.34 % |
| All Growth:      | 3.77 % |
| Top of the Hill: | 1.25 % |

In comparison,

|                      |        |
|----------------------|--------|
| Dow Jones Indl. Ave. | 3.66 % |
| S&P 500              | 3.73 % |
| NASDAQ Composite     | 6.10 % |

(These figures taken from the *Wall Street Journal*.)  
Current return information on client accounts is available during business hours by calling us at the numbers below or e-mailing [debbie@rhoadslucca.com](mailto:debbie@rhoadslucca.com).

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## Portfolio Model Changes for this Quarter

### Sleep Easy<sup>SM</sup> Portfolio Model

Bought Merger Fund

Sold Oppenheimer Senior Floating Rate

Dividends paid in Pimco Floating Income Instl.; Eaton Vance Floating Rate Fund Advisors

### Solid Oak<sup>SM</sup> Portfolio Model

Bought Profunds Short Small Cap; Merger Fund; Artisan International; Franklin Mutual European

Sold Profunds Short Small Cap; Rydex Health Care; Profunds Mid Cap; GAMCO Growth; Third Ave. Value Fund

Exchanged ProFunds Bull Inv. for Profunds Short Small Cap

### All Growth<sup>SM</sup> Portfolio Model

Bought Profund Ultra Short Small Cap; Janus Overseas

Sold RS Value

Exchanged Rydex Small Co Growth (RYWAX) for Rydex URSA

### Top of the Hill<sup>SM</sup> Portfolio Model

Bought Profunds Short Small Cap; Janus Overseas

Sold Rydex URSA; ProFunds Bull; AIM Financial Services Inv.