CHILTON
CAPITAL MANAGEMENT

# REVIEW & OUTLOOK

## 1ST QUARTER 2006

IN THIS ISSUE



### Annualized Returns

| | 1st Qtr | 1 Year | 3 Year | 5 Year | 7 Year | Since Inception 3/31/1996 |
|---|---|---|---|---|---|---|
| **CCM Growth** | 5.8 | 17.6 | 18.1 | 4.7 | 4.8 | 11.1 |
| Russell 1000 Growth | 3.1 | 13.2 | 14.8 | 1.7 | (2.6) | 6.5 |
| S&P 500 | 4.2 | 11.7 | 17.2 | 4.0 | 1.7 | 9.0 |

### Annualized Returns

| | 1st Qtr | 1 Year | 3 Year | 5 Year | 7 Year | Since Inception 6/30/1998 |
|---|---|---|---|---|---|---|
| **CCM Conservative Growth** | 2.3 | 9.2 | 14.3 | 3.4 | 3.8 | 4.9 |
| S&P 500 | 4.2 | 11.7 | 17.2 | 4.0 | 1.7 | 3.3 |

### Annualized Returns

| | 1st Qtr | 1 Year | 3 Year | Since Inception 12/31/2002 |
|---|---|---|---|---|
| **CCM High Quality Tax Exempt Bond** | 0.1 | 3.4 | 3.2 | 3.2 |
| Lehman 5 Year Municipal Index | 0.0 | 2.1 | 2.2 | 2.4 |

## "10"

Much has changed in the "10" years since CCM opened its doors in March 1996. In a very personal sense, Chilton Capital has grown from two full-time employees to now having "10" full-timers. Our assets under management have increased from just over "10" million dollars to over 300 million dollars. Thankfully, the "10" year performance of our Chilton Capital Growth Composite was 11.1% per annum since inception, and thus, we can spare you another "10" statistic.

The first quarter of 2006 showed impressive strength across the U.S. equity markets with the benchmark S&P 500 Index up 4.2%. The Chilton Capital *Growth Composite* rose 5.8% and the *Conservative Growth Composite* gained 2.3% for the three months ended March 31, 2006.

Looking back "10" years, we can see that change has been pervasive and dramatic. While any informed person could compile a credible list of major changes, we think a few are especially notable. The emergence of China and India as powerful economic factors in a process of global labor arbitrage has been highly beneficial, as well as disruptive, to the economies of developed countries. The outsourcing of jobs has pressured local labor costs in nearly all developed countries and kept inflation low. China's voracious appetite for energy and other resources with which to build and run its cities and industrial capacity has made a mockery of the mid-nineties notions that "it's all about capturing eyeballs" and that "stuff" no longer matters. We have seen global prices for nearly all commodities soar from levels of a decade ago as demand far outstripped a neglected supply chain.

The mid-nineties also marked a period of tremendous innovation and growth in the areas of computing and telecommunications equipment that, along with the 1996

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deregulation of the telecom industry, provided the necessary ingredients for the rapid adoption of the internet and the World Wide Web. The economic stimulus these factors provided for the decade of the nineties is well known. It has certainly contributed to a high profit, low inflation economy. Yet the full economic ramifications of this productivity-enhancing tool are still in the early stages and cannot yet be fully understood.

However, the biggest change in our opinion is the geopolitical environment. In 1996, the U.S. and global economies were enjoying the full benefits of the profound political and economic changes resulting from the fall of the Berlin Wall, the reunification of Germany, the dissolution of the Soviet Union, the downsizing of the U.S military, and optimism for the spread of democracy and capitalism. The "peace dividend" allowed for the freeing of a great deal of capital from defense related uses in favor of private investment, paving the way to rare budget surpluses. It was certainly a global "era of good feeling."

*"We believe the U.S. has faced many problems of both a domestic and geopolitical nature in the past and persevered to the benefit of the nation's general welfare as well as investors' appropriate reward."*

Fast forward ten years to 2006. Developed countries in general, and the U.S., in particular, are engaged in a struggle with terrorism on a global scale. If the book *Al-Zarqawi—al-Qaeda's Second Generation* is correct, al-Qaeda plans to create even more trouble in the years ahead. Iran's nuclear ambitions add to the political risks in the Middle East. Vladimir Putin's Russia has proven on several occasions to be more foe than friend to the U.S., to democracy, and to capitalism. In our own hemisphere, Latin American countries are democratically electing leaders whose philosophies and policies are considered to be anti-American. The antagonist in this movement is Hugo Chavez of Venezuela. On July 2, 2006 Mexico will elect a new president. If leftist Andres Manuel Lopez Obrador is elected, we can probably expect a shakeup of social, economic and business conditions in a country with deep and important ties to the U.S. Such an event would not likely favor U.S. interests, globalization, and free markets.

In our last *Review & Outlook*, we looked back at the events of the past five years and addressed current domestic U.S. issues. This letter reflects on the past ten years, as we take stock of the many changes we have seen. Taking both the domestic and global problems into account, there is much to worry about. But we believe the U.S. has faced many problems of both a domestic and geopolitical nature in the past and persevered to the benefit of the nation's general welfare as well as investors' appropriate reward. One need only remember the Cold War or the turmoil of the 1960's and 1970's to put today's conditions into perspective. In those decades, insightful investors made good returns in equities by seeing the big trends and owning the right stocks. We think such an investment environment exists today.

## Portfolio Actions:

Purchases:

Nokia (NOK) is the world's leading cell phone provider. The company struggled over the past two years with a fuddy-duddy form factor for its phones and poor operating leverage on weakening sales as it lost market share, primarily in the US. We expect this to reverse based on new products ready for all markets in 2006. For the developed world, Nokia has at least three high-end models that are innovative, with the requisite 'got to have' features, coming in 2006 for Europe and the U.S. Nokia continues to roll out new phones for China and India as well. To support consumer appeal, the company has created a coalition of partnerships and products to make its wireless devices attractive to service providers. For example, Nokia developed a solution to work with Microsoft Exchange servers to provide wireless email to the Nokia E-61 devices—to compete directly with the Blackberry from Research in Motion (RIMM). At the same time, RIMM has agreed to enable their products to work on the Nokia devices. It seems that not only will their new products look 'cool,' they will work 'cool'. We like both the valuation and the opportunity for Nokia to take back market share over the next few years.

**Sun Microsystems (SUNW)** designs and sells Unix/Linux servers and related products and services. We believe the company has significant new products designed to solve computing problems of the high growth internet companies like Yahoo, Google, and Salesforce.com. The servers that are based on its newest semiconductor design—a chip that that runs faster, at significantly lower power, cooler, and with higher thread count than any other chip on the market. Why is this important? Because the next generation software companies don't sell their software; they rent it. Google software is not purchased; searchers use it. Salesforce.com offers monthly subscriptions for access to its software. "Next Generation" telecommunications companies are investing in voice over internet protocol networks. Each of these companies requires secure, fail safe, fast, and cheap-to-operate server farms that can handle enormous numbers of simultaneous transactions. Sun servers fit the bill. Investors have pressured the company to be more aggressive at expense control. In December, the company laid out plans to rationalize storage manufacturing operations and to cut operating expenses further. We believe an increase in revenues will leverage the effects of the cost cutting, driving earnings higher than investors currently expect.

**Urban Outfitters (URBN)** is an emerging lifestyle retailer, currently operating three specialty retail brands: Urban Outfitters, catering to 18-30 year old men and women; Free People, a wholesaler of contemporary sportswear for women 20-35; and Anthropologie, offering women 30-45 fashionable clothes and lifestyle accessories, through 175 locations and direct through the internet and catalogs. Urban Outfitters is probably one of the largest growth opportunities in specialty retail. The goal of the CEO has remained the same since he founded the company: to create a portfolio of differentiated boutique retail brands that cater to discreet, carefully segmented consumers. We believe that the combination of appealing fashions, inspiring store environments, strong management and 20%+ square footage growth annually makes Urban a particularly appealing investment opportunity.

**KFx Inc. (KFX)** is an emerging clean coal technology company. KFx's patented K-Fuel potentially solves a major environmental problem by reducing emissions from coal-fired plants. While KFx technology has been in existence for over 20 years, only recently has it become commercially viable. Several factors have recently aligned to merit a small investment in the company:

1. <u>Tougher Emission Regulations</u>: From the Clean Air Act in 1970, to the Kyoto Protocol in 1992 and the Clean Air Interstate program in 2005, U.S. and global environmental policies are increasingly becoming more stringent to reduce emissions. As a result, utilities and other emission producing industries must find economic solutions to comply with tougher regulations. The traditional choice has been to install scrubbers to remove sulfur oxides and nitrous oxides at a high capital cost. Currently 65-70% of the U.S. generating fleet do not have scrubbers installed. Utilities may burn K-Fuel to reduce emissions to compliant levels without the capital costs associated with installing scrubbers.
2. <u>K-Fuel is now a proven technology</u>: Although coal liquefaction technology is more than 60 years old, only recently has coal benefaction been proven to reduce emissions and in commercial quantities. KFx has recently completed a commercial scale 750,000 tons/yr K-Fuel plant in the Powder River Basin that is beginning operation and should achieve full production by Q4 2006.
3. <u>K-Fuel Economics are Compelling</u>: Priced at $45 per ton, K-Fuel will allow a margin of approximately $17 per ton with the potential for an additional $15 to $35 per ton for environmental credits and premiums, while still remaining competitive with Eastern coal prices.

**Sales:**

**Transocean (RIG):** We sold our entire Transocean position during the quarter. RIG missed earnings and guided down the next two quarters because of rising costs. While this continues to be the best energy environment we have seen since the 1970's, these stocks are VERY cyclical. At the peak of the cycle, cyclical stocks appear inexpensive on an earnings basis, but expensive on a NAV (net asset value) basis. For example, RIG traded at 65% of NAV during the dark days at the bottom in 2002 and was barely cash flow break even. Now RIG looks cheap on an earnings and cash flow basis, but on an asset-based valuation, RIG is trading at almost 200% of NAV. With significant capital gains and cracks emerging in the investment case, we thought it best to move on.

**Time Warner Inc. (TWX):** We sold TWX shares out of Chilton Capital *Growth* accounts during the quarter. While we had no compelling fundamental reasons to sell the shares, we had profits in most accounts and used proceeds to establish a new position in Nokia (see above). We believe Nokia offers greater potential for capital appreciation at current prices.

## Fixed Income Commentary for First Quarter 2006

The Chairman of the Federal Reserve Board may be new, but the results of Federal Open Market Committee ("FOMC") were not. The FOMC met twice during the first quarter, once with Alan Greenspan as Chairman and once with Ben Bernanke as the Chairman. At both meetings the federal funds rate was increased by 25 basis points for a total of 50 basis points for the quarter. After these two increases, the federal funds rate is now 4.75%. The FOMC has now increased the federal funds rate at fifteen consecutive meetings, beginning in June 2004.

What was surprising was not that the federal funds rate was increased, but that the FOMC statement that was released announcing the increase hinted at more rate increases in the future. In its statement, the FOMC "judges that some further policy firming may be needed to keep the risks to attainment of both sustainable economic growth and price stability roughly in balance." This statement was identical to the statement from the January 31 meeting. This is evidence to the fact the FOMC does not believe inflation is in check. In fact, the FOMC believes that "the slowing of the growth of the real GDP in the fourth quarter of 2005 seems largely to have reflected temporary or special factors" because "economic growth has rebounded strongly in the current quarter but appears likely to moderate to a more sustainable pace." The FOMC believes the rate increases are impacting inflation in the way the increases are intended. However, the FOMC believes "possible increases in resource utilization, in combination with the elevated prices of energy and other commodities, have the potential to add to inflation pressures." There is much speculation as to when the FOMC will stop the increases. There are two FOMC meetings in the second quarter of 2006, and those meetings may help to end that speculation. As the bond markets digest the current economic data and anticipate the FOMC's next meeting in May, bond prices may be volatile.

The yield on the ten-year U.S. Treasury Note increased 45 bps from 4.40% to 4.85% with the low yield being 4.33% and the high yield being 4.86% during the quarter. The Bond Buyer 20 weekly index, a municipal bond index that is comprised of 20 General Obligation bonds rated "A1" by Moody's Investors Service with maturities of 20 years, increased 15 bps from 4.38% to 4.53% with the low yield being 4.33% and the high yield being 4.53% during the quarter. In general, bonds values decreased as a result of the interest rate movement during the quarter.

## CCM Update:

We are pleased to announce the addition of Todd Stephens to Chilton Capital's team of professionals. Todd brings over twelve years experience in the financial services industry, most recently as director of client relations at an independent investment advisor.

## Thank You

We would like to express our thanks to all of our clients who have entrusted us to manage their financial assets, with special thanks to those of you who have been clients from the beginning. We hope you have found your trust appropriately rewarded. As for us, it has been an enjoyable experience. We give it a "10."

## Performance Disclosures

| GROWTH COMPOSITE | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Total Firm | Composite Assets | | | Annual Performance Results | | | |
| Year End | Assets (millions) | U.S. Dollars (millions) | % of Firm Assets | Number of Accounts | Composite Gross | Composite Net | Russ 1000 Growth | Composite Dispersion |
| 2005 | 304 | 76 | 25% | 50 | 12.78% | 11.66% | 5.27% | 0.50% |
| 2004 | 256 | 43 | 17% | 27 | 4.97% | 3.95% | 6.30% | 0.68% |
| 2003 | 215 | 42 | 20% | 29 | 28.27% | 26.98% | 29.76% | 1.31% |
| 2002 | 165 | 15 | 9% | 19 | -22.66% | -23.43% | -27.89% | 2.30% |
| 2001 | 155 | 25 | 16% | 31 | -19.46% | -20.24% | -20.42% | 4.30% |
| 2000 | 172 | 37 | 22% | 32 | 8.33% | 7.30% | -22.42% | 1.60% |
| 1999 | 137 | 17 | 12% | 17 | 34.37% | 33.12% | 33.17% | 14.43% |
| 1998 | 109 | 25 | 23% | 12 | 25.17% | 24.00% | 38.71% | 4.70% |
| 1997 | 99 | 21 | 22% | 12 | 29.23% | 28.02% | 30.49% | 2.90% |
| 1996 | 30 | 11 | 35% | 5 or fewer | | | | |

| CONSERVATIVE GROWTH COMPOSITE | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Total Firm | Composite Assets | | | Annual Performance Results | | | |
| Year End | Assets (millions) | U.S. Dollars (millions) | % of Firm Assets | Number of Accounts | Composite Gross | Composite Net | S&P500 | Composite Dispersion |
| 2005 | 304 | 60 | 20% | 36 | 8.33% | 7.24% | 4.89% | 1.17% |
| 2004 | 256 | 54 | 21% | 41 | 3.84% | 2.82% | 10.87% | 0.64% |
| 2003 | 215 | 64 | 30% | 43 | 28.17% | 26.92% | 28.69% | 1.60% |
| 2002 | 165 | 12 | 7% | 13 | -20.66% | -21.44% | -22.10% | 1.90% |
| 2001 | 155 | 15 | 9% | 9 | -18.12% | -18.92% | -11.86% | N.A.* |
| 2000 | 172 | 15 | 9% | 5 or fewer | 7.32% | 6.30% | -9.13% | N.A.* |
| 1999 | 137 | 15 | 11% | 5 or fewer | 31.39% | 30.15% | 21.03% | N.A.* |
| 1998 | 109 | 8 | 7% | 5 or fewer | | | | |

| 2006 GROSS AND NET QUARTERLY PERFORMANCE FOR COMPOSITES | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 1Q 2006 | | 2Q 2006 | | 3Q 2006 | | 4Q 2006 | |
| | Gross | Net | Gross | Net | Gross | Net | Gross | Net |
| Growth Composite | 5.8% | 5.5% | | | | | | |
| Conservative Growth Composite | 2.3% | 2.0% | | | | | | |

| HIGH QUALITY TAX-EXEMPT BOND COMPOSITE | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | *Total Firm* | *Composite Assets* | | | *Annual Performance Results* | | | |
| Year End | *Assets (millions)* | *U.S. Dollars (millions)* | *% of Firm Assets* | *Number of Accounts* | *Composite Gross* | *Composite Net* | *Lehman 5 Yr Muni* | *Composite Dispersion* |
| 2005 | 304 | 19 | 6% | 16 | 2.19% | 1.77% | 0.95% | 0.68% |
| 2004 | 256 | 15 | 6% | 11 | 3.12% | 2.71% | 2.72% | 0.42% |
| 2003 | 215 | 7 | 3% | Five or fewer | 4.99% | 4.73% | 4.13% | N.A.* |

| 2006 GROSS AND NET QUARTERLY PERFORMANCE FOR COMPOSITE | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 1Q 2006 | | 2Q 2006 | | 3Q 2006 | | 4Q 2006 | |
| | Gross | Net | Gross | Net | Gross | Net | Gross | Net |
| High Quality Tax-Exempt Bond Portfolio | 0.1% | 0.0% | | | | | | |

*Information is not statistically meaningful due to an insufficient number of portfolios in the composite for the entire year.

Chilton Capital Management, LP (CCM) is a registered investment advisor. The firm maintains a complete list and description of composites, which is available upon request.

The CCM Growth Composite contains fully discretionary taxable and tax-exempt growth equity accounts. Prior to March 1, 2003, this composite contained only taxable growth equity accounts. The Conservative Growth Composite contains fully discretionary conservative growth equity accounts. The minimum account size for each composite is $250 thousand. The growth composite is measured against the Russell 1000 Growth Index and the Conservative Composite is measured against the S&P500 Index for comparison purposes. Balanced portfolio segments are not included in the composites. Though leverage is not part of the firm's strategy, it is occasionally used in the Growth Composite. The Growth Composite was created April 1, 1996 and the Conservative Growth Composite was created July 1, 1998. Results are based on fully discretionary accounts under management, including those accounts no longer with the firm. Non-fee-paying accounts are not included in the composites. As of December 31, 2005, the Growth Composite contains approximately 84% of the accounts managed in that strategy and the Conservative Growth Composite contains approximately 72% of the accounts in that strategy. Past performance is not indicative of future results.

The U.S. dollar is the currency used to express performance. Returns are presented gross and net of management fees and include the reinvestment of all income. Gross returns will be reduced by investment advisory fees and other expenses that may be incurred in the management of the accounts. A fee schedule is an integral part of a complete presentation. Net of fee performance is calculated using the highest management fee as described in Part II of the firm's ADV, which is available upon request. The annual composite dispersion presented is an asset-weighted standard deviation calculated for the accounts in the composite the entire year.

Chilton Capital Management, LP has prepared and presented this report in compliance with the Performance Presentation Standards of the Association for Investment Management and Research (AIMR-PPS®), the U.S. and Canadian version of the Global Investment Performance Standards (GIPS®). AIMR has not been involved with the preparation or review of this report.

A third-party verification as set forth by the AIMR-PPS standards has been conducted by Ashland Partners & Company LLP from April 1, 1996 through December 31, 2005. A copy of the Independent Verifier's Report is available upon request.

High Quality Tax-Exempt Bond Composite contains fully discretionary non-custom fixed income accounts and for comparison purposes is measured against the Lehman 5-Year Municipal Index. The minimum account size for this composite is $200 thousand. Chilton Capital Management, LP has prepared and presented this report in compliance with the Performance Presentation Standards of the Association for Investment Management and Research (AIMR-PPS®), the U.S. and Canadian version of the Global Investment Performance Standards (GIPS®). AIMR has not been involved in the preparation or review of this report.

Results are based on fully discretionary accounts under management, including those accounts no longer with the firm. Non-fee-paying accounts are not included in this composite. Past performance is not indicative of future results.

The U.S. Dollar is the currency used to express performance. Returns are presented gross and net of management fees and include the reinvestment of all income. Gross returns will be reduced by investment advisory fees and other expenses that may be incurred in the management of the account. Net of fee performance was calculated using the highest management fee of 40 basis points per year. Prior to January 1, 2004, the highest management fee was 25 basis points per year. A fee schedule is an integral part of a complete presentation and is described in Part II of the firm's ADV, which is available upon request.

Balanced portfolio segments are not included in this composite. Leverage is not used in this composite.

The High Quality Tax-Exempt Bond Composite was created January 1, 2003.

The Independent Verifier's Report is an integral part of this presentation.