For Clients and Friends of Financial Connections

The lessons of investing in 2005 reflect the importance of patience and discipline. The Dow Jones Industrial Average was down for the first year since 2002. Other indexes were modestly up. Investors trying to sidestep the weak stretches probably missed out on the short upward bursts. Trying to predict short-term market moves is, as one expert stated, "a fool's game."

2005 was another year in which diversification was rewarded. Investments in less mainstream funds paid off (commodities, energy, etc.). Value outperformed growth for the sixth consecutive year largely thanks to energy stocks, although the second half of the year favored growth stocks. International stocks outperformed the U.S. stock market. Fixed income offered small returns, and international bonds were down because of a stronger U.S. dollar. Commodity futures had another strong year.

2006

We don't know what the stock market will do this year. As usual, the economy driving the market is a mixed bag. The trade deficit, budget deficit, debt levels, and housing prices are of ongoing concern. However, there is moderate inflation, good productivity growth with a large global labor pool, and productive capacity. Europe is showing signs its economies are strengthening as is Japan.

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Quarterly Newsletter,
4th Quarter 2005,
January 19, 2006

REFERRALS TO FINANCIAL CONNECTIONS GROUP, INC.

Brian and Jill want to thank all of you who referred clients to us in 2005. It was a banner year for Financial Connections Group, Inc. But it does take time to assimilate new clients in the "Financial Connections Way" of financial planning and investment management.

In order to continue to give you high-quality service, we need to reduce the number of *new* clients. For the time being, potential clients will need to have $500,000 of investable assets in order for us to work with them.

Thank you again for your confidence and trust in us.

MANAGING YOUR CASH

It wasn't long ago some people said it doesn't matter where you leave your cash, because the interest rates are so low. That is no longer the case.

If you have more cash than you should in your checking or savings accounts, consider putting it in a money market. We recommend Vanguard for your excess cash. The California Tax-Exempt money market is yielding 2.77%, free of state and federal tax. The taxable money market fund is yielding 4.02% as of January 17.

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Financial Connections Group, Inc.

As mentioned in Jill's letter last month, Financial Connections was a sole proprietorship. In January, Jill incorporated, and Brian became an owner in the new corporation. Nothing changes in our operations, philosophy, or approach. Jill and Brian still answer the phone when they are at their desks. If you have any questions, don't hesitate to give us a call.

Year-End Package

Included with this quarterly newsletter are the following documents:

1. Reports on your investments
2. Capital gains/losses report for 2005. Please give this to your tax preparer. If Brian is your tax preparer, we will keep the document at our office.

Please give us a call to review your investments or let us know if something has changed to affect our investment approach for you.

OPT OUT

Recently, all cell phone numbers were provided to telemarketing services. You need to opt out just as you did with your home phone. Calling 888-382-1222 blocks your number for 5 years. Or, register at http://www.donotcall.gov.

If you want to opt out of the credit card and loan solicitations, consumer credit agencies have a phone number you can call. 1-888-5OPT-OUT (1-888-567-8688).

FINANCIAL CONNECTIONS GROUP, INC.
This newsletter is written quarterly by Financial Connections Group, Inc. Please contact us if there are any changes in your financial situation or investment objective(s). Remember, past performance may not be indicative of future results. Different types of investments involve varying degrees of risk, and there can be no assurance that the future performance of any specific investment, investment strategy, or product made reference to directly or indirectly in this newsletter, will be profitable, equal any corresponding indicated historical performance level(s), or be suitable for your portfolio. Information herein should not be construed as legal advice.

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YIELDS (INTEREST RATES) ON TREASURIES

The yield curve shows the interest rate paid for bonds maturing at different times. The “curve” of the graph has yields on the vertical axis and maturities on the horizontal axis (short duration to longer duration). The slope is usually upward from left to right.

Put another way, short-term yields are usually lower than long-term yields. So when the curve flattens or inverts (shorter with higher rates and longer with lower rates), investors pay attention.

As of January 13, 2006, the interest rates were:

3-month Treasury Bill	4.31%
2-year Treasury Note	4.34%
10-year Treasury Note	4.35%

Based on these rates, the yield curve is flat. This is considered an anomaly because it distorts the principle that the longer the bond maturity, the more return you get for taking added risks (i.e., of inflation, volatility, and so on).

Many times, a flat or inverted yield curve is a precursor to a recession. However, many experts feel that is not true this time. Here are some of the reasons:

1. Longer term yields have stayed low because the Federal Reserve, by raising short-term interest rates, has kept inflation in check.
2. Heavy foreign demand for U.S. debt keeps bond prices high and yields low.
3. The economy in 2006 will have slower growth but is not on the verge of a recession.

Although an inverted yield curve preceded a recession before the last five recessions, the 1995 and 1998 inverted yield curves did not. Only time will tell which version is correct.

Little Known Facts of Interest

FUN FACTS:
In 1938, Teflon (polytetrafluoro-ethylene) was discovered by an experimental chemist at DuPont, Ray Plunkett. The *Guinness Book of World Records* shows it as the slipperiest solid on earth.

Marc Gregoire, a Frenchmen, heard about Teflon from an engineering friend. He started to coat his fishing tackle with it. His wife asked him to use it to coat her saucepans. By 1958, Gregoire sold more than 1 million Teflon-coated saucepans a year.

Teflon wasn’t used in the U.S. until an American journalist experienced cooking on one in Paris and tried to bring it across the Atlantic. He eventually convinced Macy’s, New York, what Teflon saucepans could do and the store took 200 saucepans—they sold out in two days!

Today, Teflon coats spaceships, car brake pads, replacement blood vessels, and even parts of the Statue of Liberty.

FINANCIAL FACTS:
Health spending is one-quarter of after-tax spending for adults 65 and older. This number is expected to rise to 35% by 2030.

Defined-contribution plans (401(k), 403(b), etc.) outnumber defined-benefit plans (pensions) 14 to 1.

According to a MetLife study, there is a 50% chance of a 65-year-old reaching age 85 and a 30% chance of reaching 90.

WHAT DOES THE FEDERAL RESERVE DO? AND WHO IS GREENSPAN'S SUCCESSOR?

The Federal Reserve System operates as the *Central Bank* for the United States. The Federal Reserve (the Fed):

- Manages our money supply and credit,
- Keeps the country going with currency, coin, electronic funds transfers, and check-clearing,
- Functions as the banker for the federal government by providing services for the U.S. Department of the Treasury,
- Regulates the nation's banking and financial systems, and
- Administers consumer-protections laws for finance-related issues.

The Fed has several ways to guide monetary policy:

<u>Open Market Operations</u>: The Federal Open Market Committee (FOMC) can instruct a trading desk run by the Federal Reserve Bank of New York to buy or sell government securities. To tighten money and credit in the economy, the FOMC sells government securities and takes the money out of banks' reserve accounts. Banks now have less money to loan, interest rates may increase, consumers may reduce spending, and the economy may slow. When the Fed wants to loosen money supply, it implements the reverse strategy.

<u>Discount Rate:</u> The Fed sets the interest rate a Federal Reserve Bank charges a financial institution to borrow funds for a short period of time. This is the rate in the news when you see headlines "Fed raises rate one-quarter percent." It is a key to setting many lending rates.

<u>Reserve Requirement</u>: Every financial institution must have reserves. The Fed sets the percentage that must be kept in reserve.

Meet Alan Greenspan's Successor—Ben S. Bernanke

Bernanke is a top economic advisor to President Bush. He is 51 and served as a Federal Reserve Board member. His career includes being chair of Princeton University's economics department. His academic career focused on studying Fed policy and its impact on the economy.

Bernanke said his appointment will not bring any significant shift to Fed policies. Wall Street liked this statement and stocks rose when his appointment was announced. However, bonds reacted just the opposite. Bill Gross, manager of the world's largest bond mutual fund (PIMCO Total Return) said the sell off "was not an expression of dissatisfaction with the choice but merely a reflection of the uncertainty."

Some traders speculate Bernanke might be more concerned about the pace of economic growth and would be willing to permit faster inflation (which would be bad for bond investors).

As usual, no one will know until he's had time to perform in his new role.

Jill D. Hollander   Brian Pon