January 11, 2006

Enclosed are your statements for the fourth quarter of 2005.

For the quarter, equity investors saw total returns of 2.09% for the S&P 500, 2.06% for the Dow Jones Industrial Average and 2.73% for the technology-oriented NASDAQ. For the quarter, fixed income investors saw returns of 0.80% for the 1-year Treasury Index, 0.11% for the 5-year Treasury Index, and 0.28% for the 10-year Treasury Index. The riskier 10-year BB- corporate bonds had similar returns of 0.02%. These bond returns reflect a belief that the Fed's continued rate raising campaign will be successful in slowing inflation.

The past year's sector focus (with excitement limited primarily to energy, commodities and emerging markets) has created an environment remarkably similar to 1999 (when the focus was on technology). Our returns are even similar. Moreover, as in 1999, we were able to purchase outstanding companies whose business prospects created lackluster interest compared to the euphoria prevailing in the "hot" sectors. We believe that these similarities are not coincidental and that there will ultimately be another similarity, namely that the eventual loss of euphoria will deflate the sectors mentioned above for the same reason as it deflated the technology sector – the cyclicality of the businesses.

Cyclicality of businesses results from a force in capitalism often described as "creative destruction." This can have beneficial effects as suppliers create new ways to make life easier for the consumer. Who could have imagined the progress within the last ten years in personal computing power, in the low cost of long-distance communications or in the breadth of entertainment avenues? But there is a downside to all of this.

Every improvement is funded by an investor who not only believes in the superiority of the investment, but in its longevity. But what is challenging today is how quickly obsolescence sets in. The speed of the financial markets is likely to make the problem of technological obsolescence even worse for the investor. When an improvement is shown superior to others, there is investor euphoria. Soon enough, this euphoria begets a new series of investments that erode the advantage of the original improvement. The same thing happens when one person stands at a sporting event. For a short time, he has a fabulous view. But soon enough he loses it if everyone around him also rises. If investments continue to be made based on the temporary advantage attained, losses are almost sure to result and are likely to be permanent.

Our ability to work around such cyclicality is critical to the long term results we strive for. In reviewing the numbers above, you will notice that while our results have been significantly better than the S&P 500 for the entire period, they have not been superior every year. In fact, out of the seven years listed, we have outperformed the S&P 500 in only four of the seven years. That is not much better than fifty percent. Yet, by using the "head fake" of hot sectors to accumulate superior companies, we can achieve superior

results by building valuable “non-cyclical” portfolios and avoiding destructive “cyclical” losses.

In this quarter, we again also had a high level of new clients. For those who are new, we welcome you to Academy and want you to stay informed. Past quarterly letters are sometimes useful for a deeper understanding of our discipline. If you wish to receive these, please contact your financial advisor or Sue Compton at our office and they will be forwarded to you. In addition, our website (at www.academycapitalmgmt.com) has our investment reports on the individual holdings in your portfolio.

As always, we appreciate the stewardship responsibilities you entrust to us and your patience with our investment process.

Academy Capital Management