JAM JOLLEY ASSET MANAGEMENT, LLC

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"A wonderful thing about having an approach grounded in Ben Graham's "margin of safety" discipline is that you don't have to be clairvoyant, and try to predict the direction of the market. Valuation becomes your barometer leading you into stocks as attractive prices present themselves and out of stocks as they approach their intrinsic values."

Tweedy, Browne Funds
2nd Qtr Report to Shareholders

At its low point in mid-July, most major stock indexes were little changed for the year. At that point many analysts were wondering if the bull market that started in October of 2002 would even make it to celebrate its fourth birthday. Once again, the Federal Reserve came to the market's rescue, as they decided to pause in their campaign of raising interest rates. This action resulted in a strong rally for the major indexes as the S&P 500 index advanced by 5.65% and the Dow Jones Industrial Average by 5.35%. The small and mid-cap indexes, which have been the big winners over the past few years, missed out on the party. The Russell 2000 Index (small cap) returned only .44% for the quarter and the S&P Mid-Cap index actually declined by 1.08% for the quarter. Value investment styles once again outpaced growth across all market capitalizations.

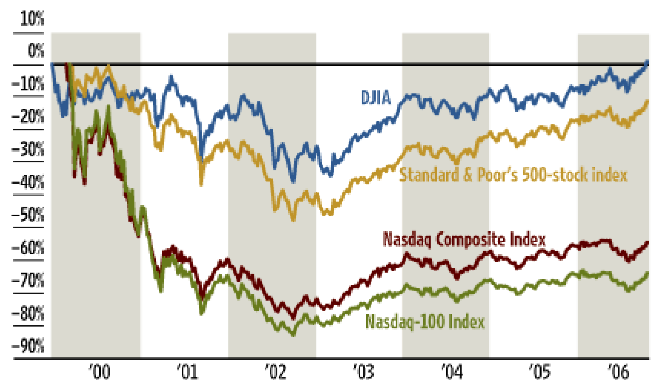
Index	3rd Quarter 2006	9 mos. ended 9/30/06
DJIA	5.35%	10.91%
S&P 500	5.65%	8.56%
S&P Mid Cap	-1.08%	3.12%
Russell 1000/Growth	3.94%	2.97%
Russell 1000/Value	6.22%	13.19%
Russell 2000	.44%	8.69%
NASDAQ Comp.	3.97%	2.41%

New Highs for Dow Jones Industrial Average

On October 2, 2006, the Dow Jones industrial average closed at 11,722.98, a new all-time high (old high was 1/14/00). With all the media attention, it probably makes some sense to take a closer look at today's market versus the market of early 2000. We quickly forget how from its high in 2000 to its 2002 low that the Dow Jones Industrial Average fell by 38%, the S&P 500 by 49% and the Nasdaq Composite by an amazing 78%. The Nasdaq composite has essentially doubled since its 2002 low, but would have to more than double again to return to its March 2000 high of just over 5048. The S&P 500 index fell harder than the Dow during the bear market and still needs to rise over 14% to get back to its record high of 1527.46 reached in March 2000. When examining the facts, it is quite logical that the mood this time around is less euphoric.

Dow Industrials Surpass Their Record...

Last week, the Dow Jones Industrial Average topped its previous record level of January 2000. A number of other market benchmarks are still below their respective peaks in early 2000.



Source: WSJ Market Data Group

Historically the S&P has needed 3.3 years (average) to return to new highs after suffering through a bear market. However, as can be seen from the data above, this time it will take much longer. Since 1900, there have been thirty-three bull markets according to Ned Davis research. In only fifteen of the thirty-three bull markets was the market able to establish new all-time highs. From the market low in October 2002, the S&P 500 has advanced by 72%. In comparison, the average bull market has returned almost twice as much from trough to peak (based on data going back to 1932). Many market strategists label the current market as a "cyclical bull market" within a "longer term secular bear market". Cyclical bull and bear markets typically last for a few years, while secular bull and bear markets can last for decades. They compare the current market with the period from 1966-1982, where the broad market went virtually nowhere, however, there were several cyclical bull and bear markets that sent stock prices up and down. A new high in the S&P 500 index would refute the "cyclical bull market" label. Only time will tell.

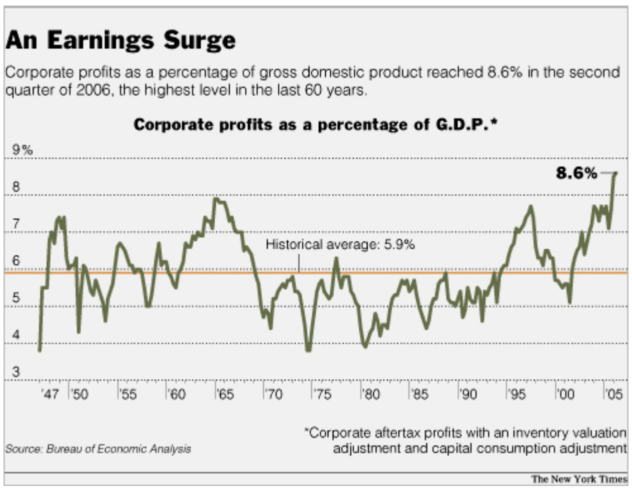
At its peak in 2000, the S&P 500 traded at more than thirty times its trailing earnings, today it trades at around seventeen times. Clearly, corporate profits for the S&P components have risen faster than their stock prices. The chart below highlights that while corporate profits have grown for most blue chip companies, the stocks have not universally kept pace. This could be referred to as price/earnings multiple compression. The valuation compression has been most evident in many of the high quality, mega-cap companies that we found to be grossly over-valued in late 1999 and early 2000. Ironically, a number of high quality, large cap stocks that we avoided in late 1999-2000 have been finding their way into our portfolios over the past couple of years.

Comparison 1/14/00 versus 9/28/06

Company	Stock Price Change %	EPS Growth %
Altria	217.4%	115.8%
Exxon Mobil	61.1%	540.8%
Procter & Gamble	7.2%	106.6%
Pfizer	-23.5%	123.1%
Coca Cola	-26.4%	73.4%
General Electric	-29.5%	75.2%
Home Depot	-40.7%	203.1%
Intel	-59.7%	1.8%

Corporate Profits

Corporate profits have grown at double digit rates for the past seventeen quarters, enabling the equity markets to rise despite rising interest rates and higher energy prices. Furthermore, according to Zack's Investment Research, most analysts are predicting that the median S&P 500 company will grow profits by 12.8% this year and 12.9% in 2007. S&P 500 profits now approximate 8.6% of gross domestic product, its highest level in Commerce Department data going back to 1947.



Weakness in housing coupled with a slowdown in consumer spending may make it difficult to achieve the forecasted double digit earnings growth in 2007. In the last few years, consumption growth has accelerated relative to income growth. This has essentially come from home equity extraction, a trend that is likely to slow dramatically going forward. The combination of higher interest rates, coupled with flat to declining property values will make it more difficult for consumers to borrow to support consumption. Furthermore, the construction and financial industries that experienced strong job growth during the housing boom will likely reverse as the housing industry weakens. According to Zacks Investment Research, there has recently been a rather sharp decline in the ratio of positive to negative earnings revisions. In late August, the ratio was at 1.35. Since then it has fallen to .80 with downgrades now exceeding upgrades for the first time all year. At this point in the economic cycle, we believe it is prudent to concentrate portfolios in high quality, large cap stocks, many of which have lagged the market over the past six years.

Fixed Income

The Federal Reserve's decision to pause the rate hike campaign kicked off a big rally in bonds in July. The yield on the benchmark 10-year Treasury note declined from a high of 5.25% on June 25th to 4.64% on September 29th. This represented the biggest quarterly decline in rates since the second quarter of 2005. This has been a highly unusual quarter with both stocks and bonds posting large gains for investors. The bond rally and the inverted yield curve signal an economic slowdown. The stock market rally and record highs in the Dow Jones Industrial Average would indicate continued economic growth. The sharp drop in oil prices is the likely reason for strength in both equities and fixed income, as lower inflationary expectations are positive for both asset classes. Bill Gross of PIMCO, the world's biggest bond manager, believes the economy is ready to slow to a 2% or lower real growth rate and that the Fed will be forced to begin to ease sometime in 2007. Others believe that Ben Bernanke has successfully engineered the "soft-landing" or "Goldilocks" economy. Not too hot, not too cold, but just right. Essentially, they are referring to an economy that can grow at roughly 3% or so with little or no inflation. According to David Rosenberg of Merrill Lynch, "As great as the third quarter was for stocks, it was equally good for bonds, and we are at a stage of the cycle where it is doubtful that both asset classes are getting it right." Rosenberg points out that pauses by the Federal Reserve tend to last eight months and we have just finished month two. It is simply too early to tell who has it right, the stock market or the bond market?

Summary

The economy is at a critical juncture as the Fed tries to engineer a soft landing. While the slowdown in housing will likely cause an economic drag, lower energy prices could provide a much needed shot of adrenalin. Profit margins are likely at unsustainable levels and estimates for 2007 could prove difficult to achieve. Equity valuations appear reasonable on an absolute basis and corporate balance sheets remain in superb shape. The record amount of private equity on the sidelines coupled with corporate buybacks will likely provide further support to equities. We remain focused on high quality large capitalization companies and believe that a waning appetite for risk could translate into wider premiums for high quality equity issues. The recent leadership in large cap versus the small and mid-cap sector seems to be gaining traction as investors realize that the large cap sector is essentially the only asset class which has not been exploited over the past few years.

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