The TANDEM Report

TANDEM Investment Advisors

Volume 7, Issue 1, January, 2006

MARKET COMMENTARY:

WHAT WILL CAUSE A SUSTAINED ADVANCE? A CHANGE IN ASSET ALLOCATION WOULD HELP

For the fourth consecutive calendar year, earnings for the companies that comprise the S&P 500 grew at a double-digit rate, with similar growth forecast for 2006. Further, S&P 500 dividends also grew for the fourth straight year, the last two at a double-digit pace. For the last seven years, S&P 500 earnings have grown over 70%, dividends have increased over 50% and the index has only appreciated 1.5%. What more will it take to get the market to sustain a positive move?

Without question, the market is a very different animal today than it was seven years ago. For one, it is no longer overvalued. But perhaps the most significant development over the last several years has been a shift in asset allocation. Faced with stagnant market returns and a low interest rate environment, many investors have searched for more enticing returns in less-traditional investments. Individuals have taken money that was once earmarked for stocks and placed it in real estate. More sophisticated investors have gone further. Today, a large and growing percentage of institutional investment portfolios are allocated to private equity, hedge funds, timber and commodities, in addition to real estate.

Where did the money come from to go into these new "hot" areas? Not long ago, most institutional portfolios allocated little to real estate, and almost nothing to the other areas mentioned. Now, it is common to see allocations for these "alternative investments" exceeding 20% of portfolios. A good portion of this real-

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A LOOK BACK AT 2005

LOOKING AHEAD TO 2006

Investors who didn't own oil stocks in 2005 didn't have a very good year. Those who waited to buy oil until the fourth quarter really had a bad year.

The oil sector of the S&P 500 was up 29.14% for the year (down 7.73% for the 4th quarter). The next best performing sector was utilities, up 12.76% for the year. Everything else was moderately up or down. We look for oil to continue to excel in 2006, but we are confident that we will also see better performance from more traditional growth areas like finance, health care and technology.

In the finance sector, we think banks will benefit from the end of the Federal reserve's rising interest rate policy. We also like the mutual fund and credit card sectors.

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INSIDE THIS ISSUE:

MARKET SCORECARD:

S&P 500:

Annualized returns:

1 year ended 12/31/05	*3.00%*
3 years ended 12/31/05	*12.37%*
5 years ended 12/31/05	*-1.12%*
7 years ended 12/31/05	*0.22%*
10 years ended 12/31/05	*7.32%*

Top Ten Holdings

As of December 31, 2005

As always, the list that follows represents our ten largest holdings ranked by total market value in the accounts that make up our Tandem Equity and Equity Income Composites. These are not recommendations for purchase. Rather, the list is simply intended to provide some insight into how we manage accounts.

Market value is determined by the number of shares of a company we own in a composite multiplied by the share price. Percentage of composite is a holding's value divided by the value of the composite. A composite is a group of accounts with similar investment strategies over which we exercise complete discretion.

For more detailed information on Tandem's composites, please visit our website at www.tandemadvisors.com.

EQUITY COMPOSITE

Rank by Market Value	% of Composite
1. BB&T Corp.	8.41%
2. Altria Group	5.34%
3. BP, plc	5.28%
4. FMC Technologies	4.63%
5. Home Depot	4.11%
6. Exxon Mobil	3.92%
7. Amgen	3.86%
8. T. Rowe Price	3.54%
9. Johnson & Johnson	3.47%
10. FMC Corp.	3.33%
Total	**45.90%**

EQUITY INCOME COMPOSITE

Rank by Market Value	% of Composite
1. Home Depot	5.10%
2. Johnson & Johnson	4.97%
3. General Electric	4.47%
4. T. Rowe Price	4.27%
5. Allied Capital Corp.	4.24%
6. BP, plc	3.87%
7. Microsoft	3.71%
8. Exxon Mobil	3.44%
9. Boston Properties	3.37%
10. Commercial Net Lease	3.20%
Total	**40.64%**

Composite Updates

EQUITY COMPOSITE

Among the best performing stocks in the Tandem Equity Composite for the 4th quarter were Outback Steakhouse, T. Rowe Price, BB&T and Wells Fargo. The oils, Kensey Nash and Cooper Companies were among the worst. Kensey and Cooper disappointed Wall Street, and now must earn back trust. We will monitor these situations closely, but will hold on for now.

We added Capital One (COF) and Texas Instruments (TXN) and sold Avon Products (AVP), Techne (TECH) and IBM (IBM). Techne gave us a great run, and it was time to take our profits. Avon suffered one too many earnings disappointments, and IBM just can't seem to get out of its own way, so we moved to greener pastures.

We also added to positions in Constellation Brands (STZ), Johnson & Johnson (JNJ) and Colgate-Palmolive (CL).

EQUITY INCOME COMPOSITE

The best and worst performers for the quarter were essentially the same in the Equity Income Composite as they were in the Equity Composite, although Boston Properties had a nice quarter for this group.

During the quarter, we added Enterprise Product Partners LP (EPD) in the pipeline industry for its attractive dividend (about 7%). We also added to existing positions in Johnson & Johnson (JNJ) and Outback Steakhouse (OSI). Our selling was largely account specific, but included Techne (TECH) in its entirety and partial sales of Microsoft (MSFT), General Electric (GE) and Tyco (TYC) where appropriate.

The accounts that comprise a composite are not necessarily identical. Some contain positions that Tandem did not buy. For more information on Tandem's composites, please visit www.tandemadvisors.com.

MARKET STATISTICS *AS OF DECEMBER 31, 2005*

STOCK MARKET INDEX DATA						
Stock Market Indices	**Close**	**% Change YTD**	**% Change 1 Year**	**% Change 3 Years**	**% Change 5 Years**	**% Change 10 Years**
S&P 500	**1248.29**	**3.00%**	**3.00%**	**12.37%**	**-1.12%**	**7.32%**
DJIA	**10,717.50**	**-0.61%**	**-0.61%**	**8.71%**	**-0.13%**	**7.67%**
NASDAQ 100	**1645.20**	**1.49%**	**1.49%**	**18.67%**	**-6.82%**	**11.06%**

YIELD TABLE				
	Current	**3 months ago**	**6 months ago**	**1 year ago**
3-month T-Bill	**3.99%**	**3.53%**	**3.12%**	**2.22%**
5-year Treasury	**4.32%**	**4.15%**	**3.70%**	**3.69%**
10-year Treasury	**4.35%**	**4.30%**	**3.91%**	**4.32%**
Prime Rate	**7.25%**	**6.75%**	**6.25%**	**5.25%**
Fed Funds Rate	**4.25%**	**3.75%**	**3.25%**	**1.75%**

PERFORMANCE BY SECTOR WITHIN THE S&P 500

THROUGH DECEMBER 31, 2005 ***(SOURCE: S&P 500 GICS SECTOR SCORECARD)***

Sector	**% of S&P 500**	**Return Last 13 Weeks**	**Return Year-to-Date**
S&P 500	100%	1.95%	3.00%
S&P 500 (Growth)	48.54%	2.10%	1.9%
S&P 500 (Value)	51.46%	1.82%	4.1%
Consumer Discretionary	10.81%	0.77%	-7.35%
Consumer Staples	9.54%	-0.13%	1.34%
Energy	9.30%	-7.73%	29.14%
Financials	21.23%	7.49%	3.72%
Health Care	13.33%	1.02%	4.85%
Industrials	11.34%	4.47%	0.36%
Information Technology	15.09%	0.92%	0.38%
Materials	2.99%	10.56%	2.16%
Telecommunication Services	3.01%	-1.10%	-9.05%
Utilities	3.36%	-6.32%	12.76%

GROWTH STOCKS: WHERE THE VALUE LIES

In the July issue of ***The TANDEM Report***, we wrote a piece entitled "The Value is in Large-Cap Growth". We compared equities (stocks) to other asset classes and concluded that stocks were undervalued. Further, we compared growth stocks to value stocks and found growth to be even more undervalued than value within equities. Apparently, our commentary failed to enlighten enough investors to bring about a surge in growth stocks. We will obviously have to increase circulation of our newsletter.

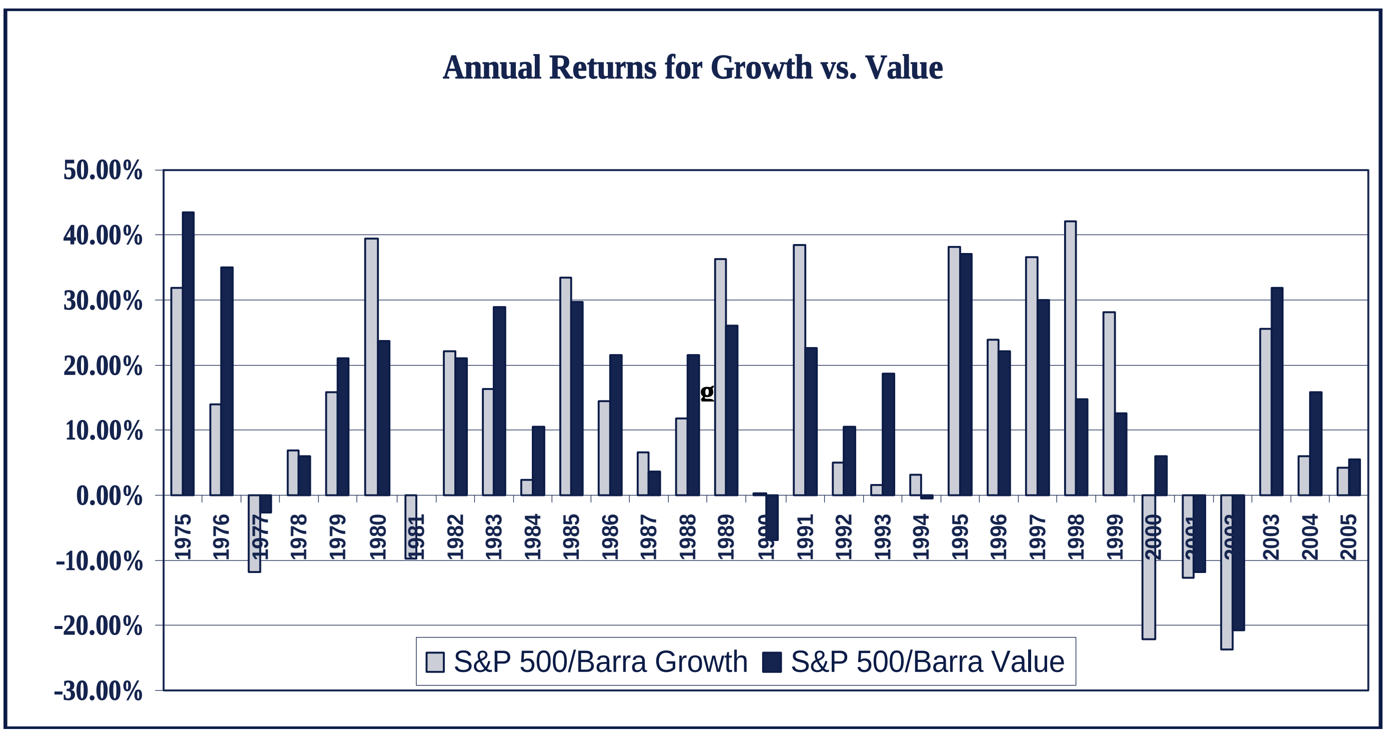
For the sixth consecutive year, the S&P 500/Barra Value Index has outperformed the S&P 500/Barra Growth Index. Value is certainly entitled to catch up, as growth outperformed the previous six years (see the chart below). But we decided this matter deserved further research.

We studied the relative performance of the two aforementioned indices going back to 1975. Since December 31, 1975, there have been 361 one-year periods (one-year ended 12/31/75, 1/31/76, etc. all the way to the one-year period ended 12/31/05). Prior to the year 2000, there was no significant statistical difference between the two. This was as we expected, for if one style had an advantage over the other, wouldn't every investor employ that particular style? In fact, of the 289 one-year periods between 1975 and 1999, growth outperformed value 145 times, and value outperformed growth 144 times. A statistical dead heat.

Our research led us to conclude that, prior to 2000, growth faired slightly better in up markets while value performed better in down markets. Since 2000, however, our research did little to explain value's winning streak. Of the 72 one-year periods ended 12/31/2005, value has outperformed 51 times, including 30 consecutive times and counting. This includes both up and down markets.

In fact, value's current string of outperformance is its longest we observed. There were 28 consecutive periods of outperformance by value in the mid-seventies (a bad market environment), but other than that, value's longest string has been 20 consecutive one-year periods.

Is thirty years enough time to draw significant conclusions? Maybe not. But the time period encompasses several bull and bear markets. It seems a reasonable sample to at least infer trends. One trend that we are comfortable inferring is that, over long periods of time, there is little difference in the performance of growth stocks versus value stocks. Therefore, we believe that growth stocks are due for a return to favor. We recognize and appreciate the merits of both styles of investing, but can only conclude that the time for growth is approaching. With such a long run for value, the real value lies in growth. If we could only increase circulation of ***The TANDEM Report.***



MARKET COMMENTARY (CONTINUED)

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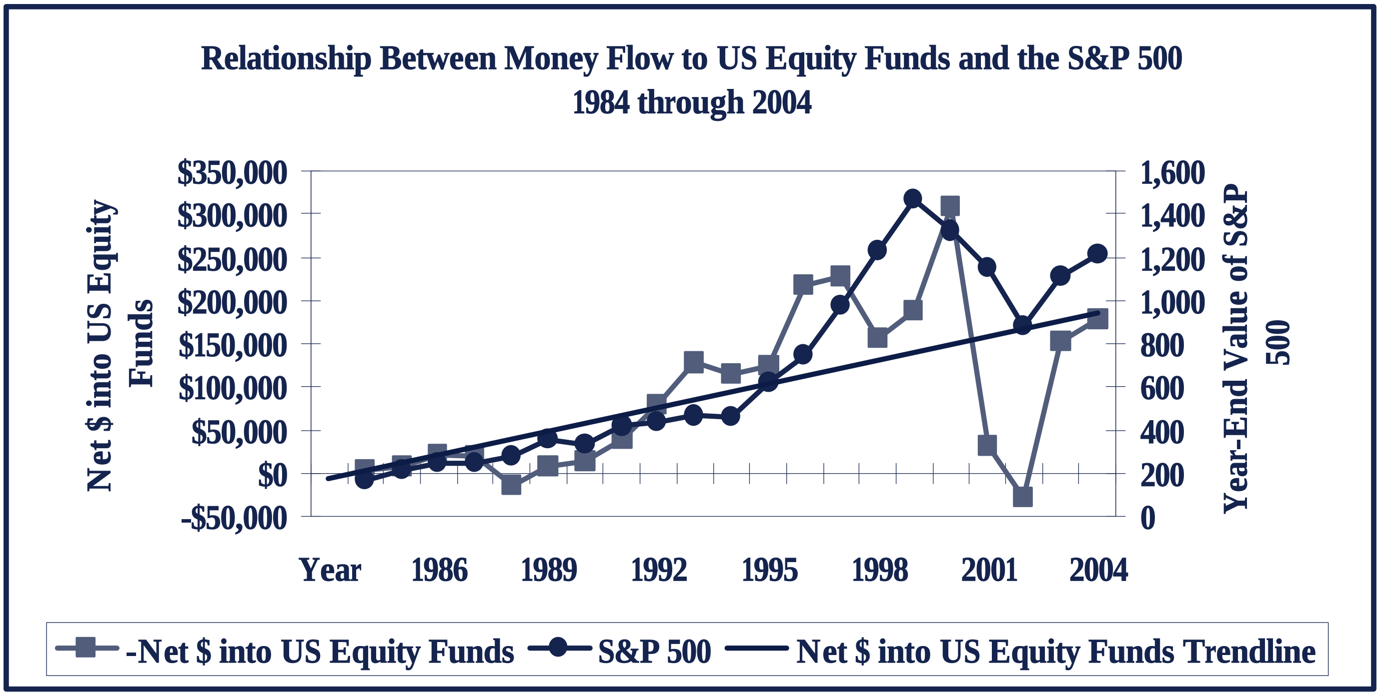
location came from a reduction of the traditional stock allocation.

In essence, the market suffers from a lack of demand for stocks among investors. The most troubling aspect of this development is that investors have traded the liquidity of stocks for investments that are not easily sold. This has two potential consequences. First, because alternative investments are illiquid, it is difficult to quickly reallocate to stocks. Second, when these alternative investments become less attractive to investors, their illiquidity can lead to an ugly exodus.

That said, we are noticing a very important trend among small investors. Money flowing into U.S. Equity funds has been steadily rising. Using data from the Investment Company Institute, we created a chart (below) illustrating the correlation between the value of the S&P 500 and new money flowing into mutual funds. The dark solid line going from the lower left of the graph to the upper right is the trend line for money flows. It depicts the general trend of money flowing into or out of mutual funds. Historically, it has been bullish for stocks when actual money flow crosses above the trend line. It appears we are approaching that level now.

A market driven by positive fund flow is a strong market. With the individual investor leading the way, we believe the "smart money" will ultimately follow. When assets begin to be meaningfully reallocated to stocks, we will see a sustainable positive move for stock prices.



A LOOK BACK (CONTINUED)

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In health care, pharmaceuticals may finally get a break, although we believe there are limited growth prospects for the industry. We prefer medical device makers.

On the technology front, we are shying away from the big names of the nineties in favor of names that will benefit from a surge in consumer demand for new technologies.

We expect that 2006 will be a good year for individual growth stocks that have been out of favor for some time. While earnings have continued to grow, valuations have not, making these stocks very appealing. Last year was basically negative if oil is excluded. We are optimistic that the year ahead will see a much broader advance. That said, our fingers are firmly crossed.

www.tandemadvisors.com

In Charlottesville:

2 Boar's Head Place
Suite 105
Charlottesville, VA 22903

Phone: (434) 979-4300 or
(800) 527-0101

(This section intentionally left blank)

In Charleston:

901 Daniel Island Park Drive
Suite 201
Daniel Island
Charleston, SC 29492

Phone: (843) 216-3791 or
(800) 303-8316

Tandem Investment Advisors, Inc. was founded in 1990 to provide professional portfolio management with uncompromising service to investors. For more than fifteen years, we have worked in Tandem with our clients to attain their investment goals. If we can provide further assistance, please contact us.

John B. Carew
Phone: (434) 979-4300
e-mail: jcarew@tandemadvisors.com

Allen Ouzts
Phone: (843) 216-3791
e-mail: caotandem@danielislandmedia.net