

The **TANDEM** Report



Volume 7, Issue 4, October, 2006

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MARKET SCORECARD:

S&P 500:

Annualized returns:

1 year ended 9/30/06	8.71%
3 years ended 9/30/06	10.28%
5 years ended 9/30/06	5.12%
7 years ended 9/30/06	0.58%
10 years ended 9/30/06	6.87%

Russell 3000 Growth:

Annualized returns:

1 year ended 9/30/06	6.05%
3 years ended 9/30/06	9.13%
5 years ended 9/30/06	4.83%
7 years ended 9/30/06	-2.19%
10 years ended 9/30/06	5.27%

MARKET COMMENTARY:

ONE QUARTER DOESN'T CONSTITUTE A TREND, BUT IT'S A START

There is an old saying on Wall Street - "The trend is your friend." This was, by almost any measure, a terrific quarter for growth stocks and a terrific quarter for Tandem clients. It may be a bit premature to label one quarter a trend, but every trend has to start somewhere.

After six long years, growth stocks are finally enjoying a moment in the sun. As we have reported here frequently, an unprecedented disparity between growth and value stocks emerged after the market bottomed in 2002. But for the quarter just ended, growth outperformed (see page 3), and may well be on a mission to close the gap. Even the hedge funds are reportedly moving money into growth stocks.

There is evidence that the market leader-

ship baton is being passed from the commodity and cyclical stocks to companies with dependable earnings. True blues like General Electric, Microsoft and Johnson & Johnson all had great quarters as the price of oil, gold and other commodities suffered a fairly meaningful setback.

Technology stocks, like Microsoft and Applied Materials, previously flat on their backs, have shown signs of life. Financials, led by T. Rowe Price, Allied Capital, American Express, BB&T and Wells Fargo in our portfolios, were among the best performing sectors in the S&P 500. Even Health Care (our names include Johnson & Johnson, Pfizer, Amgen and Biomet) has awoken from its slumber to post an exciting quarter.

It is not news that the price of oil has
(Continued on page 7)

BALANCING RISK AND RETURN

Our stated portfolio management goal is to provide competitive returns with less risk than the market. We take seriously the responsibility of prudently managing our clients' portfolios, and therefore must consciously weigh the tradeoff between risk and return. It is a vital part of our approach.

The last few years saw investors diminish concern for risk in an effort to seek

maximum return. For awhile, most were rewarded. But all things revert to the norm, and we have seen that lately in the volatility of prices.

Some risks are worth taking while others are not. We took a risk that FMC Technologies would rise more dramatically than the rest of the energy sector as long as oil prices were rising, and we were right. We accepted the risk that Legg Mason would
(Continued on page 5)

TOP TEN HOLDINGS

AS OF SEPTEMBER 30, 2006

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

EQUITY COMPOSITE

Rank by Market Value	% of Composite
1. BB&T	8.33%
2. Altria Group	5.25%
3. BP, plc	5.12%
4. FMC Technologies	4.97%
5. T. Rowe Price	4.46%
6. Exxon Mobil	4.33%
7. FMC Corp	3.99%
8. Home Depot	3.83%
9. Johnson & Johnson	3.69%
10. Amgen	3.20%
Total	47.17%

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 INCOME COMPOSITE

Rank by Market Value	% of Composite
1. Johnson & Johnson	5.23%
2. T. Rowe Price	5.23%
3. Home Depot	4.91%
4. General Electric	4.84%
5. Microsoft	4.19%
6. Abbott Labs	4.18%
7. Allied Capital	4.14%
8. Amgen	4.01%
9. General Dynamics	3.92%
10. Exxon Mobil	3.80%
Total	44.46%

COMPOSITE UPDATES

EQUITY COMPOSITE

The oil sector finally broke down, but we fared well. Exxon Mobil (up 9.37% for the quarter) was the best performer we follow in the sector, and we were able to take some very nice profits in FMC Technologies. We diversified our energy holdings by adding Enterprise Products Partners LP, a pipeline and natural gas company with a hefty dividend.

We saw very strong performance in the Health Care, Information Technology, Consumer Staples and Financials sectors. T. Rowe Price (+26.55%), Motorola (+24.07%), Pfizer (+20.84%), Microsoft (+17.38%) and Constellation Brands (+15.12%) all enjoyed a spectacular quarter. We sold Kensey Nash and OSI Restaurant Partners (Outback Steakhouse) and added to our position in Home Depot, a stock we believe to be grossly unappreciated. We also saw the banks come to life, and General Dynamics was up nearly 10%.

EQUITY INCOME COMPOSITE

Much like the Equity Composite, the Equity Income Composite's energy investments prospered in spite of the Energy sector. Exxon Mobil (+9.37%) and Enterprise Products (+7.43%) more than compensated for BP's woes (-5.79%).

We added to our positions in Enterprise Products, Home Depot and Procter & Gamble while selling OSI Restaurant Partners. We realized solid returns from the same stocks sighted in the Equity Composite along with AT&T (+16.74%), P&G (+11.47%), Abbott Labs (+11.35%) and Boston Properties (+14.31%).

The accounts that comprise a composite are not necessarily identical. Some contain positions that Tandem did not buy. The Equity Composite is designed to produce principal growth, while the Equity Income Composite is designed for principal and income growth. For more



MARKET STATISTICS AS OF SEPTEMBER 30, 2006

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	1,335.85	7.01%	8.71%	34.13%	28.33%	94.36%
Russell 3000 Growth	2,292.74	3.11%	6.05%	28.21%	26.59%	67.18%
DJIA	11,679.07	8.97%	10.51%	25.92%	32.00%	98.55%
NASDAQ 100	1,654.13	0.54%	3.28%	26.88%	41.58%	124.26%

YIELD TABLE				
	Current	3 months ago	6 months ago	1 year ago
3-month T-Bill	4.86%	4.99%	4.60%	3.53%
5-year Treasury	4.56%	5.15%	4.83%	4.15%
10-year Treasury	4.61%	5.19%	4.86%	4.30%
Prime Rate	8.25%	8.25%	7.75%	6.75%
Fed Funds Rate	5.25%	5.25%	4.75%	3.75%

PERFORMANCE BY SECTOR WITHIN THE S&P 500

THROUGH SEPTEMBER 30, 2006

(SOURCE: S&P 500 GICS SECTOR SCORECARD)

Sector	% of S&P 500	Return 3 Months	Return 2006 YTD	Return 2005	Return 5-Yr Annual
S&P 500	100%	5.2%	7.0%	3.0%	5.1%
S&P 500/Citigroup Growth	49.59%	5.7%	3.9%	-0.2%	2.5%
S&P 500/Value	50.41%	4.7%	10.2%	6.2%	7.6%
Consumer Discretionary	10.14%	4.7%	6.8%	-7.4%	6.3%
Consumer Staples	9.58%	5.1%	8.6%	1.3%	4.0%
Energy	9.34%	-2.1%	10.4%	29.1%	15.2%
Financials	22.26%	7.3%	9.2%	3.7%	7.0%
Health Care	12.68%	9.8%	4.7%	4.9%	0.1%
Industrials	10.93%	-0.6%	5.4%	0.4%	6.0%
Information Technology	15.27%	8.3%	1.7%	0.4%	5.1%
Materials	2.87%	-1.1%	4.5%	2.2%	10.4%
Telecommunication Services	3.50%	9.6%	22.5%	-9.0%	-5.2%
Utilities	3.42%	5.2%	7.9%	12.8%	2.5%



GUEST COMMENTARY

THE IMPORTANCE OF APPROPRIATE BENCHMARKS

BY BRENT E. BENTRIM

In the last newsletter, John Carew wrote about Tandem's performance benchmark change. This topic sparked my interest because the majority of today's investors, whether individuals or institutional, have yet to fully appreciate the importance of investment style. It is important to understand that a benchmark (in Tandem's case the Russell 3000 Growth) establishes a goal for the money manager.

When John founded Tandem nearly 20 years ago, the Standard & Poor's 500 Index was virtually the only standard to measure market returns. Until the late 1990's, most money manager evaluations were simplistic: how has Tandem performed relative to 'the market.' No one

	Value	Blend	Growth
Large			
Medium			
Small			

A manager's style benchmark should not be assigned by manager preference, but instead by attributing its investment re-

turns over a period of years to determine which style the manager most closely mimics.

The matrix below verifies that Tandem can attribute a high correlation of its returns to the Russell 3000 Growth Index. Utilizing this insight, an investor or her

	Large Value	Large Core	Large Growth	Mid Value	Mid Core	Mid Growth	Min Value	Min Core	Min Growth	All Growth	Tandem	Energy
Large Value	100%											
Large Core	80%	100%										
Large Growth	60%	78%	100%									
Mid Value	83%	67%	40%	100%								
Mid Core	81%	79%	69%	87%	100%							
Mid Growth	50%	67%	88%	42%	74%	100%						
Min Value	69%	57%	47%	87%	87%	57%	100%					
Min Core	59%	64%	73%	66%	86%	86%	85%	100%				
Min Growth	43%	53%	79%	35%	66%	93%	60%	87%	100%			
All Growth	82%	89%	92%	69%	89%	88%	71%	85%	79%	100%		
Tandem	78%	89%	86%	65%	83%	80%	64%	76%	71%	94%	100%	
Energy	57%	53%	36%	65%	62%	47%	58%	55%	37%	55%	56%	100%

is certain how the S&P 500 became 'the' proxy for 'the market,' considering it accounts for only 70% of the capitalization of the U.S. Stock Market and is dominated by companies with huge market capitalizations (its largest 25 stocks account, on average, for nearly 1% of the entire market – the other 6500 'non 500' positions have an average weight of 4/1000 of 1%). Today, most money managers only tangentially resemble 'the market.'

Enter Morningstar. Its contribution was to segment 'the market' by style and market capitalization. Now every money manager can be 'filed' into one of nine boxes at the top of the next column:

investment consultant can truly make an apples to apples comparison of all money managers with similar investment strategies. (You may also notice, following up on John's article last quarter, that I included the energy sector on the matrix. Clearly comparing Tandem to an energy fund is not a fair assessment since there is only a 56% correlation between the two.)

Standard deviation (monthly)	Value	Core	Growth
Large	4.09%	4.45%	6.69%
Medium	4.15%	4.35%	7.85%
Small	3.83%	5.63%	9.70%

Another important outcome from understanding a money manager's

(Continued on page 5)



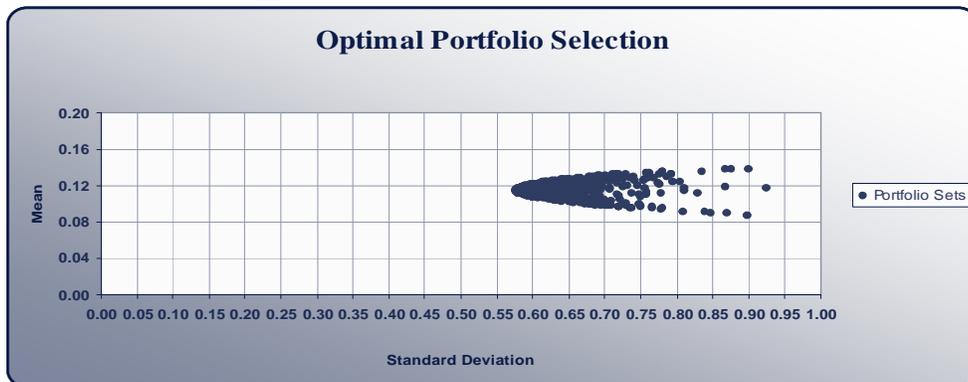
GUEST COMMENTARY (CONTINUED)

(Continued from page 4)

style benchmark is risk management. Using standard deviation as a proxy for risk – although it is really something completely different: a measurement of volatility – the range of returns can be determined. Modern (or in my firm's case, Post Modern) Portfolio Theory is based on the theory that along an efficient frontier an investor will find a point where the risk/return tradeoff is optimal. The investor (sometimes aided by an investment consult-

age of her total portfolio to allocate to different money managers by knowing the manager's style benchmark. Using the expected returns of the money managers or their proxy style benchmark, greater control of portfolio volatility can be achieved.

Do not get me wrong, Tandem's decision to disclose greater information is not purely charitable; it is also designed to help differentiate the firm from an increasingly crowded supermarket of money managers. Reflecting back on the conversation in regards to the energy fund, I can see John standing in the vegetable isle explaining "but sir, our broccoli is not supposed to taste as good as ice cream, we have less calories...".



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Family Wealth Management in Charleston, SC.

ant) now is capable of determining the optimal percent-

OUR GOAL (CONTINUED)

(Continued from page 1)

be able to smoothly absorb their acquisition of Citigroup's money management arm, and we were wrong (so far). But in every case, we put securities through a rigorous process and are satisfied that the risk is worth taking.

That process, from which we do not stray, involves a multi-step process that is worth reviewing. From a universe of all publicly traded stocks, we screen for those companies that demonstrate four characteristics:

1. Consistent earnings growth.
2. Consistent dividend growth, if dividends are paid.
3. Dominance or uniqueness.
4. Corporate consistency in leadership, markets, etc.

The reason for this detailed screening process is to determine if confidence in a particular security is warranted. Without confidence, we are only *hoping* that we made the right decision. Without confidence, we cannot be patient. Typically, good investments perform best a few years after they are purchased. We must have confidence that we have purchased a stock worth owning in order to give it time to work.

After we have identified securities worth owning, we must determine a fair price to pay. The best company on the planet is a bad investment if purchased at the wrong price. To determine a fair price, we subject stocks we own or are considering owning to our proprietary Tandem Valuation Model - a computer model we have developed, re-developed, tested, invested substantially in and practiced for the last twenty years. The model allows us to determine if we should buy, add to, avoid or sell securities based on valuation.

No model is infallible, including ours. But history shows that ours is pretty good. The result of this process is a portfolio built of securities that have a great history and bright future bought at a price that allows us to make money over time. There is nothing sexy about this, and that is by design. We are able to reduce volatility and the need for trading, thereby minimizing risk.

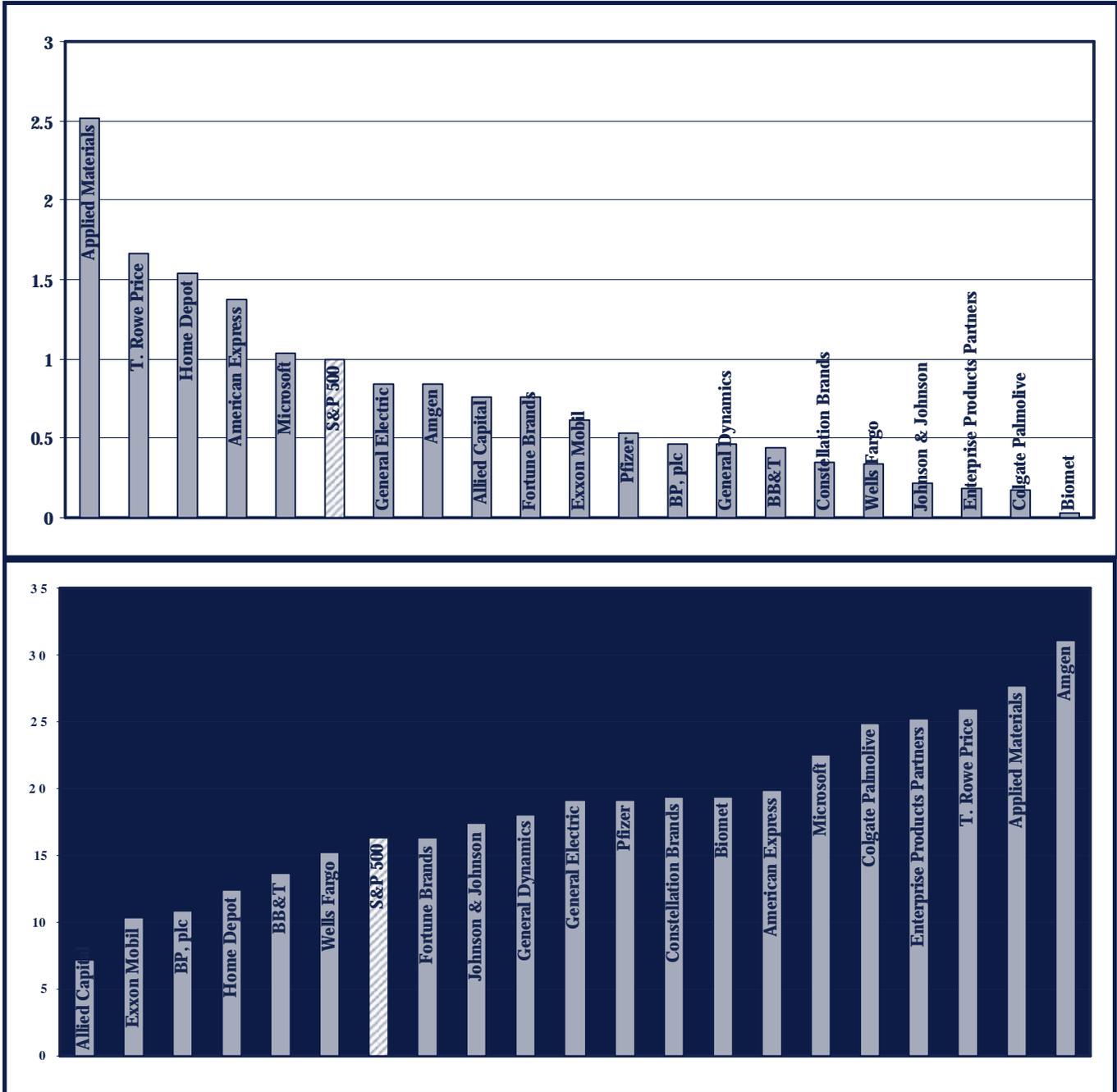
In our clients' quarterly statements, we provide the beta for every security in the portfolio. We have discussed beta several times in these pages, but suffice it to say that a stock with a beta less than one is less volatile than the

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RISK ANALYSIS

The first chart below displays the beta for the quarter ended 9/30/06 for the twenty most widely held stocks among all Tandem accounts. The bottom chart compares PE ratios for the same securities.



OUR GOAL (CONTINUED)

(Continued from page 5)

market and a stock with a beta greater than one is more volatile. The greater the volatility, the greater the risk. You will notice from the top chart above that most of our securities have a beta less than one, but not all.

Our aim is to eliminate company risk, leaving only price risk. If we buy an undervalued or fairly valued asset, it may take time for the market to appreciate its true value. We can afford to wait if we are confident we have bought the right stock at the right price.



MARKET COMMENTARY (CONTINUED)

(Continued from page 1)

fallen considerably since our last report. Most stocks in the energy sector suffered accordingly. But not all. We were able to realize a handsome profit in FMC Technologies, while Exxon Mobil and Enterprise Products Partners posted solid gains as well. In our core energy holdings, only BP took a hit - largely as a result of company specific troubles.

With widespread concerns about inflation, rising interest rates and a potential recession looming, it seems that investors are beginning to eschew excessive risk in favor of dependability. Another old adage - "the market climbs a wall of worry" - is working to our advantage. As riskier investments are punished, the safe haven of growth begins to take on a more prominent role in portfolios. Of course, we never strayed from our discipline, so we are well positioned to benefit from such a sentiment shift.

In the last issue of *The TANDEM Report*, we featured a story about the difference between investing and

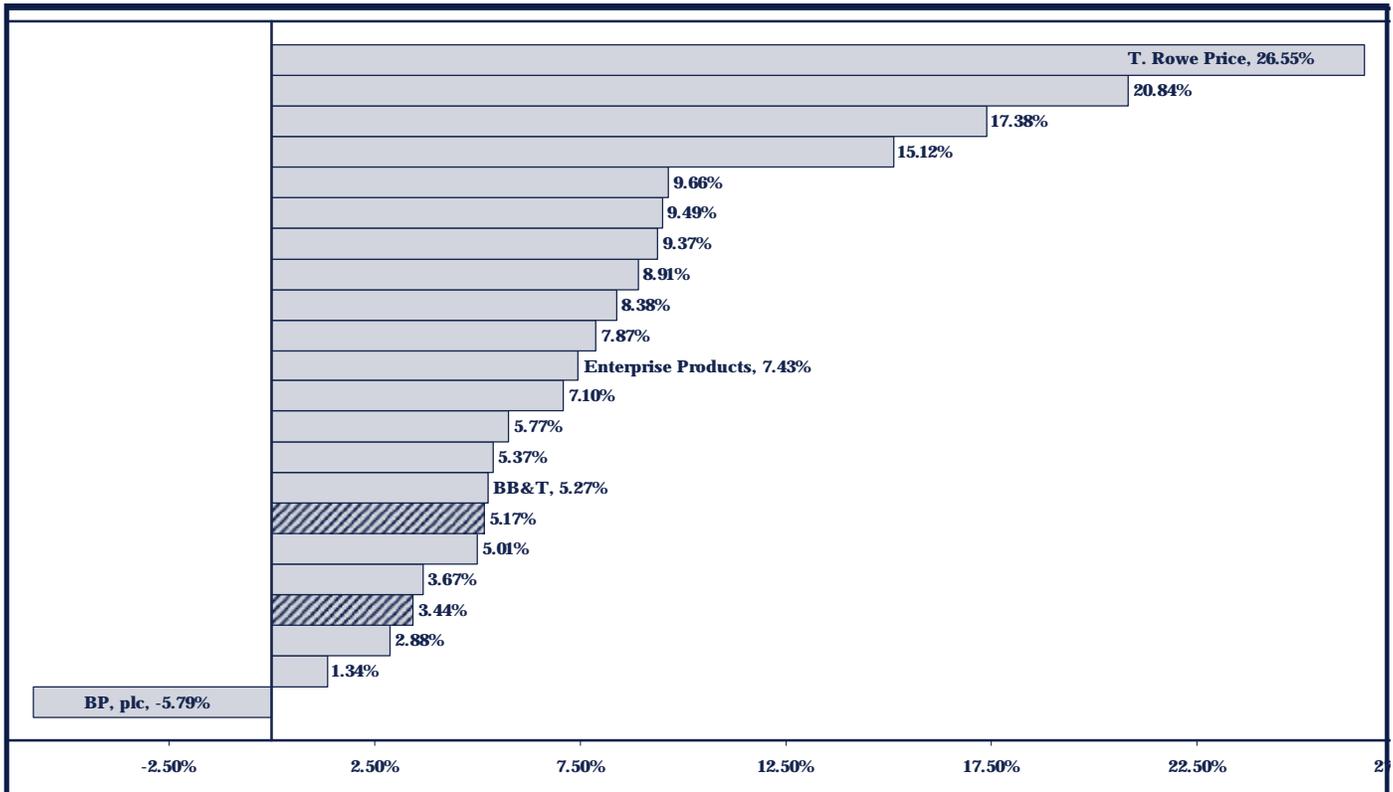
speculating. To be clear, we are investors with a long-term perspective. We typically do not focus on quarterly returns. Over the sixteen years we have been doing this, we have certainly seen better quarters than the one just ended. But this quarter just seems important. It gives confidence that our sector is undervalued and due to be appreciated. Time will tell.

We have been fortunate in that we have been able to outperform growth and keep pace with the broader market in a very difficult time to be a growth investor. But it sure has been hard work. We wouldn't mind a little wind at our back for a change.

So please indulge our enthusiasm. If this marks an important shift in sentiment, as we suspect it does, we anticipate continued outperformance for growth for quarters to come. For now, we are enjoying the first bright spot in almost five years. It's not a trend yet, but it may be a new beginning.

RETURN ANALYSIS

The chart below illustrates share price appreciation for the quarter ended 9/30/06 for the twenty most widely held stocks among all Tandem accounts. Percentage returns are based on closing prices for June 30 and September 30, 2006.





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All performance figures, charts and graphs contained in this report are derived from publicly available sources believed to be reliable. Tandem makes no representation as to the accuracy of these numbers, nor should they be construed as any representation of future performance.



*Because Working in Tandem
is a Better Solution*

Portfolio Management Since 1991

Equity

Equity/Income

Balanced

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