New Castle Investment Advisors, LLC

Creating your Dreams.

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Customized portfolio management for the discerning investor

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The Company

New Castle Investment Advisors, LLC is an independent asset advisory firm specializing in customized portfolio management for high net worth investors. The firm is completely independent and works with a select group of clients who expect individual attention and expert advice. All client information is confidential and less than one hundred families or relationships will be represented. The investment bias of the firm is value investing, or growth at a reasonable price—at below average expenses.

The principal of the firm is Mark Connolly, former Deputy Secretary of State and Director of Securities Regulation for the State of New Hampshire. Connolly has been recognized nationally as a leading advocate of securities market reform. As a former securities regulator, he led one of the first investigations into corporate malfeasance of Tyco International, resulting in a then-unprecedented securities settlement and a successful effort to replace the Board of Directors of that company. This settlement is now being used to fund a national corporate governance and investor protection program. Connolly has also been a leading advocate of mutual fund reform, taking action against several national firms for inadequate disclosure and fraud. He has been cited by the *Wall Street Journal*, *The New York Times*, *Business Week*, and the *Boston Globe* for his regulatory efforts and market reform advocacy; in addition, in 2007, he was the recipient of the Securities Enforcement Award of the Year by the North American Securities Administrators Association and the same year was awarded a commendation by the New Hampshire Governor and Executive Council for his regulatory efforts.

A graduate of Dartmouth College and the Kellogg Graduate School of Management at Northwestern University, Connolly has worked in the financial services and investment advisory business for over twenty years. Beginning his professional career in 1984 as an analyst with First Chicago, he was also associated with Wellington Management in Boston, where he served as a vice president and worked in pension fund asset management. He has also worked as a private banker at Fleet Private Clients Group, where he assisted high net worth clients establish customized investment portfolios. In addition, Connolly worked for over ten years as a senior executive at Chubb Securities and Chubb Life Insurance Company, where he managed institutional accounts and oversaw the direct investment in venture capital, real estate, and bonds and equities.

Connolly lives in New Castle and among his community activities has served as a trustee for the New Hampshire Audubon Society as well as New Hampshire Child and Family Services. He also served on the committee that developed the most recent ten-year Master Plan for the Isles of Shoals and Odiorne Point in Rye.

The New Castle Investment Advisors Investing Approach

"Long ago, Sir Issac Newton gave us three laws of motion, which were the work of genius...Sir Issac might as well have gone on to discover the Fourth Law of Motion: For investors as a whole, returns decrease as motion increases."

—Warren Buffett

Our approach is to create a customized portfolio for each client, with the goal being to outperform the general market cycle over time, with a careful eye towards managing risk as well as limiting portfolio turnover to minimize taxes and fees. It is a combination of qualitative and quantitative analysis. We start first with a top-down approach—where the economy is headed. We then transition your assets into equity and fixed income instruments, and the percentage allocated to each macro asset class will depend on such factors as your total account holdings, the degree of qualified assets or 401-k type funds you have available, your expected tax bracket, as well as your estimated holding period. For example, the older the client and/or shorter the expected portfolio holding period, the greater propensity will be to use fixed income. The type of fixed income instrument (corporate, municipal, treasuries or mixture of the three) as well as duration or weighted average maturity will depend on such factors as your tax bracket and prevailing relative interest rates and credit quality. We believe in active management of fixed income holdings because such an approach allows the portfolio to better weather the principal reducing tendency of static holdings in an increasing interest rate environment.

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The equity portion of the portfolio will consist of core holdings that mimic the key indices of the market, e.g. the S&P 500, the S&P 400, the Russell 2000. The S&P index alone accounts for some 80% of the total domestic market and will account for the lion-share of your equity holdings; the rest of the core equity structure will consist of mid-cap and small-cap equities, which will include international and emerging market holdings—and depending upon the maturation of the economy, certain weightings may be biased towards growth or value. The non-S&P equity asset classes will account for a smaller portion of the portfolio, with the percentage weightings dependant on such factors as your age, risk tolerance and prevailing economic trends.

Passive instruments, such as exchange traded funds, will often be used as they are tax-efficient and offer relatively low-expenses. Selectd fund managers may be used in some instances for smaller company holdings and international equities, as it has been shown that active management in these particular asset classes can add value (or, in stock market terms, alpha). For example, at this time, the prevalent international equity indicie (MSCI EAFE), underweights certain countries like Japan that offer long-term out-performance characteristics; or, as another example, small company managers may be used if over-concentrated industry weightings in small cap indices prevail and/or certain small company portfolios evidence strong performance because they contain companies undercovered by Wall Street analysts—as long as the given manager has low fees and the portfolio turnover is low.

A tactical overlay or opportunistic weighting may be added to certain client portfolios—opportunistic, meaning, in some instances, individual equity holdings offering considerable long-term (or in rare instances, short-term) potential or individual country/industry concentrations offering compelling value, e.g., oil exploration or oil service companies in 2004–2006. Such tactical overlays or satellite holdings will not account for more than 20% of the equity portion of the portfolio, and in most instances no one equity position will exceed 5% of total equity value.

In some client situations, alternative investments, such as private equity (taking advantage of company restructuring), hedge funds, art/collectables, and real estate may play a roll in investment planning. New Castle Investment Advisors can help guide your considerations.

Retirement Planning in Perspective: The New Castle Investment Advisors Approach

"If a man will begin with certainties, he shall end in doubts; but if he will be content to begin with doubts, he shall end in certainties."

—Francis Bacon, The Advancement of Learning

Accumulating assets and withdrawing them requires a different approach. Increasing ones exposure to bonds to generate income is an obvious portfolio re-positioning move. But this should be done gradually as one approaches retirement and exposure to stocks should remain the important focus as bond investments seldom grow enough after taxes and inflation to support retirement and to pass assets onto heirs or other beneficiaries. A bond portfolio would likely lose real inflation-adjusted value over time.

The best protection against diminishing portfolio power is to remain committed to stocks—even in retirement. However, the more exposed you are to stocks, the greater the likelihood you would be exposed to short-term loss. A 60/40 stock-to-bond split is a good starting place. The actual percentage split will be determined by your age at retirement and expected lifespan as well as such factors as need for income and any estate planning considerations. The New Castle Investment Advisors retirement approach will generally be to actively manage the bond portion of the portfolio and to orient the equity portion towards dividend paying stocks—meaning a larger orientation towards large cap stocks at the expense of smaller cap ones—and to try to meet your income needs from interest and dividends, thus preserving and growing the underlying equity value of the portfolio. In short, retirement or income planning is not a one-size fits all type of investment strategy. It all depends on the identified need for income as well as balancing income and growth and managing the portfolio with estate planning goals in mind.

Gaining Perspective

"Take all of your savings and buy some good stocks and hold until it goes up, then sell it.
If it doesn't go up, don't buy it."

—Will Rodgers

Or, to put it another way, a Nobel prize winning economist once wrote, "God must have loved the lone-wolf investor, because he made so many of them." And how has the average investor fared in recent years? Consider this: it is estimated the S&P 500 Index realized a 13% annualized return for the twenty-year period ending 2003. However, the average investor in stock mutual funds realized an annual return of just 3.5% over this same time period. Why? Simply put: the average investor makes the buy-and-sell decision at the wrong time. That is to say, the average investor reacts emotionally, and one needs perspective and patience to make money—not emotion.

The Market in Perspective

From 1872 until 2001, stocks on average achieved a compound annualized return of 9.1%. Of this percentage amount, dividend pay-outs accounted for some 4.8%, or about one-half this long-term return. And looking at more recent history, the market returns of the 1980s-1990s combined to produce the best 20-year results in the some 130-year history of the U.S. stock market. The success of these two decades is evident in that this was also the first time in the history of the domestic stock market that returns exceeded 10% in successive decades. However, because of the extraordinary asset inflation these two decades produced—particularly pronounced leading towards the Millennium—the 2000-2002 stock market decline was the third worst consecutive-year downturn in the history of the stock market and the worst since the Great Depression.

Annual Returns By Decade US Stock and Bonds Market

	1920s	1930s	1940s	1950s	1960s	1970s	1980s	1990s
Large Company	19.2%	-0.1%	9.2%	19.4%	7.8%	5.9%	17.5%	18.2%
Small Company	-4.5%	1.4%	20.7%	16.9%	15.5%	11.5%	15.8%	15.1%
Intermediate US Bonds	4.2%	4.6%	1.8%	1.3%	3.5%	7.0%	11.9%	7.2%
Inflation	-1.1%	-2.0%	5.4%	2.2%	2.5%	7.4%	5.1%	2.9%

Source: ibbotson

It is helpful to place market returns into an historic context. The period leading up to and following the Roaring Twenties were bad economic times—high inflation first and then a stock market crash, leading to the worst decade in stock market history; the period leading up to and following the fifties were average equity return decades while the post-World War 11 period generally saw strong economic growth and thus above-average stock market returns. The sixties and seventies were a period of cultural and economic transition, leading to stagflation and mixed stock market performance. The eighties witnessed the beginning of the taming of the prevailing inflationary spiral, thus launching the 1980s–1990s bull market.

What is interesting to note about the market since the eighties and until recently is the relative strength of the bond market—due largely to the harnessing of inflation. Inflation and increasing interest rates can both

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be bad for bond and stock returns. How the Federal Reserve now deals with these two fundamental economic factors will determine the strength of the market during the next several years.

In looking at the market, note that over time stocks outperform bonds. In fact, historical analysis shows equities outperform bonds 60% of all one-year periods and 73% of the time when the time horizon is extended out five years. And over twenty years, equities outperform bonds 99% of the time. This said, bonds should play a meaningful role in a portfolio. In fact, they should play a significant part—to generate income and also to serve as a counter-balance to equities. In the short-run, the stock market can be quite volatile, and over time, bonds perform differently than equities. For example, being in bonds during 2000-2002 meant a stabilizing offset to poor equity returns. In fact, bonds typically make money during bear stock markets; of note, in the past twelve of thirteen years since 1950 in which domestic stocks declined, the bond market actually increased in value.

As can be seen from the table below, particular asset classes do exhibit out-performance characteristics over various time horizons, e.g., small companies versus larger ones and value stocks versus growth stocks. But the shorter the time frame, the more uncertain it can be in judging when certain asset types will

Selected Asset Classes	Proxy	1990	1993	1995	1997	1999	2001	2003	2005
Equity:									
Large U.S. Stocks	S&P 500 Index	-3.1%	10.1%	37.6%	33.4%	21.0%	-11.9%	28.7%	4.9%
Small U.S. Stocks	Russell 2000 Index	-19.5%	18.9%	28.4%	22.4%	21.3%	2.5%	47.3%	4.6%
Hedge Funds	HFRI Fund of Funds	17.5%	26.3%	11.1%	16.2%	26.5%	2.8%	11.6%	7.5%
Real Estate Investment Trusts	Dow Jones Wilshire REIT Index	-23.4%	15.1%	12.2%	19.5%	-2.6%	12.4%	36.1%	13.8%
Large Non-US Stocks	MSCI EAFE Index	-23.2%	32.9%	11.6%	2.1%	27.3%	-21.2%	38.6%	14.0%
US Fixed Income	Lehman US Aggregate Bond Index	9.0%	9.8%	18.5%	9.7%	-0.8%	8.4%	4.1%	2.4%

Selected Asset Classes	Annual Return 16 Years	Risk (Standard Deviation)
Large U.S. Stocks	10.6%	15.5%
Small U.S. Stocks	10.7%	18.6%
Hedge Funds	9.9%	6.7%
Real Estate Investment Trusts	11.9%	15.5%
Large Non-US Stocks	5.1%	18.0%
US Fixed Income	7.4%	4.2%

Source: Zephyr Associates

outperform. Typically, the higher the relative return, the more risk or volatility (called standard deviation in statistical terms) can occur in the short run—and small company stocks are more volatile than large ones and a value stock can either be a hidden jewel waiting to be discovered or one headed towards the trash bin. Knowing when and how to balance equity asset classes as well as cash and bonds is largely what professional money management is all about. Some research shows that over 90% of equity performance in a given portfolio is due to asset allocation and not individual stock selection. Getting this balance right is more important than stock picking.

Growth Versus Value Investing 1996–2006				
Index Name	1 Year	3 Years	5 Years	10 Years
Large-Cap Indexes				
Russell 1000 ® Index	15.46%	10.98%	6.82%	8.64%
Russell 1000 ® Growth Index	9.07%	6.87%	2.69%	5.44%
Russell 1000 ® Value Index	22.25%	15.09%	10.86%	11.00%
Mid-Cap Indexes				
Russell Midcap ® Index	15.26%	16.00%	12.88%	12.14%
Russell Midcap ® Growth Index	10.66%	12.73%	8.22%	8.62%
Russell Midcap ® Value Index	20.22%	18.77%	15.88%	13.65%
Small-Cap Indexes				
Russell 2000 ® Index	18.37%	13.56%	11.39%	9.44%
Russell 2000 ® Growth Index	13.35%	10.51%	6.93%	4.88%
Russell 2000 ® Value Index	23.48%	16.48%	15.37%	13.27%
Source: Russel Indexes				

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It is important to re-emphasize that one should never put all his or her eggs in one investment basket. Statistically speaking, while it is tempting to have a portfolio made up of all small and mid-size value companies (see table above), this would not be a wise strategy because it is just not possible to predict when outperformance in any given asset class will occur. For example, while over a long time frame small stocks should produce better relative results—and value stocks should outperform growth ones—knowing when this will occur is simply a guessing game.

In fact, one prominent research study has shown that the vast majority of the so-called small cap premium can be attributed to a relatively short period of stock return, indicating just sixteen months of outperformance over a thirty-year time period. Being in the market all of the time, with some calculated tweaking, is the best strategy.

Growth and value stocks evidence limited correlation, meaning chances are when one of these asset classes underperforms the market, the other outperforms—as can sometimes be the case for large versus small stocks. Also, in considering a multi-asset class approach to portfolio management, keep in mind that investing globally is a wise diversification approach. While in recent years, developed country stock market returns have become more correlated with the U.S., there still is a diversifying advantage foreign stocks add to a portfolio. And consider that over sixty percent of the value of all stocks on a worldwide basis is now held outside the U.S.

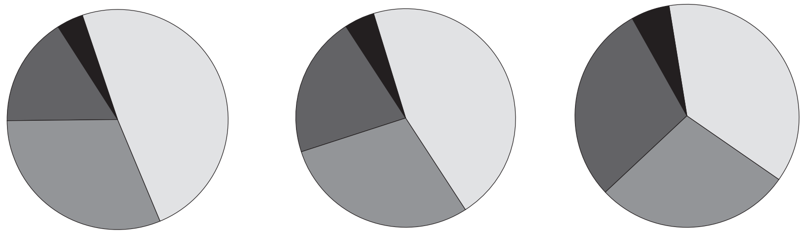
World Stock Market Capitalization 2000–2006

	2000	2003	2006
Amercas ex. U.S.	4.0%	4.5%	5.7%
United States	48.8%	45.5%	37.7%
Europe, Africa, and Middle East	31.3%	29.2%	28.4%
Asia and Pacific	15.9%	20.8%	28.7%

2000–2006 **(Compound Annual Growth Rate)**

8.78% - World Markets
4.57% - Americas
3.33% - United States
16.21% - Americas ex. U.S.
6.78% - Europe, Africa, and Middle East
21.72% - Aisa and Pacific

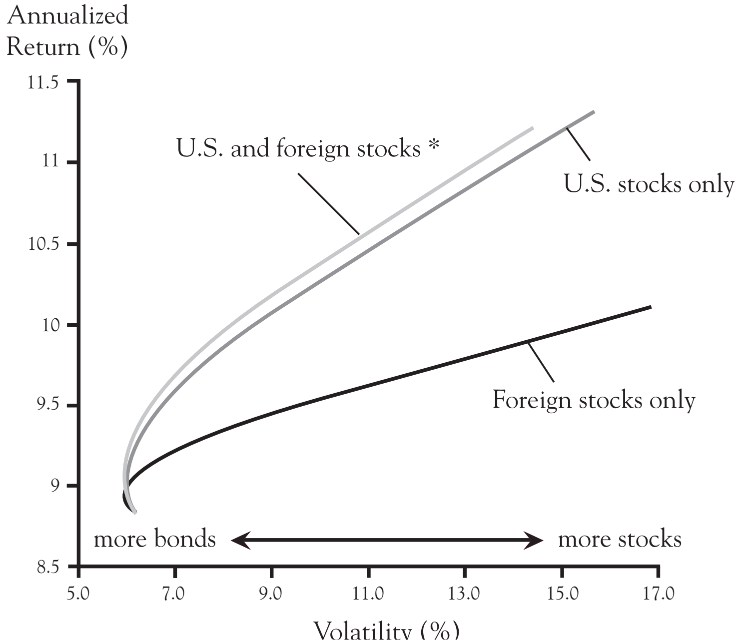
Source: World Federation Exchanges



Looking abroad means greater opportunity and lower risk. The Risk/Reward Improvement Adding Foreign Stocks graph on the following page shows how a global allocation (70% U.S. versus 30% foreign stocks) actually resulted in a greater return with lower risk characteristics between 1970–2003 versus a portfolio of just U.S. stocks or foreign-only stocks. Research has demonstrated that adding foreign equities to a portfolio can add to return and lower risk if the percent included is relatively low. This does not mean the slope of this graph will stay the same in future years or that a 30% allocation is the right choice (the direction of interest rates as well as other financial factors also have to be considered). It just means that one should include the entire market, large and small, developed and emerging, in a well-diversified portfolio.

Looking ahead, it is unlikely either equity or bonds will realize exceptional results during the next several years. In statistical terms, the reason for this is called reversion to the mean, or the market (still) self-correcting from the outsized returns of the past two decades. Everything in life, including human behavior and financial markets, achieves a certain level of expected performance or stasis. That is, over time, the expected performance of a dynamic entity reverts to an expected return or mean, and the market is still correcting from the excess returns of the 1980–1990s and other forces, such as interest rates and inflation, will

Risk/Reward Improvement Adding Foreign Stocks 1970–2003



U.S. stocks are represented by the S&P 500; foreign stocks by the MSCI EAFE Index; and bonds by five-year Treasuries.
* 70% U.S. stocks, 30% foreign
Source: Compustat, CRSP, Federal Reserve, MSCI, Bernstein

likely contribute to historically lower relative market returns for the foreseeable future.

However, trying to gauge the duration of the reversion process as well as when relative out-performance will once again kick in is an impossible task to discern. Consider this: It has been estimated that just ten trading days in a given decade can determine approximately half the return over that period of time. To put it another way, a recent study demonstrates that being out of the S&P 500 between 1973–2003 on the ten best trading days over this time period would have reduced the annual market return from 11% to 6%, and missing the top twenty days would have reduced the return to 2%.

Professional Asset Management

"Bodies in motion tend to stay in motion"

—Sir Isaac Newton's First Rule of Physics

In the short run, market performance and volatility are merely background noise. They do not mean much—except how you react—and you should not react if you have a well-developed plan. What matters most is results over-time and having the fortitude to make investments for the long-term. Internet or day-trading is a fools game, and the only true winners in the stock and bond markets are those who understand that market dynamics as well as security return characteristics are not ultimately determined by particular equity selections. The vast majority of a portfolio's return is due to asset allocation in terms of the particular mix of equities, fixed income, and cash as well as portfolio weighting in terms of company size (market cap) in addition to growth and value holdings—and shifting the allocation as an economic cycle plays out over time.

The key to investment management is balancing the prevailing trends of the market with the principal of regression analysis, or gauging risk in terms of the speed of the market to switch gears as the economy matures. This means asset class diversification, which depends on two prevailing factors: where the economic cycle is trending and where you are in terms of your own individual or family life cycle.

Customized portfolio management does not mean one-size fits all. It means understanding your individual risk tolerance and constructing a portfolio of individual equities and bonds that reflect both your life dynamics and that of the market. For example, coming out of a recession or economic slow-down, smaller companies have a tendency to outperform the overall market but the percentage allocation of small stocks in your portfolio also depends upon your need for income (small companies typically do not pay dividends) as well as shifting economic dynamics—large company stocks typically outperform in the later stages of an economic recovery because they have relative superior pricing power in a maturing economy as inflationary pressures build and interest rates increase.

Two points should be made in terms of professional portfolio construction and mutual funds. First, mutual funds are inherently tax inefficient because shareholders absorb tax hits due to fund redemptions as well as high portfolio turnover, which can approach 100% or more for some mutual funds in any given year. Lipper reports that the average portfolio turnover rate in 2004 was almost 50%; heightened turnover translates into taxes and trading fees.

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Second, mutual fund fees and trading expenses are too high. Lipper also reports that the median domestic stock fund expense ratio as of June 2005 was 1.45%; add in the trading expenses, and total costs and fees can be over 3% for many mutual funds. And what does this mean for you, the investor: sub-par performance. It is well documented that in the vast majority of instances, the S&P 500 stock index will beat out large company mutual fund performance. Studies have demonstrated that over a ten-year time period this relative out-performance translates into the S&P 500 beating over 90% of domestic mutual funds. And how does this translate into investment performance? Over a 30-year time period, an extra 1% per year return can mean 33% more money—seemingly small annual return differences, compounded over time, will result in significantly higher returns.

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