

7.40	66.10	31.39	21.43
3.90	56.22	26.66	15.99
0.39	46.33	22.59	11.90
-1.09	36.12	18.58	9.86

Cedarwinds Quarterly

Performance Updates and Market Commentary for Long-Term Investors

Vol. 2 Q3-06

Asset Class % Returns*

	9/30/06	Annualized Returns**			
	YTD	1 Year	3 Years	5 Years	
Bonds					
Short-Term	3.46	2.30	1.60	2.88	
Two-Year	3.31	1.90	1.51	3.16	
Five-Year	3.16	0.77	2.06	4.93	
Intermediate	2.84	1.72	2.53	4.73	
Domestic Stocks					
Large Market	8.49	4.85	14.25	0.39	
Large Value	11.23	10.24	20.56	9.14	
Small Cap	6.92	6.08	23.73	11.53	
Small Value	10.36	7.79	29.16	19.11	
Micro Cap	6.03	5.69	26.22	16.45	
Real Estate	24.15	13.15	26.54	19.02	
International Stocks					
Intl Large Value	19.74	15.27	30.57	11.53	
Intl Small	10.88	21.96	36.35	18.09	
Intl Small Value	13.09	23.23	40.37	22.62	
Emg Mkts	10.18	29.86	39.29	17.81	
Emg Mkts Value	16.12	30.81	47.61	25.51	
Emg Mkts Small	13.50	25.75	40.96	21.94	
Continental Small	24.04	18.40	36.18	18.19	
Japanese Small	-11.51	38.29	41.11	18.53	
Asia Pacific Small	18.71	8.00	30.44	18.65	
UK Small	23.07	12.63	29.76	12.60	

Description of DFA Index Funds

Description of DFA Index Funds	TICKER	
Short-Term Bonds	1-Year Fixed Fund	DFHX
Two-Year Bonds	2-Year Global Fixed Fund	DFGX
Five-Year Bonds	5-Year Government Fund	DFGX
Intermediate Bonds	5-Year Global Fixed Fund	DFGBX
Large Market	Large Company Fund	DFLCX
Large Value	US Large Value Fund	DFLVX
Small Cap	Small Cap Fund	DFSTX
Small Value	US Small Value Fund	DFSVX
Micro Cap	US Micro Cap Fund	DFSCX
Real Estate	Real Estate Fund	DFREX
Intl Large Value	International Value Fund	DFVX
Intl Small	International Small Fund	DFISX
Intl Small Value	International Small Value Fund	DISVX
Emg Mkts	Emerging Markets Fund	DFEMX
Emg Mkts Value	Emerging Markets Value Fund	DFEVX
Emg Mkts Small	Emerging Markets Small Fund	DEMEX
Continental Small	Continental Small Company Fund	DFCSX
Japanese Small	Japanese Small Company Fund	DFJSX
Asia Pacific Small	Asia Pacific Small Company Fund	DFRSX
UK Small	United Kingdom Small Company Fund	DFUKX

*Source: Dimensional Fund Advisors (www.dfaus.com)

The information contained herein is obtained from sources we believe are reliable, but we cannot guarantee its accuracy.

** Calculated based on calendar year results.

Past performance does not guarantee future returns.

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THE RISK - RETURN RELATIONSHIP

Part 1: RED LIGHT, GREEN LIGHT

"Buy the Ticket, Take the Ride"

Hunter S. Thompson

Introduction

This edition of our newsletter represents the first installment in an extended series which sets out to examine various aspects of how we manage the risk-return relationship in our line up of blended index fund portfolios.

The general context of our review will consider the following well-traveled tenets of investing:

- "PAST PERFORMANCE IS NO GUARANTEE OF FUTURE RESULTS"
- "INVESTMENTS MAY LOSE VALUE"
- "HIGHER EXPECTED RETURNS REQUIRE TAKING HIGHER RISK"

These three phrases, individually and in combination, epitomize the fundamental challenge facing all investors: The past is not the future, you can lose money, and there is no free lunch.

The basic problem – and essential opportunity – is that investing involves a basic leap of faith. "You pay your money and you take your chances." It is a simple, binary proposition: Investors accept the downside possibility of loss in exchange for the upside potential for profit. No pain, no gain. Investments can be losers – "in the red," or winners – "in the money" – green.



With a perfectly clear crystal ball we would never lose money – we would never be in the red, we would always be guaranteed green.

Unfortunately, this utopian world does not exist and so, as investors, we must accept risk as a fact of life. The key challenge is the manner in which we embrace risk and how we manage it as an opportunity for gain. This requires a clear understanding of the risk-return relationship associated with investing along with having appropriate analytical tools to effectively measure and intelligently manage it.

Performance Patterns

A colorized view of historical investment performance at the underlying fund level and at the model portfolio level helps illustrate how we manage the risk-return relationship. The following chart reflects the annual performance of the underlying funds used in our model portfolios. Red represents loss years and green represents profitable years.

Continued on back . . .

	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	YTD 9/30/06	
Equity Index Funds																						
US Large Company Fund	18.47	5.23	16.81	31.49	-3.10	30.12	7.32	9.63	1.29	37.07	22.64	33.09	28.68	20.81	-9.25	-12.09	-22.23	28.49	10.72	4.85	8.49	
US Large Cap Value Fund	20.27	3.87	24.05	27.46	-22.55	34.76	16.05	17.08	-4.55	38.36	20.24	28.12	11.98	4.79	10.22	3.84	-14.92	34.42	18.25	10.24	11.23	
US Micro Cap Fund	6.85	-9.31	22.87	10.19	-21.56	44.62	23.35	20.97	3.09	34.48	17.65	22.78	-7.32	29.79	-3.60	22.77	-13.27	60.72	18.39	5.69	6.03	
US Small Cap Value Fund	5.10	-4.86	30.80	11.52	-26.12	42.96	34.98	26.48	1.23	29.28	22.33	30.75	-7.30	13.05	9.01	22.65	-9.27	59.40	25.39	7.79	10.36	
Real Estate Securities Fund	19.74	-6.59	17.48	2.72	-23.44	23.84	15.13	15.44	-8.40	12.06	33.84	19.34	-15.38	-1.98	28.39	13.16	4.18	35.59	32.07	13.15	24.15	
International Value Fund	65.77	35.07	38.76	18.13	-21.63	9.76	-9.86	46.87	14.50	11.50	7.81	-3.15	14.87	16.30	-0.16	-15.26	-8.52	49.93	28.80	15.27	19.74	
International Small Company Fund	59.54	40.67	25.95	30.77	-17.94	5.83	-20.59	34.39	15.91	2.66	3.91	-23.72	8.19	21.86	-5.41	-10.52	1.91	58.78	30.92	21.96	10.88	
Int'l. Small Cap Value Fund	59.54	40.67	25.95	30.77	-17.94	5.83	-20.59	34.39	15.91	1.16	0.95	-22.72	5.27	19.04	-3.09	-4.59	5.79	66.48	34.80	23.23	13.09	
Emerging Markets Fund	62.66	37.87	32.35	62.31	-1.97	38.40	3.33	81.39	-5.72	2.15	11.41	-18.91	-9.43	71.70	-29.15	-6.78	-9.45	60.17	29.93	29.86	10.18	
Emerging Markets Value Fund	62.66	37.87	32.35	54.31	1.86	40.74	-4.67	107.23	14.62	-7.62	12.26	-15.10	-5.52	84.26	-34.16	-0.99	-1.70	76.21	39.53	30.81	16.12	
Emerging Markets Small Cap Fund	62.66	37.87	32.35	84.29	2.47	25.51	10.35	91.20	3.49	-9.17	5.77	-21.88	-3.68	85.38	-31.84	-2.59	-0.18	72.80	28.88	25.75	13.50	
Fixed Income Funds																						
One-Year Fixed Income Fund	8.92	6.44	7.38	9.59	9.10	9.83	5.18	4.39	2.46	7.98	5.81	6.00	5.70	4.60	6.73	5.76	3.90	1.61	0.89	2.30	3.46	
Two-Year Global Fixed Income Fund	8.15	5.76	6.10	9.91	8.95	8.73	4.74	3.68	2.49	7.92	7.14	5.86	6.48	4.57	6.47	6.08	5.30	1.90	0.74	1.90	3.31	
Five-Year Government Fund	13.05	3.68	6.30	9.50	10.85	14.62	7.30	8.30	-3.16	9.56	6.58	6.38	5.43	3.78	6.76	7.04	11.79	2.69	2.74	0.77	3.16	
Five-Year Global Fixed Income Fund	13.13	3.66	6.68	12.74	8.34	12.76	6.49	11.55	-4.34	16.03	10.78	8.31	8.36	3.71	6.66	5.93	10.39	2.98	2.89	1.72	2.84	

Data Source: Dimensional Fund Advisors (www.dfaus.com)

An examination of the red/green color patterns leads to some interesting observations. The 20+ year time period encompasses a total of 315 fund periods across 15 different equity and fixed income funds. Over this timeframe there were 58 periods where fund performance was negative (red) and 257 periods that recorded positive returns (green). In other words, 18% of the fund periods were unprofitable while 82% added value. From a broad asset class perspective, the fixed income fund category was profitable 98% of the time while the equity fund category was profitable 76% of the time. At the individual fund level, only two funds were profitable every year for the entire period covered – the one- and two-year fixed income funds. Using this red/green approach, the worst performing funds were the emerging markets and emerging markets value funds which were each unprofitable in seven of the 21 periods, or 33% of the time. Converting the underlying fund performance above into our consolidated model portfolio framework creates a tighter color pattern as reflected in the chart below.

STRATEGIC ASSET ALLOCATION

	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	YTD 9/30/06
Aggressive Growth	29.01	10.81	25.12	25.87	-16.43	28.53	8.88	28.79	2.35	23.00	17.39	14.13	5.93	20.86	0.36	1.38	-10.42	46.20	22.40	11.91	12.40
Growth	25.28	9.97	20.91	22.70	-11.35	25.04	8.20	24.16	1.75	20.38	15.30	12.84	6.01	17.46	1.59	2.32	-6.59	37.97	18.41	9.77	10.67
Normal	21.56	8.92	16.92	19.52	-6.27	21.54	7.53	19.62	1.12	17.77	13.22	11.41	6.07	14.05	2.80	3.23	-2.89	29.38	14.33	7.64	8.85
Balanced	19.69	8.31	15.00	17.93	-3.74	19.79	7.19	17.39	0.78	16.47	12.20	10.64	6.08	12.35	3.39	3.68	-1.09	24.96	12.26	6.58	7.92
Moderate	17.83	7.65	13.13	16.35	-1.21	18.04	6.85	15.17	0.43	15.16	11.18	9.83	6.09	10.63	3.97	4.11	0.68	20.48	10.16	5.52	6.96
Conservative	14.10	6.16	9.52	13.17	3.84	14.54	6.18	10.81	-0.30	12.55	9.15	8.11	6.09	7.20	5.12	4.96	4.12	11.30	5.87	3.39	4.97
Capital Preservation	10.37	4.45	6.09	10.00	8.87	11.04	5.51	6.54	-1.08	9.94	7.16	6.22	6.07	3.76	6.23	5.78	7.41	1.90	1.41	1.27	2.88

IMPORTANT NOTE: Cedarwinds Investment Management, LLC, a registered investment advisor incorporated in March 2004, established its first independent client investments in late 2004. Performance data shown represents hypothetical time-weighted results of Cedarwinds' model portfolios. These portfolios have been constructed using a strategic blend of up to 15 underlying index mutual funds managed by Dimensional Fund Advisors, Santa Monica, CA, and have been designed to seek certain risk-return relationships. Along with live data, simulated data has been used for performance reporting periods prior to the inception date of the underlying mutual funds used in the construction of the model portfolios. Simulated fund returns do not represent trading in actual accounts. The simulated performance results do not represent the impact that material economic and market factors might have had on the fund management decision-making process compared to the fund manager actually managing client money during that period. Simulated performance also differs from actual performance because it is achieved through the retroactive application of a strategy designed with the benefit of hindsight. Performance results reflect annual rebalancing. Results have not been audited or reviewed by any third party. Average annual total returns of live data at the underlying fund level are net of DFA fees and include reinvestment of dividends and capital gains. Indexes and simulated data used prior to fund inception date do not reflect deduction of DFA fees, trading and other expenses. At the model portfolio level, performance results reflect the monthly pro-rata deduction of Cedarwinds' standard annual investment management fee of 40 basis points; monthly fee deduction is a requirement of our software used for backtesting. Actual Cedarwinds' advisory fees are deducted quarterly, in advance. Transaction costs and account maintenance charges are not considered. The composition and variability of the S&P 500, an unmanaged market value-weighted index, and the composition and volatility of the models managed by Cedarwinds are materially different. Factors such as the size and performance of specific positions in accounts, the length of time certain positions are held, the timing of purchases and sales, client objectives, cyclical securities price trends, market trends and other factors all influence performance results materially and therefore actual client performance for any portfolio may only match model performance by coincidence. Past performance is no guarantee of future results and current performance may be higher or lower than the performance shown. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Please contact Cedarwinds Investment Management (info@cedarwinds.com) for additional information on fund and portfolio performance results, data sources and descriptions, fund prospectus and fees. Data Source: Dimensional Fund Advisors (www.dfaus.com)

Continued on next page . . .

At the model portfolio level, 11 out of 147 periods were unprofitable, meaning that 7% of the time the returns were negative and 93% of the time our portfolios added value. Four portfolios lost value two times over the 21 year period, or 14% of the time. These portfolios had relatively high concentrations of equity exposure. In our “green” view, the best performing portfolios – the Capital Preservation, Conservative and Moderate portfolios – had high concentrations of fixed income funds and lost value only one year, meaning they were profitable 95% of the time.

An important statistical inference can be easily made by simply observing the color patterns at the fund level versus the aggregate portfolio level: performance volatility is lowered and the probability of positive results significantly improves by the fund blending process. The bottom line? Through proper index fund diversification we are, *over time*, able to engineer the risk-return relationship to our advantage.

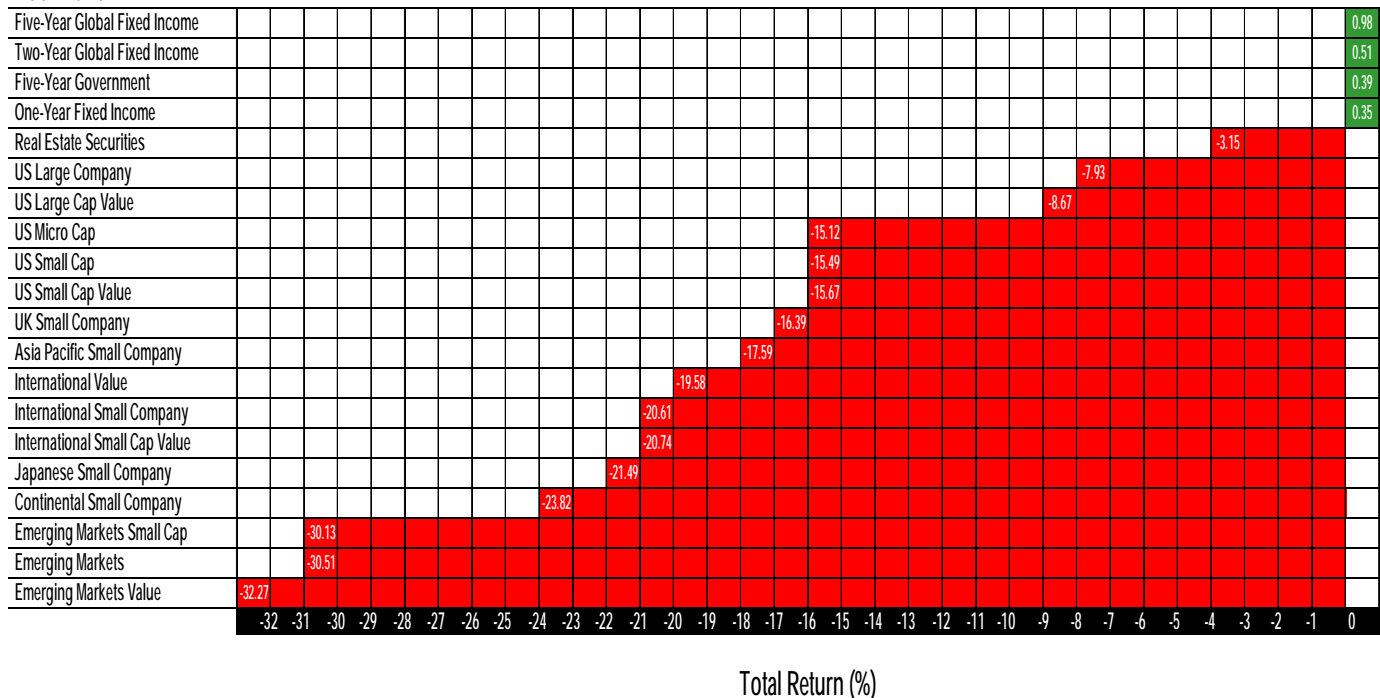
Red Light Running

The phrase “*over time*” is the operative term behind our program. Because we advocate a patient, disciplined, and fully invested approach to portfolio management, there will be occasional stretches when we must tolerate short-term “red” periods in order to benefit from the longer-term “green” periods. The key is to avoid the trap of market timing, as seductive and emotionally enabling as it may be. By consciously staying the course – “running the red light” – we are able to control the urge to slow down or stop because it is impossible to accurately predict when the light will turn green again or how long it will stay one color or the other. We do believe, however, that with proper asset allocation and fund diversification there is a certain predictability to the longer-term pattern that green wins over red. To realize the benefit of this pattern, time is our ally, discipline is our strategy and diversification is how we get the job done.

A recent example of the need for patience occurred during the second quarter of this year when all markets hit a significant downdraft starting in mid-May and running through mid-June. As the chart below depicts, over a five week period, *all* equity asset classes started a rapid descent before leveling off in mid-June, then moving up through the end of the month. In particular, the more volatile asset classes – emerging markets and international – took the steepest dive, sharply reversing the very strong run-up that had characterized their performance over the last several years. As tempting as it may have been to bail on these funds during this sudden correction, the philosophy of our program is *not* to make this type of market timing call by liquidating out of short-term, “red” movements.

May 9 through June 13, 2006

Index Fund

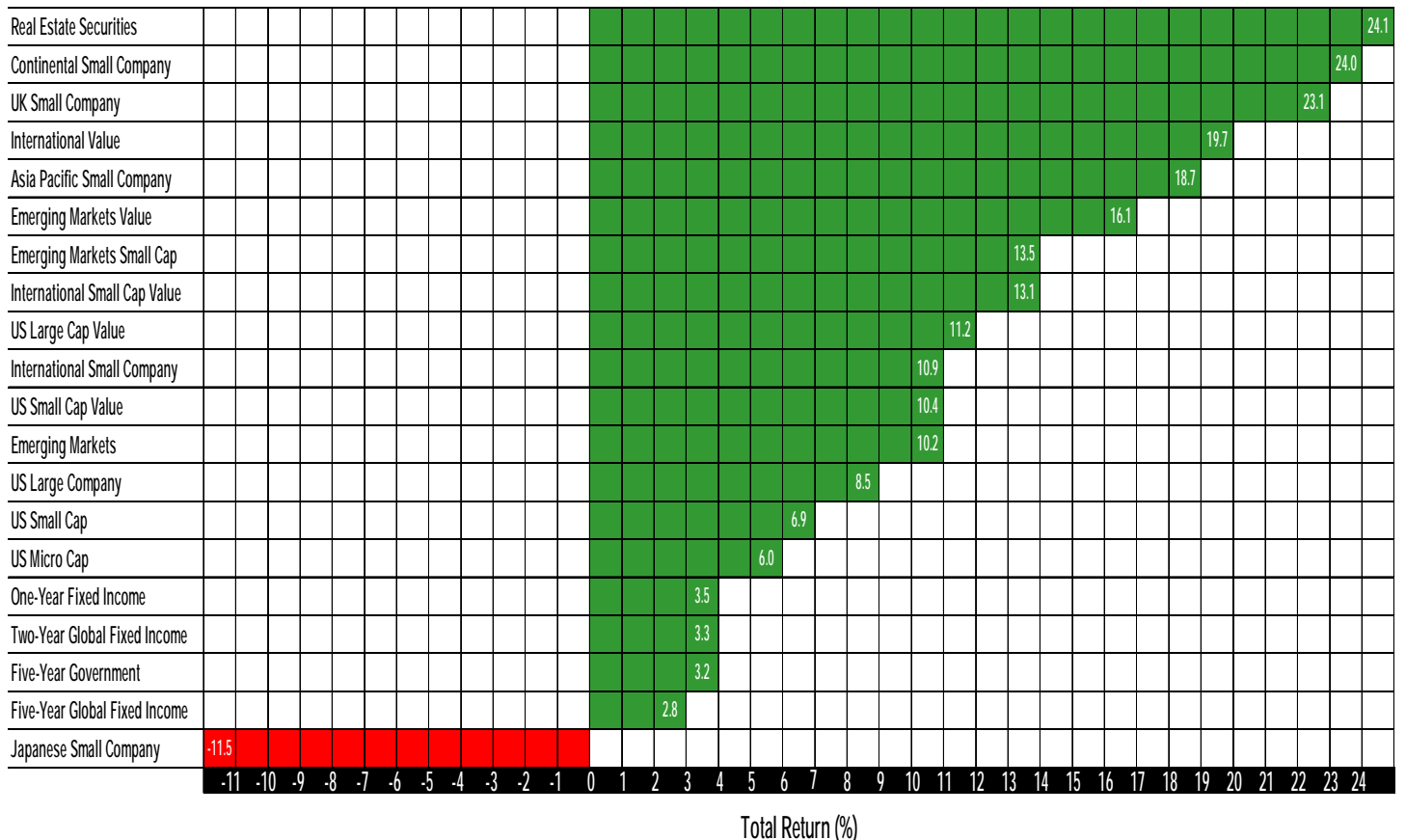


Data Source: Dimensional Fund Advisors (www.dfaus.com)

By lengthening the calendar through September YTD, despite the difficult mid-May through mid-June red period, underlying fund performance has blended into a more normal “green prevails” picture over the longer timeframe. This may offer small consolation to investors joining our program in early May, but *over time* they should be back in the green. The key assumption here is that the investment returns of the asset classes represented in our model portfolios regress to their historic mean (average) performance.

Year-to-Date September 30, 2006

Index Fund



Data Source: Dimensional Fund Advisors (www.dfaus.com)

Summary

Our “red light, green light” analogy is simplistic, but intentionally so. It serves to graphically illustrate that over time, our disciplined process of blending together diversified asset classes has served investors well by taking advantage of known and measurable risk-return relationships. Clearly, *past performance is no guarantee of future results* and *investments may lose value*. However, we believe there is a compelling predictability associated with the pattern of portfolio returns available in our structured investment management program.

Our next edition of [Cedarwinds Quarterly](#) will dig deeper into the technical nuances of fund level volatility. We will focus on the statement, “*higher expected returns require taking higher risk*” and demonstrate how our fund blending process creates longer-term performance predictability in the overall risk-return relationship of our model portfolios. In doing so, we will expand and enrich our color palette from a simple red/green template to portray the full spectrum of fund and portfolio dynamics.