

SECOND QUARTER REPORT 2005

July 2005



LUCIEN, STIRLING & GRAY
ADVISORY GROUP
"Smart Decisions About Serious Money"
4005 Guadalupe Austin, Texas 78751
Phone: 512-458-2517 Fax: 512-458-3120
www.lsggroup.com

A MESSAGE FROM THE PRESIDENT

Thomas G. Twombly



We are pleased to provide you with our report for the period ending June 30, 2005.

From an investment market perspective, the second

quarter of 2005 was a good deal better than the first, with most of the domestic equity market indexes posting positive returns, and with the long-beleaguered NASDAQ, and growth stocks in particular, showing remarkable strength in the final two months of the quarter. International markets as a whole softened, and bonds performed well as long-term interest rates remained stubbornly low.

In turn, each of our model portfolios performed well. As you will see in the second section of this report, we remain pleased with the characteristics of each of the portfolios as they are currently allocated, and are particularly impressed with relative performance of almost all of the managers we have entrusted with assets.

From the perspective of consumer protection and investment market rules and regulations, the recent period was not necessarily so positive. In spite of strong

opposition from various groups such as the Financial Planning Association (FPA), the National Association of Personal Financial Advisors (NAPFA), and others, The Securities and Exchange Commission recently adopted the so-called "Merrill Rule", which is named after the firm that supported it most vigorously. This rule now permits a broker to offer fee-based account services to clients without having to register as an Investment Advisor, and specifically, without being bound by the strict fiduciary responsibility that accompanies that important registration.

Only advice; caring, studied, intelligent, honest, long-term, on-going advice can help to address the challenges this generation and others face as we move forward

We believe this ruling can only result in greater confusion and potential mistrust among the investing public, and a greater potential for abuse among the unaware. At a time when we are only just beginning to see significant punishments meted out for fraud and financial abuse, we are disappointed in any ruling that doesn't provide greater clarity and transparency to this important profession. We are concerned that regulators have missed an important opportunity to draw a clear and necessary distinction between salespeople and true advisors. As a Registered Investment Advisor, we take our responsibilities to our clients very seriously, and we believe others who truly seek to advise and lead

Thomas Twombly
President

Walter L. Wilson, III
Exec. VP, Operations

Glenda Summers,
CFP®
Sr. Advisor Associate

Cass Grange
Sr. Advisor Associate

Mark Ward
Sr. Advisor Associate

Bryan Uecker
Sr. Advisor Associate

Megan Poore
Advisor Associate

Bleckley Dobbs
Advisor Associate

valued clients should willingly hold to the same standard, because demographic trends make the stakes very high.

The very front edge of the baby boom generation starts to turn 60 this month, and from this point forward approximately 10,000 people a day will reach that milestone. For many, major life transitions are just around the corner, and all of them involve complex financial questions intertwined with deep emotional issues. Caring for aging parents, inheriting, career transitions, retiring, providing for children and grandchildren, and trying to manage an investment portfolio that may still have to last another 40 years are but a few of the personal challenges that for many are literally moments away. The future of Social Security, the stability of Medicare, the structure of our local, state and national tax systems, pension reform, and unfunded pension liability are but a few of the national challenges that we will all face together, whether we like it or not.

These issues are inextricably intertwined with our lives. They are complex, ever changing, and unique and personal in the ways in which they will affect each of us. There is no product that can address their challenge, and no transaction that can solve the problems they pose – no matter how you choose to pay for it. Only advice; caring, studied, intelligent, honest, long-term, on-going advice can help to address the challenges this generation and others face as we move forward. With major financial houses taking steps specifically to disavow the centrality of advice to their business operations, we think a major leadership opportunity has been missed. Their loss is our gain, and we promise to do everything in our power to uphold that responsibility.

We appreciate a great deal the confidence you have placed in us, and we are honored that so many of you have continued to refer valued friends and acquaintances to us. We look forward to continuing our improvement, and to being the most trustworthy advisors we can be.

Have a great summer!

Thomas Twombly
President

CORE MODEL COMMENTS

Conservative Growth Model: After finishing the first quarter with a slight negative return, this portfolio has now pulled into positive territory for the first half of the year. With slightly more than 20% of assets allocated to fixed income managers, the model benefited from fairly solid returns in the bond markets this quarter as long-term interest rates remained low, and as investors in general remained cautious. The equity component of the portfolio, which is approximately 58% of assets, remains conservatively allocated, with 90% of holdings in large or mid-cap stocks, and 84% in value or blend positions. Within those areas, we are maintaining an over-emphasis on Consumer Goods, Industrial Materials, Energy, and Utilities (45%+) and are purposely underweighting Information Economy and Growth stocks. The modest allocation to small company stocks of about 5% of total assets was beneficial this quarter as that sector performed particularly well. With a cash position of almost 20% of total assets, the model as a whole is managing to keep pace with major U.S. indices with only half the volatility.

2nd Quarter	YTD	One Year	Lifetime
2.07%	1.49%	7.87%	43.80%
Inception Date 06/03/1999			

Core Growth Model: After finishing the first quarter with a decline of slightly more than 1%, this portfolio managed to complete the first half of the year almost even, which puts it ahead of all major U.S. equity indices on a year-to-date basis. The portfolios holdings in international stocks, which performed well in the first quarter, served as a drag in the most recent period. In particular, allocations to European equities (9%-10% of total holdings, or almost half of our international holdings) were negatively affected by the dollar's sharp rise against the Euro in May after the French vote not to join the EU. Overall U.S. equity holdings, which represent approximately 47% of total assets, provided solid performance in the recent period, particularly in May and June as markets rebounded strongly from earlier declines. We continue to maintain broad balance between Value, Blend, and Growth styles of investing, with more than 80% of equity holdings in the large and mid-cap arena. Small-cap holdings, which comprise the remaining 19%, provided a good boost and helped to counter-balance declines experienced in international markets. Cash holdings of slightly more than 11% also provided a welcome buffer to volatility.

<u>2nd Quarter</u>	<u>YTD</u>	<u>One Year</u>	<u>Lifetime</u>
0.96%	-0.12%	6.08%	26.59%
Inception Date 05/31/2003			

Growth Model: With a return of over 2% for the most recent period, this portfolio managed to erase the slight loss experienced in the first quarter, and has kept ahead of the S&P 500, the Dow, the Wilshire 5000, and the NASDAQ on a year-to-date basis. As in the Core Model, declines in international positions, which currently represent approximately 30% of total assets, were more than offset by an overweighting in small and mid-cap stocks, which rallied strongly in the latter two thirds of the period. Fixed income positions, which represent slightly more than 12% of total assets, provided a further buffer against weakness in European equities as long-term interest rates in the U.S. continued to decline. A cash position of approximately 10% of total holdings helped to reduce overall volatility, and provides opportunity funds for future use. We remain purposefully underweight in the information economy, and are looking for an opportunity to increase the holdings in the energy sector sometime during the intermediate term as an entry point presents itself.

<u>2nd Quarter</u>	<u>YTD</u>	<u>One Year</u>	<u>Lifetime</u>
2.11%	1.76%	9.69%	615.08%
Inception Date 10/16/1992			

SPECIALTY MODEL COMMENTS

Diversified Growth Model: With a return of 1.7% for the period, this model managed to regain a slight loss in the first quarter, and finish the first half of 2005 with a gain of 1.1%. Though somewhat meager in absolute terms, we remain very pleased at this portfolio's design and performance. It closes out June well ahead of all U.S. equity indices, including the S&P500, the Dow, the NASDAQ, and the Russell 2000, and also well ahead of the MSCI World Equity Index. Designed as a broadly diversified, all-equity portfolio that holds only minimal cash, the Investment Policy Committee divides its assets among ten professional money management firms. We are pleased to note that each of the separate components is performing well against its peers, and 9 out of ten have beaten their respective benchmarks soundly, providing the portfolio as a whole with great risk-adjusted returns. We continue to be rewarded for reallocations that were made at the end of 2004, and we believe we are well-positioned for the remainder of the year.

<u>2nd Quarter</u>	<u>YTD</u>	<u>One Year</u>	<u>Lifetime</u>
1.72%	1.11%	9.71%	26.61%
Inception Date 10/31/2000			

Aggressive Growth Model

With a return of almost 3.4% over the last three months, this model was the top performer for the period. The model continues to maintain a significant overweighting in international holdings (almost 50%), with Europe representing almost half of that. While this proved quite beneficial in the first quarter, for reasons mentioned previously, this produced a drag on returns in the second quarter. Nevertheless, the portfolios heavy weightings in Healthcare and Technology provided sufficient reward to more than offset for this. By far the most volatile of the portfolios we manage, this portfolio currently has more than 80% of its equity investments in the mid and small-cap arena, and 59% in the growth style box.

<u>2nd Quarter</u>	<u>YTD</u>	<u>One Year</u>	<u>Lifetime</u>
3.36%	3.15%	15.44%	64.86%
Inception Date 09/08/1998			

EDUCATION MODEL COMMENTS

UT ORP Because this model is restricted to a fairly limited list of funds authorized through the University of Texas Optional Retirement Plan, the Investment Policy Committee often finds itself somewhat confined in its breadth of choice. Nevertheless, we continue to be pleased at this portfolios overall allocation. At the close of the quarter, approximately 46% of assets were allocated to U.S. equities, 27% to international equities, and the remaining 27% to fixed income, convertible securities, and cash holdings. With this broadly diversified approach the portfolio provided a total return for the period of 1.25%, which compares favorably with the average global balanced fund. Unfortunately, this was not sufficient to overcome the declines experienced in large-cap equities in the first quarter, and the portfolio finishes the first half of the year with a decline of 1.1%. By continuing to maintain a broadly diversified approach, with an emphasis on larger companies and a slight bias towards Growth investments, the Committee believes the portfolio is well-positioned for the foreseeable future.

<u>2nd Quarter</u>	<u>YTD</u>	<u>One Year</u>	<u>Lifetime</u>
1.25%	-1.01%	5.65%	21.0%
Inception Date 08/10/1999			

Retirement Growth: With a year-to-date total return of almost 1.7%, this broadly diversified portfolio has managed so far to outpace all major equity indices for 2005, and lags only the Lehman Brothers Aggregate Bond index in total return for the year to date. The committee maintains an almost equal weighting between U.S. and international equities (34% to 36%) and has allocated the remaining 30% to fixed income, convertible securities, and cash positions. Approximately 80% of total equity holdings are in the mid and large-cap arena, with a slight bias towards Growth investments. Though the allocation to smaller company stocks provided a particularly welcome boost to portfolio returns in the most recent period, we believe that the present allocation will serve our clients in this model well as the year progresses.

<u>2nd Quarter</u>	<u>YTD</u>	<u>One Year</u>	<u>Lifetime</u>
1.75%	1.68%	12.63%	47.50%
Inception Date 06/03/1999			

Growth & Capital Preservation

With an end-of-period allocation of almost 22% cash, 24% bonds and convertible securities, 42% U.S. equities, and almost 12% international equities, the most conservatively managed of our higher education models remains broadly diversified and committed to substantially reduced volatility. Despite this, it finishes the period with the best results of the three, posting a total return of 1.98% for the quarter. This erases losses experienced in the first quarter, and puts this portfolio ahead of all major equity indices for the first six months of 2005. The portfolios smaller weightings to international positions, and particularly European

equities, were beneficial during the quarter, as those markets experienced declines in May as a result of the French decision not to join the EU. A comparative overweighting to bond positions was also beneficial during the quarter as declining long-term interest rates in the U.S. helped to buoy fixed income holdings.

<u>2nd Quarter</u>	<u>YTD</u>	<u>One Year</u>	<u>Lifetime</u>
1.98%	0.50%	8.50%	26.68%
Inception Date 11/30/2001			

Upcoming Events

Fireside Chats:

*"After years of investing religiously,
how do I make my money last?"*

Speaker: Thomas Twombly

September 1, 2005

6:30 – 8:00 pm

General Market Results

	<u>2nd Quarter</u>	<u>YTD</u>	<u>One Year</u>
<i>CPI</i>	0.57%	2.15%	2.48%
<i>DJI</i>	-1.62%	-3.65%	0.66%
<i>Nasdaq</i>	2.89%	-5.45%	0.45%
<i>S&P 500</i>	1.36%	-0.82%	6.30%
<i>Russell 2000</i>	4.32%	-1.25%	9.45%
<i>MSCI EAFE</i>	-0.75%	-0.85%	14.13%
<i>LB Agg Bond</i>	3.01%	2.52%	6.81%

Lucien, Stirling & Gray Advisory Group, Inc. is a Registered Investment Advisory firm providing fee-based asset management and planning services to individuals, corporations, trusts and foundations.

For more information about our firm, please visit our website at www.lsggroup.com • Model holdings may change due to ongoing management • Sector and style breakdown is constructed with the best available information and therefore is only as accurate as the available information • Past performance in no guarantee of future results • It is impossible to invest directly in indices • Percentages may not equal 100 due to rounding



4005 Guadalupe Austin, Texas 78751
Phone: 512-458-2517 Fax: 512-458-3120
www.lsggroup.com