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January 2006 Newsletter

Executive Summary

Review of 2005 - Most of the U.S. stock indices reported modest positive total returns during 2005. Once again, medium and small capitalization stocks out-performed large capitalization stocks and “value” stocks out-performed “growth” stocks. Stocks in the energy sector had the best returns, followed by utilities.

Review of Bridges’ 2005 Top Recommendations – The average total return of the three top recommendations was 23.75% compared to 7.53% for the Standard & Poor’s 500 Average for the January 31 –December 31, 2005 period. A strong 86% total return from Omnicare offset a weak -19% return from Tyco International.

Outlook for 2006 – We agree with economists’ forecasts of 3.0%-3.5% growth in real GDP in 2006 compared to an estimated 3.5% growth rate in 2005. Higher interest rates, slower growth in consumer demand and high energy prices will restrain growth, but expected growth from Japan and China and expected increases in capital spending should provide offsetting strength. We expect the Federal Reserve to increase the rate of Fed Funds another 0.25%-0.50% in the first quarter of 2006, and we expect the yield on the 10-year Treasury note to remain in a range of 4.0% to 5.0% during the year. Growth in corporate earnings is expected to slow to 6%-8% in 2006 from the 12%-13% growth rate in 2005. However, we believe this earnings deceleration is already reflected in the reduced valuations of most stocks.

Investment Committee’s Top Recommendations for 2006 – This year’s top recommendations include: healthcare companies, Amgen (AMGN, $73), Medtronic (MDT, $57), and Zimmer Holdings (ZMH, $67); energy companies, Nabors (NBR, $76), Chesapeake Energy (CHK, $31) and Anadarko Petroleum (APC, $103); and Home Depot (HD, $40).

Review of 2005

Most of the U.S. stock indices reported modest positive total returns during 2005. In general, corporations are expected to report another year of strong earnings growth. For example, earnings per share for the Standard & Poor’s 500 Index are estimated to have increased 12% in 2005 over the previous year. However, in most cases increases in stock prices lagged behind the earnings growth rate, possibly due to investor concerns over rising short-term interest rates, higher energy prices and slowing economic growth.

Once again, medium and small capitalization stocks out-performed large capitalization stocks and “value” stocks out-performed “growth” stocks as shown in Exhibit 1.

Exhibit 1

Stock Index	2005 Total Return
Standard & Poor’s 500	4.90%
Dow Jones Industrials	1.72%
NASDAQ Composite	1.37%
S&P MidCap 400	12.65%
S&P SmallCap 600	7.67%
S&P/BARRA Growth	3.97%
S&P/BARRA Value	5.84%
Russell 1000 Growth	5.26%
Russell 1000 Value	7.05%

Note: Total Return equals price change plus dividends

By far, stocks in the Energy Sector had the best total returns in 2005, due to sharply rising energy prices and significantly higher earnings. Utilities were the second best Sector due to a recovery in earnings from merchant energy and oil & gas segments, as well as investor interest in high yield securities. The weakest Sector was Telecommunications due to competitive pricing and slowing growth. Stocks in the Consumer Discretion Sector also lagged due to slowing sales and competitive pricing in many retail segments. A summary of the Standard & Poor’s 500 Sectors is presented in Exhibit 2.

Exhibit 2

S&P Sector	2005 Total Return	2005 Earnings Growth
Consumer Discretion	-5.1%	0%
Consumer Staples	4.0%	8%
Energy	31.4%	46%
Financials	6.4%	5%
Health Care	6.9%	7%
Industrials	2.4%	16%
Information Technology	1.1%	17%
Materials	3.6%	19%
Telecommunications	-6.5%	10%
Utilities	17.4%	11%
S&P 500	4.9%	12%

Source: Baseline

The Federal Reserve continued its plan to raise the target rate on short term Fed Funds in order to restrain economic growth and inflation. The Fed increased its target rate by a quarter percentage point at each of the eight meetings during 2005, raising the rate to 4.25% by year-end. However, long-term interest rates remained in a relatively narrow range during the year, apparently due to benign inflation indications (outside of energy) and strong foreign capital flows into the U.S. As a result, the yield curve became very flat by the end of the year with yields on short-term securities nearly equal with that on long-term securities, as shown in Exhibit 3.

Exhibit 3

	Yield			
Security	12/31/04	2005 Low	2005 High	12/31/05
90-Day Treasury Bills	2.22%	2.20%	4.08%	4.08%
5-Year Treasury Note	3.65%	3.58%	4.56%	4.35%
10-Year Treasury Note	4.26%	3.89%	4.65%	4.39%
30-Year Treasury Bond	4.86%	4.19%	4.91%	4.54%

Source: Baseline

Review of Bridges' 2005 Top Recommendations

In our January 2005 newsletter we identified our top three recommendations: American International Group (AIG, $67), Omnicare (OCR, $53) and Tyco International (TYC, $27). The returns for 2005 are presented in Exhibit 4.

Exhibit 4

Security	01/31/05 Price	12/31/05 Price	2005 Total Return	2005 EPS Growth
American International	$66.29	$68.23	+3.85%	11%
Omnicare	$30.75	$57.22	+86.46%	7%
Tyco International	$36.14	$28.86	-19.07%	2%
Average			+23.75%	
S&P 500			+7.53%	

We need to remind you that past performance should not be considered as an indication of future performance. The average total return of the three recommendations out-performed the total return of the Standard & Poor's 500 Average during 2005. However, the dispersion of the returns around the average was very wide. Omnicare performed extremely well, but Tyco International was a disappointment. Tyco's revenues and earnings in 2005 were weaker than we and other analysts were expecting, which caused the stock to under-perform. This experience demonstrates the value of diversification in a portfolio. On the whole, our top recommendations have performed well since their introduction in 2003. A summary of Bridges' top recommendations from prior years is available upon request through you account manager.

Outlook for 2006

As we enter 2006, it appears that the rate of economic growth has slowed. December retail sales were up just 0.7% over November and were up 6.4% over December 2004. However, if sales at auto dealers and gasoline stations were excluded, December retail sales increased only 0.1% over November. Consumer credit declined at a 0.4% annual rate during November, marking the first consecutive two-month contraction since June 1992. There have also been signs that the housing market is cooling. Housing starts declined 8.9% in December from the previous month, and building permits declined 4.4%. Another setback was the sharp increase in the price of oil -- back up to close to $70 per barrel during January due to political unrest in Nigeria and concerns over Iran's nuclear intentions.

However, there are also some positive signs. The spot price for natural gas has plunged during the past month from a high of over $15.00 per thousand btu to $8.70 currently, due to mild winter weather and high inventory levels. While this is still higher than the $6 per thousand btu price of a year ago, it is much more manageable for consumers and businesses to absorb. Japan, the world's second largest economy, is finally experiencing an economic revival after more than a decade of recession and deflation. Stronger demand from Japan, coupled with continued growth from China and other developing Asian countries, should help an array of companies that export products from the U.S. or that face competition from imported products. Finally, many U.S. corporations are generating strong cash flows and have reduced debt and increased cash on their balance sheets. We expect some of this cash to be spent on increased capital spending in a host of industries that need to increase and/or modernize their production capacity. This includes such industries as petroleum, mining, utilities, railroads, aerospace and industrial exporters.

Economists are forecasting more modest economic growth of 3.0% to 3.5% in real Gross Domestic Product (GDP) in 2006 compared to estimated growth of 3.5% in 2005. While growth in consumer spending is expected to moderate due to higher interest rates, high energy prices and high debt levels, business capital spending and exports are expected to pick up much of the slack. Inflation has remained subdued despite the sharp increases in energy prices. While the Consumer Price Index (CPI) increased 3.4% during 2005, the "core" CPI (excluding food and energy) increased at only a 2.2% annual rate, matching the core CPI rate in 2004. Inflation in other costs, such as labor, has been restrained due to increases in productivity and global competition. The Federal Reserve is expected to cease their strategy of continual quarter-point increases in the target rate on Federal Funds sometime in the first quarter of 2006. We expect short-term interest rates to peak in the 4.5%-4.75% range during 2006, and we expect the yield on the 10-year Treasury Note to remain in a range of 4.0% to 5.0%.

Due to modestly lower expected economic growth, analysts are expecting earnings for the companies in the Standard & Poor's 500 Average to increase 6%-8% in 2006, compared to a 12%-13% increase estimated in 2005. We believe that this deceleration of earnings growth is largely reflected in current stock prices. Equity valuations, which seemed reasonable entering 2005, appear even more attractive at the outset of 2006, both in absolute terms and relative to bonds, given our expectation of continued solid corporate earnings growth in 2006. We believe that if interest rates on the 10-year Treasury remain at or below 5% during 2006, fair value for the S&P 500 would be about 17-20x estimated earnings of $80 per share, or a range of 1360-1600. The midpoint of that range would be 1480, about 18-19% above the year-end S&P level of 1248. The average P/E for the S&P 500 over the past decade, excluding 1999 and 2000, which were outlier years for equity valuations, was 19x. The average 10-year Treasury yield over the 1994-2004 time frame was 5.5%, so the market's valuation entering 2006 seems to be discounting a rise in interest rates during the year. If interest rates stay below 4.5-5.0% during 2005, equity returns could be materially better than the 7%-9% the consensus currently expects. Even if rates do rise to the 5.0-5.5% range, high single digit to mid-double digit returns for stocks would seem possible given continued earnings growth in 2006 and the fact that equity appreciation generally lagged earnings growth in 2005, creating some level of undervaluation at the outset of 2006.

Large capitalization growth stocks performed better on a relative basis in 2005 than 2004, but in many cases saw their growth in earnings and business value exceed their share price appreciation. As such, companies with strong prospects for future growth remain attractively valued both in an absolute sense and relative to historic valuation parameters.

We continue to find attractive companies in a wide range of sectors. We continue to recommend over-weighting the health care sector, given the aging of the population in developed countries and the propensity of seniors to spend increasing amounts on health care. We also favor strong weightings in the energy and information technology sectors. On balance in 2006, we would expect to marginally decrease our exposure to consumer discretionary spending companies as the economic cycle lengthens and slows; as interest rates and energy costs rise, consumers may reign in their spending. That said, valuations in that area remain reasonable and long term prospects for companies such as Home Depot remain solid. We find valuations stretched in the utilities and telecommunications sectors and view those segments of the market as relatively unattractive.

Investment Committee's Top Recommendations for 2006

Based on our investment strategy and our knowledge of specific company fundamentals, our Investment Committee chose seven top recommendations for 2006. In keeping with our strategy of over-weighting the healthcare and energy sectors, we have included three healthcare and three energy stocks in this year's top recommendations.

Amgen (AMGN, $73) is a leading biotechnology company that has grown rapidly through the development and acquisition of new drugs. Its major drugs include: Epogen and Aranesp, which are marketed for the treatment of anemia associated with chronic renal failure; Neupogen, which stimulates the production of white blood cells, Neulasta, which reduces the risk of infection associated with the treatment of certain non-myeloid malignancies, and Enbrel, which reduces the symptoms of rheumatoid arthritis. Amgen is expected to increase earnings at a 15%

annual rate over the next five years, and analysts estimate it will earn $3.65 per share in 2006 compared to $3.21 in 2005.

Medtronic (MDT, $57) is the leading manufacturer of device-based medical therapies, including heart pacemakers, heart valves and other devices for treating heart-related disorders. Medtronic also offers therapeutic and diagnostic devices used for the treatment of diabetes, neurological, gastroenterological, urological, and movement disorders, spinal and neurosurgery, neuro-degenerative disorders and ear, nose and throat surgery. Medtronic is expected to increase earnings at a 15% annual rate over the next five years, and analysts estimate it will earn $2.54 per share in 2006 compared to $2.22 in 2005.

Zimmer Holdings (ZMH, $67) is a leading manufacturer of orthopaedic reconstructive implants (e.g. artificial knees and hips), spinal implants, trauma and related orthopaedic surgical products. Zimmer's products are sold under the brand names NexGen, VerSys, ZMR and Trilogy. Zimmer's revenues and earnings are expected to continue to grow rapidly due to the aging populations in developed countries and the development of advanced implant techniques. Analysts estimate Zimmer should earn $3.60 per share in 2006, up from $3.07 in 2005 and they estimate earnings should average 16% annual growth over the next five years.

Nabors Industries (NBR, $76) is the world's largest land drilling contractor with 600 land drilling rigs and 950 land workover and well servicing rigs, located primarily in North America. The increase in oil and gas prices and the increase in exploration budgets by petroleum companies have created strong demand for drilling rigs, which is expected to last for at least several more years. Nabors plans to significantly expand its capacity over the next several years, which, combined with sharply higher rates for drilling rigs, is expected to lead to much higher earnings for the Company. Analysts estimate that Nabors should earn about $4 per share in 2005, $6 per share in 2006 and $8 per share in 2008.

Chesapeake Energy (CHK, $31) is a large independent exploration and production company that primarily owns natural gas reserves in the U.S. The Company acquired large tracts of drillable acreage over the past five years, which should enable it to expand its future production of natural gas at an estimated annual rate of at least 15%. Analysts estimate Chesapeake Energy should earn $3.45 per share in 2006 compared to $2.50 in 2005.

Anadarko Petroleum (APC, $103) is one of the largest U.S.-based independent oil and gas exploration and production companies. Anadarko's reserves are nearly evenly divided between oil and natural gas, and are primarily located in North America. Management expects to increase its production of oil and gas at a 5%-9% annual rate over the next five years. Analysts estimate Anadarko should earn $12.35 per share in 2006 compared to $10.25 in 2005.

Home Depot (HD, $40) is the largest retailer of building materials, home improvement products, and lawn and garden products in the U.S. Home Depot and competitor Lowe's control approximately 20% of the U.S. market, and they have been aggressively increasing market share at the expense of smaller retailers. During the past three years, CEO Nardelli has centralized certain administrative functions, which has improved efficiencies and profit margins. In addition, Home Depot recently broadened its strategy by acquiring companies that supply professional contractors, which should supplement growth in the future. Analysts estimate that Home Depot will grow earnings at a 13% annual rate over the next five years. Earnings per share are estimated to increase 13% in fiscal 2007 (ends January 2007) to $3.03 compared to $2.67 in the current fiscal 2006.

These companies represent only seven out of the 20 to 40 stocks that we typically hold in a client's equity portfolio and the 90 stocks that currently are on the Company's Comprehensive Approved List. The Investment Committee has chosen the above companies as their top recommendations because they believe that they offer the most compelling combination of strong long-term fundamentals and an attractive current price. However, that doesn't mean that these stocks will be placed in every client portfolio. Because of the unique requirements of each account due to differing client objectives, tax issues, and existing security or industry concentrations, we may decide not to own some of these securities in certain accounts. Consequently, a recommendation in this letter does not assure the inclusion of that company in your portfolio.

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