



221 Delta Ct. #4
Tallahassee, FL 32303

Phone: (850) 425-1110
Fax: (850) 386-1188
Web: www.RedHillsCapital.com

Visit us at
www.RedHillsCapital.com

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Independent Advice
Individual Solutions

THE FUN(NY) PAGES

Why We Resurrected the Newsletter

We took a few issues off to focus on some other marketing angles, but the time has come to bring the newsletter back out of the closet. There were several reasons for doing so, and we'll share a few of them here.

- ◆ Because Ross threatened us if we didn't
- ◆ Because Richard can't scream for 60 minutes like Jim Cramer
- ◆ We vowed to write a newsletter every time gas went up by a dollar
- ◆ William's book deal for "Harry Potter becomes Judge Potter" got mired in lawsuits



But most importantly....

- ◆ Because our clients asked about it.

TALLAHASSEE'S REAL
MONEY MANAGERS

RED HILLS REVIEW

Spring 2006

Volume 6, Issue 1



WILLIAM C. LAMB, JR.
RICHARD M. O'LEARY
ROSS P. OBLEY, CFA

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Upcoming Dates of Importance

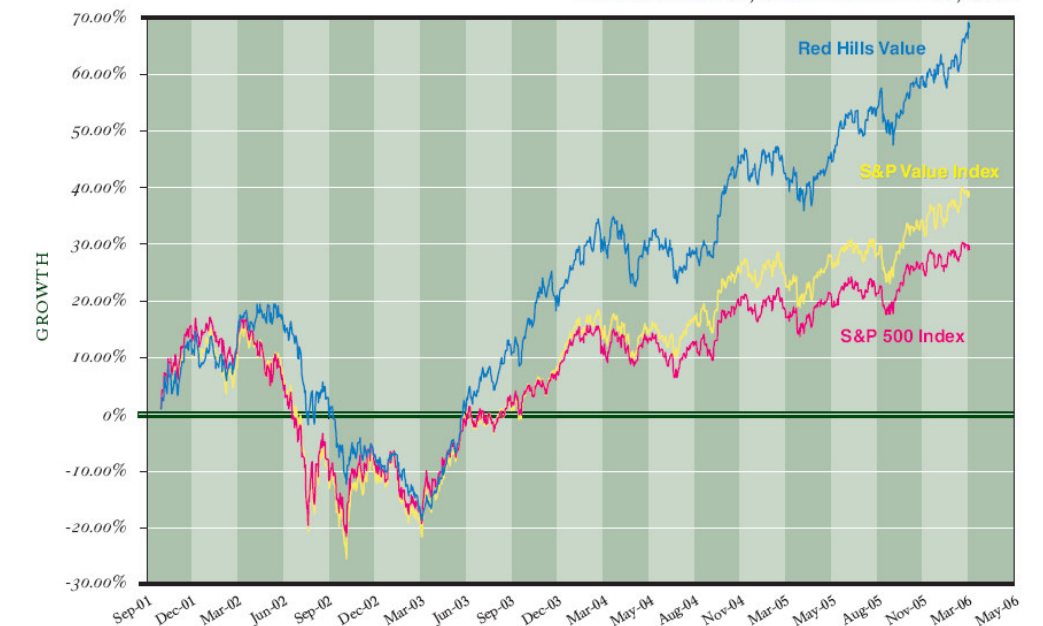
- June 13, 8:30 Retail Sales
- June 14, 8:30, Consumer Price Index
- June 15, 8:30, Jobless Claims
- June 20, 8:30, Housing Starts
- June 22, 10:00 Leading Economic Indicators
- June 26, 10:00 New Home Sales
- June 27, 10:00 Existing Home Sales; Consumer Confidence
- **June 29, 2:15PM FOMC Rate Announcement**
- June 30, 8:30 Personal Income / Personal Spending; (9:50) Consumer Sentiment
- July 3, 10:00 Construction Spending
- July 5, 8:30, Auto & Truck Sales; (10:30) Crude Inventories

RED HILLS VALUE

WELCOME ROSS!

Red Hills is proud to welcome aboard Ross Obley, CFA. Ross comes to Red Hills from Capital City Trust where he served as Chief Investment Officer. We are excited about this move and view this as a major step in bringing consistent, quality management to our clients' portfolios.

Red Hills Value Equity Portfolio
SEPTEMBER 26, 2001 – MARCH 31, 2006



| | RHV | SVX | S&P 500 |
|---------------------|----------------|---------|---------|
| 3/31/06 | | | |
| Since Inception | +68.27% | +38.13% | +28.58% |
| 1 Year | +19.31% | +12.46% | + 9.60% |
| 3 Year (annualized) | +27.01% | +19.23% | +15.14% |

The Red Hills Value portfolio represents a basket of equities selected by Red Hills Capital. As securities are added or subtracted from the basket, corresponding purchases or sales are made in individual accounts. The Red Hills Value portfolio is best suited for clients looking for capital appreciation and should be used as part of a well-developed asset allocation strategy.

Accounts are insured to the first \$500,000 (including \$100,000 cash) by SIPC (Securities Investor Protection Corporation) and to the account balance by private insurance held by RBC Dain Rauscher. Trades are executed through Kaplan Securities, member Boston Stock Exchange, NASD, SIPC, Clearing and Custodial services by RBC Dain Rauscher. Past performance is no guarantee of future results. Red Hills Value data from Marketocracy, S&P 500/Barra Value data from Reuters. Both data sets represent indices and not actual accounts. S&P data do not include dividends. Red Hills Value performance is net of fees.

Also of interest: the Beta (a volatility measure) of the portfolio was 0.66 compared to 1.00 for the S&P 500, indicating more stable growth than the S&P 500.

Our assets managed in Red Hills Value have reached a record high. Please tell a friend! Help them join Tallahassee's winning investment team.

MARKET COMMENTARY

FED WATCHING

“When you invest in a business, especially in a start-up business, you invest in the people.”

Michael Egan

When will the Fed be finished?

The Fed has raised the federal funds rate 0.25% at 16 consecutive meetings and it now stands at 5.0%. Depending on the economic report *du jour*, market sentiment fluctuates regarding whether or not a fed funds increase is forthcoming at the next Federal Reserve Open Market Committee (FOMC) meeting in late June. The FOMC must weigh nascent signs of economic slowing with the potential for worsening inflation. The federal funds futures market places a 48% likelihood of a .25% June increase. The question is...“when will the Fed be finished?” The answer has implications for both the stock and bond markets, and should be “soon” unless unforeseen inflationary pressures develop. Adding uncertainty to the mix is the impact of new Fed Chairman Ben Bernanke and what his presence means to monetary policy.

On its web site, the duties of the FOMC are defined as “promote economic growth, full employment, stable prices, and a sustainable pattern of international trade and payments.” What the web site omits are current Fed opinions regarding each goal and the relative importance assigned to each of those priorities. Adding complexity is the fact that achieving one of the goals may come at the expense of one of the other targets. For example, economic prosperity and/or full employment correlates with upward wage pressures and may work against stable prices.

The principal tool of monetary policy is adjustments to the federal funds rate. The Fed expects to elevate the overall cost of credit

throughout the economy by raising the target overnight interest rate financial institutions charge each other. The challenge facing the FOMC is to slow the economy to a sustainable growth rate while not going too far causing a recession. The task is made more difficult because there is a lag time, estimated at approximately nine months, between a rate hike and its economic impact.

Right now, we’re benefiting from a sound economy with only the earliest hints of possible slowing. Corporate earnings continue at very high levels, the 4.6% unemployment rate is close to full employment according to economic textbooks, and the consumer is still spending. The biggest unknowns are the degree of inflationary pressures and when the consumer, which represents 2/3 of domestic GDP, begins to curtail consumption. Incipient inflationary signs are apparent and both the stock and bond markets fluctuate up or down depending on whether or not market sentiment concludes the Fed is ahead or behind the curve in fighting inflation. Logically, a consumer pullback contributing to slower economic growth is likely considering the cost of gasoline, higher interest rates, and the perception of a slowing housing market.

The Fed has publicly stated that it would be data dependent in determining whether additional rate hikes are needed. A cautious posture makes sense, as economic stresses would occur if the consumer significantly cuts spending at the same time that previously enacted rate increases gain measurable traction. Our forecast: two more rate increases before year-end and a 5.5% federal funds rate signaling the end of this FOMC tightening phase.

Why I Came to Red Hills Capital by Ross P. Obley, CFA

I consider myself very privileged to have joined the Red Hills Capital team. I’ve been friends with William and Richard for years, and always made a concerted effort to stay abreast of how the firm was doing. They proved their quality ethics and commitment to client satisfaction years ago. The exemplary track record of the Red Hills Value portfolio is indicative of their stock picking skills. Joining Red Hills Capital allows me to work in an entrepreneurial environment, associate with a firm with a proven track record, and time to provide quality, personalized service to each and every client. Hopefully, my addition to the team enhances the firm’s money management experience levels and credentials, benefits the clients with expanded services and expertise, and solidifies the foundation for firm growth and success.

... (T)o provide quality, personalized service to each and every client.

RED HILLS VALUE UPDATE

The success continues! We are very happy to report that 2005 was the 4th consecutive year that Red Hills Value has outperformed the S&P 500, posting a 7.70% return (after fees) compared to the S&P’s 2.99% (without dividends) or 4.89% (total return). Through the first quarter of 2006, we managed a gain of 6.7%. Some of our performance has been due to allocations in foreign companies such as China Petroleum (SNP) and EnCana (ECA) as well as some domestic commodity-sensitive positions like copper producer Phelps Dodge (PD). On the negative side, we abandoned a long-term holding: Fresh DelMonte Produce (FDP). Unfortunately for us, some issues of corporate management coupled with a weak market for their fruits compelled us to sell. A sale, but not a negative, was the dropping of our position in United Healthcare (UNH). UNH entered the portfolio as a result of their acquisition of long-time holding Pacificare Health Systems (PHS). Red Hills Value Investors received 110 shares of UNH for every PHS share they held as part of that acquisition. We sized up UNH on its own merits and could not justify its being part of the value portfolio. As a result, we unloaded the position back in February fortuitously missing some of the debacle that UNH has become mired in as a result of its stock option pricing procedures.

Recent additions to the basket of stocks include: Kindred Healthcare (KND), Honda Motors (HMC), and an increased position in Sanderson Farms (SAFM) a poultry producer that had sold off to extreme levels on bird-flu worries. We

happily picked up extra shares in the \$20 range and are keeping a close eye on the company, their performance, and the global avian flu situation.

As to what lay ahead, the portfolio remains sensitive to swings in energy and commodity prices. While we believe the prices for both are more likely to maintain or increase than they are to decrease over significant time frames, we are willing to cut those positions should the market environment make the investments untenable. In addition, we continue to keep a special eye out for companies that profit from the aging of America’s baby boom generation. Father Time waits for no man, so we may as well profit from his steady march if we can’t delay it! In addition, companies that cater to America’s increasing obesity issue remain on our radar. Be it in orthopedics, diabetes management, or other related health fields, we believe this to be a long-term opportunity for investors. As a result, we continue to maintain approximately a 10% cash position in Red Hills Value. This money is set aside for extraordinary buying opportunities and to provide a volatility cushion offsetting the effects of the aforementioned energy and commodity holdings.

The bottom line is we remain committed to selecting quality companies that offer value to our long-term investment clients. We hope the string of excellent performance remains unbroken. Stay tuned for updates as events unfold!

“A good reputation is more valuable than money”

*Publilius Syrus
(100 BC)*

Father Time waits for no man, so we may as well profit from his steady march

Featured Stock: Kindred Healthcare Inc. (KND)

The highlighted stock in this issue is Kindred Healthcare (KND on the NYSE). Kindred was bought on March 2 (at \$21.64/share), when it was trading just below its book value (0.98 Price/Book ratio). A company’s book value is defined as its total assets minus intangible assets and liabilities such as debt. A company’s book value might be more or less than the market value of the company. However, we use low book value ratios as one of the metrics by which we identify undervalued stocks. KND was also trading at a Price/Earnings Ratio (PE) of 7.8. We see a \$30 stock price as a viable target for KND when we compare this stock to others in its industry.



The featured stock is presented for informational and educational purposes only and does not constitute a recommendation to buy or sell the security. Red Hills may be long or short the Featured Stock or any other investment listed in the newsletter. NEVER buy a stock based on what you read in this, or any other newsletter. Individual equities should form part of a balanced asset allocation and are subject to substantial risk.