January 9, 2007

Dear Friends,

Our investment results last year were achieved in a market environment that adhered closely to our expectations as expressed in recent quarterly letters. The S&P 500 Index rose 13.6%, returning 15.8% with dividends reinvested. The Dow Jones Industrial Average rose 16.3%, ending the year near an all-time high. Bond investors had less to celebrate as the Lehman Government/Corporate Bond Index returned just 3.8% for the year, consistent with our long-held view that bonds are fully-priced. Factors propelling shares higher included a pause in the Fed's interest rate increases, continued strong corporate profits and a decline in energy prices.

In this positive climate for stocks, few investment managers beat the S&P 500 or the Dow Jones Industrial Average, according to press reports. Even Bill Miller, manager of the Legg Mason Value Trust and one of the smartest investors we follow, failed to extend his 15-year streak of beating the S&P 500, ending the year up only 5.9%. We believe a primary reason for the failure of many managers to outperform the market last year was the relatively strong performance by high-quality, larger-capitalization stocks that have the biggest weight in the major indexes. Consistent with this theme, we initiated positions in Legg Mason, Nestle, McGraw-Hill, Harley-Davidson, ConocoPhillips and American Standard.

Long-standing clients are familiar with our firm's adherence to the principles of value investing, which underlie our approach to portfolio management. We seek companies managed by high-integrity owner-managers, who run the business for the benefit of shareholders. We invest in companies and industries that we understand, characterized by recurring revenue, high returns on capital and relatively low cyclicality. Our portfolio companies tend to have sustainable competitive advantages, what Charlie Munger refers to as a "moat." Finally, we aim to buy stocks at attractive prices, as measured by low multiples of price to earnings, tangible book value or cash flow. Even the best company bought at too high a price can produce a disappointing investment result. We invest relatively more capital behind our highest conviction ideas. Our strategy aims to minimize the risk of significant capital loss while achieving positive results.

One way to uncover promising opportunities is to look closest at those companies and industries that have under-performed the market, are misunderstood or do not fit neatly into institutional portfolios (result of share price too high, float too small, no earnings guidance, etc.). Last year we found a number of attractive opportunities in the financial services and branded consumer industries. Our largest individual holding, Berkshire Hathaway, rose 24% in 2006 as investors shifted their attention from temporary concerns such as hurricanes, Buffett's gift of stock to the Gates Foundation or the complexity of Berkshire's subsidiary businesses, toward the company's high and growing intrinsic value. Markel Corp., also an insurance company, rose 51% last year as investors overcame fears of potential weather-related losses and warmed to the company's underwriting discipline, its defensible niche in specialty insurance and its exemplary investment record. The Dutch brewer Heineken appreciated 50% in 2006 as investors weighed the company's valuable brands, leadership position in emerging markets and successful restructuring efforts more heavily than the consensus view of beer as a mature product category. Each of these stocks contributed to our positive results last year.

A glance at widely-owned growth stocks that disappointed investors in 2006 helps make the case for going where others are not. Whole Foods Market, Advanced Micro Devices and Yahoo each lost more than one-third

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of their market value last year. Many technology and healthcare stocks fell, and even Google trailed the S&P 500 and Dow Jones indexes for 2006. As is so often the case investors who favored less glamorous businesses generally did better than those following the stampede into high-profile growth stocks. Value investing will go in and out of fashion (mostly out when stock markets are soaring) but we believe it is the only time-tested, sensible way to invest. The merits of such an approach are best seen when markets stumble and, as usual, we see reasons to be cautious.

In sharp contrast to 2002, when many investors were negative on the prospects for U.S. equities *after* a three-year bear market that sent the S&P 500 Index falling more than 45% from its high, today such pessimism is hard to find. Paradoxically, widespread bullishness is a contrary indicator, and we believe there is too much optimism in certain capital markets. Since 2002 the S&P 500 has appreciated more than 60% without experiencing a down year – this despite a calamitous war in Iraq, massive fiscal and trade deficits, soaring commodity prices and geopolitical tensions. The yield curve remains inverted, meaning that long term interest rates are lower than short term rates, which could suggest a period of economic weakness. We expect long term rates to rise in the months ahead and, as a result, economic growth to slow more sharply than is currently expected. With 95% of the world's population living outside the United States, it doesn't take too much insight to believe that international investments will continue to attract capital and that the competitive landscape for U.S. companies will intensify. To manage and prosper in this economic environment, our clients' portfolios are more heavily-weighted in large-cap stocks than they were several years ago, and they contain more international stocks. For the majority of our clients with balanced portfolios, we hold modest reserves in the form of cash and short-term bonds, favoring investment grade credits in the current environment of tight spreads.

Our quarterly letters reinforce a basic tenet of our firm, which is to provide excellence in investment management at a fair fee, coupled with objective, insightful wealth management advice. On the investment side, you can count on our firm to manage your assets as we manage our own, with careful attention to risk and a keen eye for opportunity. The performance of our equity Composite is summarized below[1]:

	12/31/02 – 12/31/06	2006
DWA Equity Composite	+68.8%	+15.6%
S&P 500 (Index only)	+61.2%	+13.6%

With respect to wealth management advice, our family and individual clients benefit from reviewing key planning matters, including gifting, trusts and estates, with us. Please give us a call if we can be helpful with your investment needs. In the meantime, best wishes for a healthy, happy and profitable New Year.

Sincerely,

Jay Winthrop
Robert R. Douglass, Jr.
Lea Highet
Charlie Howard
Arthur Y. Allen

[1] Equity composite includes all fee-paying, discretionary accounts that provide data to Douglass Winthrop's Advent system with an equity weighting of 65% or greater and a total value of $100,000 or greater on the last day of the prior quarter. Equity composite results are calculated using a "Time Weighted Rate of Return" methodology, are gross of fees, and include the reinvestment of dividends. The equity composite excludes accounts that maintain legacy positions not initiated by Douglass Winthrop where these positions comprise more than 25% of account's

value, and accounts open for less than one quarter. Unless stated otherwise, results for benchmark indexes are index-only returns. Past performance is no guarantee of future performance. Results are unaudited.