MARYLAND CAPITAL ADVISORS INC.
◇ Registered Investment Advisory ◇

INVESTMENT COMMENT — June 14, 2006
Update on our Passive, Asset Class Balanced Strategy

Equity and commodity markets have moved sharply lower since May 10th, when US stock markets were at the highest levels of the year. In just the last 23 trading days, the DJIA and S&P 500 indexes posted over 7% declines – but they represent only large, domestic stocks. Note the larger, double-digit losses in other equity asset classes. The best-performing non-bond asset class *declined* 2.8% (REITs), while Emerging Markets stocks lost over 25% of their value in less than a month!

What happened? As clients have heard me say, the markets are "de-leveraging". The Federal Reserve has incrementally raised interest-rates since June 2004 and we seem to have, finally, reached a tipping-point that caused leveraged investors to sell their positions and repay their margin loans. Investors have increasingly used borrowed money (i.e. leverage) to pursue "enhanced" returns and have done so across all asset classes – even the riskiest (i.e. Emerging Markets, Commodities, etc).

What are the implications for our passive asset allocation strategy? Recall that, as stated in our client Investment Policy Statement, we seek to diversify portfolios by combining investments whose long-term returns have low or negative correlations with one another. When markets experience an overall loss of "liquidity", short-term returns among many asset classes are more highly correlated (move toward 1.0). The effect of higher correlations means that short-term portfolio returns will be more volatile, until correlations normalize.

Table 1: Asset Class Performance
May 10 - June 13, 2006

		Total Return
EQUITIES	Large Cap Growth	-7.7%
	Large Cap Core	-7.6%
	Large Cap Value	-7.3%
	Mid Cap Growth	-12.2%
	Mid Cap Core	-10.0%
	Mid Cap Value	-7.8%
	Small Cap Growth	-15.5%
	Small Cap Core	-13.5%
	Small Cap Value	-11.5%
	Large Cap International	-15.5%
	Emerging Markets	-25.4%
ALTS	Real Estate Investment Trusts	-2.8%
	Commodities	-9.9%
	Precious Metals	-20.5%
	Hedge Fund of Funds	N/A
BONDS	Treasuries 1-3yr	0.4%
	Treasuries 7-10yr	1.3%
	Treasuries 20-30yr	2.9%
	Treasury IPS (TIPs)	0.8%
	Mortgage-Backed (MBS)	0.7%
	Inv Grade Short Duration	0.5%
	Inv Grade Intermediate	0.9%
	Inv Grade Long Duration	1.9%
	High Yield Intermediate	-0.7%
	Municipals Short Duration	0.4%
	Municipals Intermediate	0.7%
	Municipals Long Duration	0.9%
	International	-2.3%
	Emerging Markets	-3.3%
	Floating-Rate	0.1%
INDEX	S&P 500	-7.3%
	DJIA	-7.8%
	NASDAQ 100	-10.6%
	US Domestic Bonds	0.9%
	US Dollar Index	2.3%

Source: Bloomberg L.P.
Note: Returns include reinvested dividends.

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While it is impossible to accurately "market time", the discipline of asset allocation requires periodic rebalancing of client portfolios – which means that we may be selling bonds and buying stocks in some client accounts as equities fall. This rebalancing, over time, enforces a discipline of "selling high and buying low". In doing this, however, we recognize that the markets may still be in the process of awakening to the significant "opportunity cost" of investing in non-bond asset classes. Currently, an investor can purchase a 1-year US Treasury bond at a price to yield 5.17% – not a bad risk-free return.

Two questions clients might be pondering:

1. Are the specific investments in my portfolio performing as well or better than other passive investments?
2. Is my portfolio performing well versus actively-managed funds that seek to "beat the market"?

My response to question #1 is client-specific. Our Quarterly Client Portfolio Report details the performance of our selected investments versus other funds and benchmarks – I will review this with each client.

In response to question #2, despite the long-standing academic work that refutes the notion that anyone can predict market movements consistently, there are always Wall Street "experts" claiming they can. The evidence in Table 2 indicates that most active managers didn't expect this market move – at all. It is also interesting to note that the index of those hedge funds that supposedly manage downside stock market risk by shorting stocks ("Long-Short Equities") didn't seem to be "hedged" at all.

Table 2: Active versus Passive Strategies	Return YTD	Return 5/10-6/12
Passively-Managed		
Vanguard 60/40 Allocation	-0.1%	-4.1%
DFA 60/40 Allocation	+2.0%	-5.9%
Actively-Managed		
Hedge Fund Index – "Long-Short Equities"	-0.1%	-6.5%
Hedge Fund Index – "Global Macro"	+1.4%	-6.8%
Legg Mason Value Trust	-7.4%	-5.6%
Merrill Lynch Global Allocation	+2.7%	-8.1%
Morgan Stanley Strategist	+3.0%	-5.2%
UBS Global Allocation	+1.0%	-5.9%

Source: Bloomberg L.P., Hedge Fund Research Inc.
Note: Returns are calculated inclusive of reinvested dividends.

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