CAZ INVESTMENTS

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2nd Quarter 2005

CAZ CORNERSTONE PORTFOLIO
Quarterly Update

Solid But Unexciting...

The 2nd quarter was a solid quarter in many respects (i.e., corporate profits), but it was not particularly exciting. The geo-political environment remained relatively stable during the quarter, bond yields trended lower, energy prices were range bound and the dollar strengthened versus other currencies. All of this gave us a lukewarm environment in which most investors were unwilling to continue selling, and stocks were able to rally substantially off their April lows.

Our portfolios performed extremely well during the quarter, including solid out performance of our benchmarks in all areas. Year-to-date we have developed a substantial lead on the indices and will work hard the rest of the year to extend that advantage.

After seeing some of the major averages down more than 10% since January 1, we now have most stock indices trading around flat for the year. The battle being waged in the market is over valuation. Corporate profits are coming in line with, or better than, expectations. Therefore, the decision becomes what level the market is willing to pay for the company cash flow streams.

In our 4th quarter letter, we talked about this struggle and how we felt it would play out. We stated that we expected 10-12% cash flow growth, with a possible pullback in valuations of 5-7%. The result would be a market that potentially could rally by 5-7% plus dividends. Nothing has occurred to cause us to change that forecast. So far, the valuation correction appears to have been front loaded to the beginning of the year while corporate cash flow is coming in almost exactly where we expected. As we write this, it appears that the cash flow growth and the expectation for solid 2nd quarter earnings are being factored into the valuation equation. In spite of the terrorist bombings in London, the market is making a new four-year high. Again, nothing dramatic has occurred, but stocks are being given credit for their solid cash flow growth.

Barring some large unknown event, we suspect the market will continue to recognize the solid growth coming from companies and reward investors with higher prices. Several indicators are beginning to show positive trends for the first time in quite a while. One of these is the budget deficit. We have expressed concern about this several times and while it is still MUCH larger than we would like to see, it is beginning to decline at an accelerating rate. Credit for this has been given to the higher tax receipts from tax cuts stimulating new business growth and profitability. Whether this continues to hold true or not, we don't know. If the tax receipts are growing as a result of the tax cuts, then that is a trend we would expect to continue for quite awhile. This is a positive for the dollar and long-term interest rates. When you couple this with high, but stable, energy prices you begin to get a picture of slow growth with moderate inflation. This describes a good environment for stock market valuations.

As we have stated before, the fly we see in the ointment is top line revenue growth. Companies continue to deliver on expectations of cash flow, but revenue growth continues to be modest. In the 1st quarter, revenue growth was helped by the weak U.S. dollar. Now that the dollar has begun to strengthen, we may begin seeing some companies actually miss their top line targets. The question will be whether or not the valuation benefit from the strong dollar is more important than the revenue shortfall. We will be monitoring this very closely. It is imperative that companies develop new ways to grow revenue. This is essential for cash flow growth to remain strong.

As always, please do not hesitate to let us know if there is anything we can do for you. We hope all of you enjoy the remainder of your summer.

All my best,

Christopher Alan Zook
Chairman and Chief Investment Officer