BCN ADVANTAGE: 2005 ANNUAL REPORT

January 2006	BCN Advantage Act/Mgmt	100% Invested Buy/Hold	50% Invested Buy/Hold	100% Cash
Total Return:	6.93% [1 2 3]	10.70% [1 2]	7.00% [1 2]	3.30% [1 2]
Jan ' 97 = $100,000 [4]	$280,012	$225,825	$189,461	$135,334
Beta (2005):	0.49	1.00	0.50	0.00
Risk Adjusted Return:	7.08%	10.70%	7.00%	3.30%

1 Performance results are based on the Federated Kaufmann Fund (10.8% for 2005), the Vanguard Index 500 Fund (4.8% for 2005), the Dodge & Cox International Fund (16.8% for 2005) and an average money market return of 3.30%. The results may not reflect the actual performance of BCN Advantage clients. Past performance does not guarantee future results.
2 Performance results show the year-over-year change to net asset values and do not include the reinvestment of dividends (if any) other than interest earned from the money market fund.
3 Performance results are net of BCN Financial management fees.
4 BCN Financial Inc. is the registered investment advisor. Performance from January 1997 to June 1998 was provided through Quest Securities as the registered investment advisor.

2005 BCN Advantage Signals

	Date	Market	Cash
1	01/01/2005	100%	0%
2	02/22/2005	40%	60%
3	07/01/2005	40%	60%
4	10/01/2005	40%	60%
5	12/31/2005	40%	60%
	Present	100%	0%

Not for the Faint of Heart
For the major market indexes, 2005 was a roller-coaster ride in the truest sense – peaks and dips and rolls that ultimately ended (almost exactly) where the ride began. The DJIA finished -0.61%, the S&P 500 +3.0%, and the Nasdaq +1.4%.

The ride was anything but smooth. The Nasdaq staggered through 4 major swings: -13% from January to May; +16% from May to August; -8% from August to mid-October; and +8% from mid-October to December. The Nasdaq began the first 3 weeks of January by selling off 7%. After a brief bounce in February, when we made our only move of 2005 – to 60% cash on February 22nd – the Nasdaq continued its rapid decent, all the way down to 1904 on April 28th. Though this proved the low for year, it wasn't close to the end of the ride. After climbing back to 2209 by August 3rd, the Nasdaq began another steep slide, this time to 2037 on October 12th. Then, powered by a record 14th consecutive quarter of double-digit earnings, the market reversed again, finishing the year at 2205.

The first question, of course, is why we didn't take greater advantage of these swings. To be honest, I firmly believe that not moving 100% back into stocks in mid-May was a mistake. Our key indicators aligned positive, but the effects of 8 (now 13) Fed rate hikes and intransigent high energy prices had yet to impact the economy. In the absence of a clear trend, the freefall of 2000-2002 was still too fresh in everyone's mind. And this is worth repeating: tactical market timing is based on trend analysis, NOT prediction. If the course of the year proved anything, the markets of mid-May had yet to establish an up-trend.

So why did BCN Advantage clients out-perform the major indexes so significantly? Because we don't invest in indexes, and more importantly, because many of the mutual funds we recommend to our clients had outstanding performance. There was money to be made in 2005, predominately in defensive positions like natural resources (oil & gas) and precious metals. And international funds again did well. Never overlook the value of fund selection – a vital component of the BCN Advantage service. Because of outstanding fund selection, most BCN Advantage clients were able to out-perform the markets, while keeping more than half their money in cash!

What Changed?

The minutes of the December FOMC meeting, released January 3rd, the first trading day of the year, contained this key sentence: "Given the information now in hand, the number of additional firming steps required probably will not be large." On this news, the markets (which had been drifting downward in the last weeks of December and were again testing key support) roared. From our perspective, something much more important occurred: our key indicators once again aligned positive, and the major indexes all broke above their protracted trading ranges. This is the strongest green-light we have seen since April 2003, and we must interpret this as the beginning of a major new up-trend. Irrational exuberance? Possibly. But remember that Greenspan uttered those infamous words in 1996, a full 4 years before the markets finally topped.

The Wall of Worry

Our gains over the past year give us sufficient cushion to move fully into this market, which is beginning to resemble 1995-1999, the last time the Fed ended a cycle of sustained interest rate hikes. The major indexes have broken through key resistance levels and the economy appears to be firing on all cylinders – with earnings, employment, GDP and productivity all robust.

But we are proceeding with trepidation, because we know full well the underlying risks. The Fed appears to be nearing the end of its tightening cycle, with the markets expecting only 2 more rate hikes ending with the March 28th FOMC meeting. Any Fed action beyond that will be viewed with great pessimism.

Oil remains above $60 a barrel, but that appears to be last year's news. 2006 brings new concerns: A yield curve on the verge of inverting – usually a precursor of economic slowdown and possible recession. The nation's personal savings rate could well be negative for 2005, something that hasn't happened since the Great Depression. "If we can believe the numbers, personal savings in the United States have practically disappeared," wrote former Federal Reserve chairman Paul Volcker in April.

Since 1999, household debt has grown twice as fast as after-tax income, but household net worth has soared, driven by rising home prices and stock market gains. In 2006, many economists believe housing prices will flatten, breaking the cycle of refinancing that has allowed consumers to borrow and spend. Freddie Mac projects that consumers have withdrawn a record $200 billion in cash-out financings in 2005 – a figure that's expected to fall to $110 billion in 2006, potentially slowing a U.S. economy that depends on consumers for nearly 70% of GDP.

Unless the $8.2 trillion Federal debt ceiling is raised by mid-March, the U.S. "will be unable to continue to finance government operations," wrote Treasury Secretary John Snow, in a recent letter to Congress. The debt ceiling, of course, will be raised (it's been raised more than 70 times in the last 50 years). Unfortunately, the collateral damage in the face of our immense national debt (which equals roughly $27,000 per man, woman and child in the country) could be severe: the most notable casualty may well be the refusal of Congress to renew (much less make permanent) the 15% tax on capital gains and dividends. This too would be viewed with great pessimism.

Finally, this cyclical bull market that began in March 2003 is now in its 34th month, already beyond the historical average of 30 months (for the 15 bull markets over the past 75 years). Whether conditions more closely resemble the summer of 1999 or the spring of 2000 makes a very real difference, and the economic data clearly favor a more optimistic outlook – at least for now. If we are nearing the end of this current bull run, the gains over these final months could be substantial – hence our decision to become fully invested. But when the markets turn, be prepared: We will move to the sidelines at the first sign of trouble.

As always, we look forward with great optimism. We appreciate your faith and confidence. And we are eager to apply the lessons learned for your benefit.