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"People cannot stand too much reality"

Dr. Carl Jung, a founding father of modern psychology

I remember reading these words as a freshman in college and thinking, "what nonsense!"

This expert in human behavior made no sense to me at all nor did the 8:00 a.m. class start time on Thursday morning. Accordingly, my interest in "Introduction to Psychology" quickly waned.

Twenty-five years later I am wondering if perhaps Dr. Jung was correct after all and here's why:

Oil prices top $50 per barrel. Our trade deficit grows while our national debt approaches 8 TRILLION dollars…. And yet we have the fastest growing economy of developed nations, personal incomes are increasing, our stock market indices reached a 3½ year high on March 4th while mid and long-term interest rates remain at low real and nominal levels.

Just as Dr. Jung's statement confused me years ago, current events in our financial markets also seem counterintuitive to me.

"A national debt, if it is not excessive, will be to us a national blessing."

Letter to Robert Morris from Alexander Hamilton, April 30, 1781

This table shows the growth in our national debt over the past *55* years:

06/30/1950 .....$257,357,352*
12/30/1960 .....$290,216,815*
12/31/1970 .....$389,158,403*
12/31/1980 .....$930,210,000*
09/30/1990 .....$3,665,303,351*
09/30/2000 .....$5,674,178,209*
04/03/2005 .....$7,784,082,143**

**BUREAU OF PUBLIC DEBT*
***UNITED STATES NATIONAL DEBT CLOCK*

Approximately $2.8 trillion of new debt was created in the 1990's. This total represents more debt than amount of debt created in the nation's entire history prior to 1990. Each man, woman and child living in this country today owes approximately $25,000.

The good news is that foreigners continue to buy and hold U.S. debt. This fact partially explains why mid and long term interest rates remain moderate despite our burgeoning debt load. This past January alone, foreign long-term net capital flows into the U.S. was $91.5 billion.

Foreign countries export goods to our country in greater quantities than they import from us thus leading to our trade deficit. We pay for these goods in part by printing money (we spend more than we make) and issuing U.S. Treasury obligations. We then sell many of these obligations to the same foreign countries that are exporting their goods and services to us. It is a wonderfully symbiotic relationship to this point.

In 1986, foreign parties controlled approximately 15% of our outstanding debt. At the end of 2004 this percentage had increased to 44%.

Our trading partners complain that our record current account deficit threatens the stability of the global economy because it contributes to the devaluation of the dollar. If currency traders drive the value down further European and Japanese exports will be hurt.

Yet our trading partners are heavily dependent on U.S. consumption to fuel their economies' anemic growth. Approximately 50 percent of Japan's growth last year resulted from exports much of which was sent to the U.S. market. European economies are similarly dependent on the U.S. market. On balance, the deficit is a positive for many nations.

We wonder how long this trend can continue without causing long-term interest rates to increase. We wonder if Alexander Hamilton would consider our current debt situation a national blessing. At some point, a day of reckoning will arrive and we will need to address and deal with these imbalances. For now, it appears our foreign friends will continue to support our spending habits.

For our part, we continue to concentrate our efforts on managing bond portfolios for our clients.

We are pleased to report that **The Bernardi Short/Intermediate Composite** outperformed comparable indices for the first quarter of 2005. Since inception, this Bernardi composite has returned an annualized 4.97% compared to 4.69% for the Lehman 5 year index and 3.87% for the Lipper Short/Intermediate fund average over the same period of time. For complete performance results, please visit www.bernardisecurities.com and click on the **"Portfolio Management – Performance Charts" tab.**

During the first quarter, we were more successful than the general market, in part, because of our lower portfolio durations and some nice price appreciation from our "story" bond positions as credit spreads narrowed during the quarter. Portfolios were near fully invested and this added to performance; we see no reason to deviate from this approach.

Rising short and intermediate term interest rates during the first quarter caused most municipal bond funds to suffer losses according to Lipper Inc.'s first quarter total return data. According to Lipper, Inc., the average intermediate municipal fund lost – .74% during the first quarter.

Yields on 10 year "AAA" rated general obligation bonds rose approximately 30 basis points during the first 3 months of the year and now yield approximately 3.85%.

The taxable yield on the 10-year Treasury bond now stands at around 4.30%. Two months ago the bond yielded 4% so investors have seen erosion in the value of their 10-year government bond holdings in the past two months. Last June when the Federal Reserve Bank began raising short-term interest rates, the 10-year Treasury bond was yielding 4.7%. Since that time the Fed has nearly tripled short-term interest rates. Will long-term rates eventually follow?

This all seems out of the ordinary to many and perhaps it is. Time will tell us all. We know that for the time being, the bond market is not expecting interest rates to rise significantly.

We will all have to wait and see about that.

"COSTS DO MATTER….THE CUSTOMER IS KING!"

Two simple concepts.

Both have long been guiding principals at **Bernardi Securities, Inc.**

We strive to honor both as we help manage our clients' futures.

Last month I had the remarkable experience of meeting and spending an evening with John Bogle, founder of the Vanguard funds.

Over dinner, he shared many of his experiences and insights. For me, the above two statements were the most important things he shared.

I have long admired his candid and straightforward approach to running the company. Much of the group's success is a result of the principled approach he has championed for many years.

Two simple concepts both of which are familiar and important to all of us. Over the years, much of our clients' success is a result of our adherence to these two principles. It was nice to hear their importance affirmed by someone of such high stature.

We thank you for your continued confidence in our portfolio research and management process.

As always, please call us with any questions or comments.

Sincerely,

Ronald P. Bernardi,
President/CEO
April 2005