INVESTMENT OUTLOOK

March 31, 2006

In our quarterly investment reports, we frequently discuss our views on the economy, business conditions, and market prospects. Here, in the spring of 2006, our expectations have changed little from three months ago. We believe the economy and corporate profits will maintain their healthy overall growth of the past three years, but corporate expenditures and international sales are beginning to account for a larger share of the expansion. Consumer spending will continue to feel some pressure from higher energy costs, rising interest rates, and weaker home prices. However, this restraint may be countered by strong job growth, perhaps the most important determinant for personal expenditures. We also continue to believe that the broad stock market averages are reasonably priced to offer good appreciation potential, as corporate profits continue to rise. Stock market gains could improve from recent anemic growth once interest rates finally level off, even at levels slightly above 5%.

In this report we thought it would be informative to focus on an individual stock in order to demonstrate our effort to make long-term investments in under-valued growth companies. Staples, the leading office supply retailer, is a success story that exemplifies all of the criteria we look for in an investment.

Staples has been one of the core companies in the Saybrook portfolio since 2000. Overexpansion in the office-supply industry, combined with a recession and subsequent "jobless-recovery", had caused the company to be significantly undervalued at that time. After spending a day with senior management at their Framingham, Massachusetts headquarters in the fall of 2003, we were increasingly impressed with the company's long-term prospects and became even more confident in our investment. Subsequently, its stock price has risen 136% over the last three years.

The company caters to small businesses, which have flourished during the current expansion and been one of the strongest growth areas in the US economy. Focusing on this segment allows Staples to remain somewhat insulated from fluctuations in overall consumer spending, and less vulnerable to changes in the housing market and any impact those may have on the consumer. A large portion of the company's business consists of non-discretionary office supplies, contributing to relatively predictable top line growth compared to other retailers. We expect small business growth and employment gains to continue, allowing Staples to expand into new markets and achieve further sales gains in existing stores.

Staples has a number of internal initiatives in place that are helping to drive sales and profit gains at a rate well above the office supply industry. The company has developed a line of high-margin "Staples-brand" office products, representing an impressive 18% of sales. This very profitable merchandise could ultimately account for 30% of all sales. Office supplies are especially appropriate for a "store brand"; after all, how many customers can identify a dominant "brand-name" manufacturer of file folders, envelopes, copier paper, and even staples? This initiative, in combination with an increasing percentage of inventory sourced directly from manufacturers overseas, should be a significant source of margin expansion over time. In addition, the company is opening highly profitable copy centers in all of its stores to help capture a larger share of the customer's "wallet". Margins in the copy center are double those in the rest of the store and sales are growing at double-digit rates. Staples is taking category expansion even further, as it plans to offer mail and shipping services, custom printing, and an expanded line of furniture.

Sales at Staples' retail stores have grown impressively, but the fastest growing segment of Staples' business is delivery direct to companies. Sales in this division should continue to grow at a mid-teens rate, as its share of the fragmented U.S. market is still only 7%. Moreover, Staples' retail and delivery businesses in Europe are in the midst of a rebound. The company has recently completed a large-scale store remodeling effort in the UK and there are signs of economic recovery in several European countries where Staples operates. After a period of significant investment overseas, Staples is poised to reap profits in its international division (13% of total revenues), with margins rising from breakeven towards the company goal of 7-7.5%.

With the company's initiatives spread across varying geographies, business segments and merchandising efforts, we like Staples' balanced approach to growth. A superior management team with a proven track record of successful execution gives us confidence in Staples' long-term strategy. Since our initial investment in Staples in late 2000, we have continued to add to holdings and buy the stock for new investors. Favorable returns from this investment have been the result of the aforementioned strong earnings gains, investor recognition in the form of a higher price/earnings ratio, and the recent addition of a modest, yet growing, dividend. The earliest positions in our portfolios have almost tripled in value, and 2005 purchases have risen 10-20%. We believe that Staples strong internal initiatives offer potential for 15%+ long-term annual profit growth and similar stock market gains.