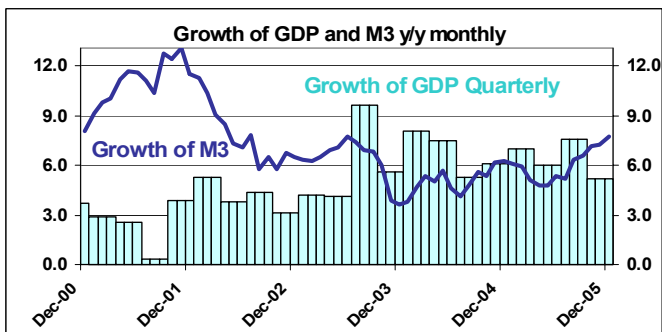




Cascade Investment Commentary

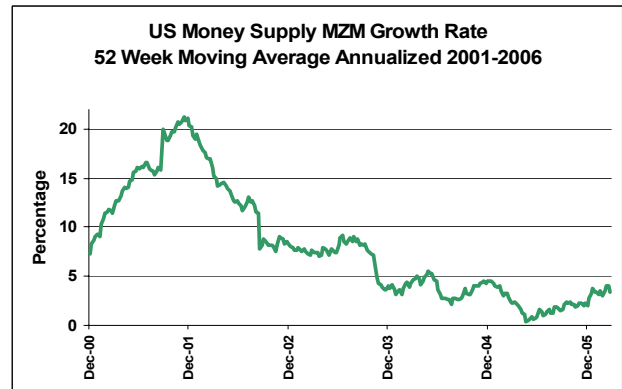
The financial news in the first quarter of 2006 was dominated by talk of what policy change, if any, Mr. Bernanke would institute at the Fed. We think the real news story was the GAO audit of the financial condition of the U.S. at www.fms.treas.gov/fr/05/05frusg/05frusg.pdf. Precious metals are acting like a canary in a mine to news of debt levels and future inflation.

We at Cascade do not particularly mourn the passing of the Greenspan era for it was increasingly acting in our opinion not as the sound central bank of the world's reserve currency, but as the servant of the Congress to whom it reports- we are all aware of the fiscal probity of Congress. Rather we mourn the passing of M3 reporting, which was the broadest measure of money that could be used for investment purposes. M3 included large institutional money market funds and thus the true purchasing power potential of the market.

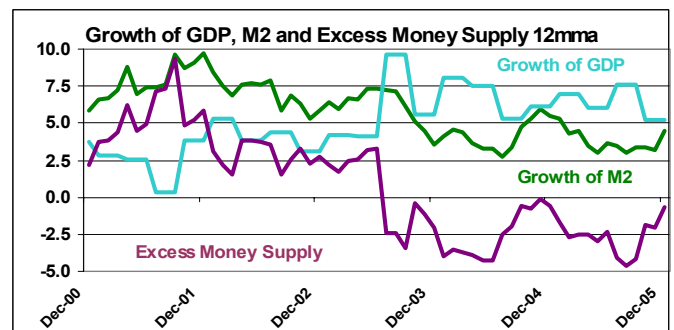


Our last look at M3 tells us an interesting story. The political panic of the micro-recession of 2001 led the Fed to flood the markets with excess liquidity (the rate of M3 creation was larger than the rate of GDP growth). This excess money found its way quickly into the “the carry trade” and real estate markets. From 2003-2005 M3 was a little behind the GDP rate not adding to further inflationary pressure. The recent growth of M3 is now 8.1% and the nominal growth of GDP in Q4 2005 up 5.2%. Where the extra 3% went is important. Did it fuel the continuing bubble in mortgage lending or did it finance the continuing rise in energy costs?

The tools left to us are MZM and M2, and they are telling us a similar yet not exact story. The graph below depicts the growth of MZM or money with a zero maturity, meaning it can be spent without delay. The Fed has virtually no control over this because it reflects the nation's preference for levels in savings accounts, checking accounts and money market funds.



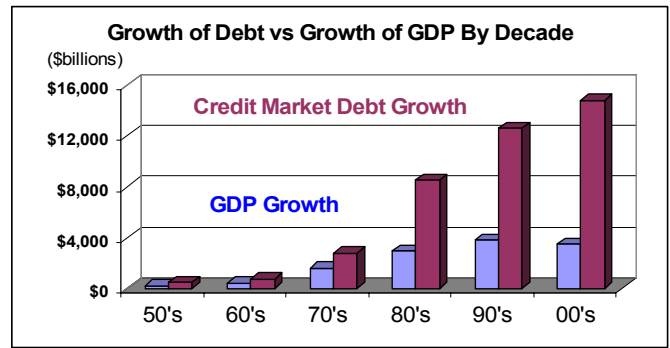
We also follow the Fed-influenced M2 which is the broad measure of deposits that may be used to purchase stocks and bonds. We have presented this graphic before as we seek to know if there are ample funds (excess money supply) for additional stock purchases. The growth rates of MZM and M2 are related but somewhat dissimilar. Both are now rising and we worry that the Fed may be raising rates at the front door while shoveling money out the back fueling future inflation.



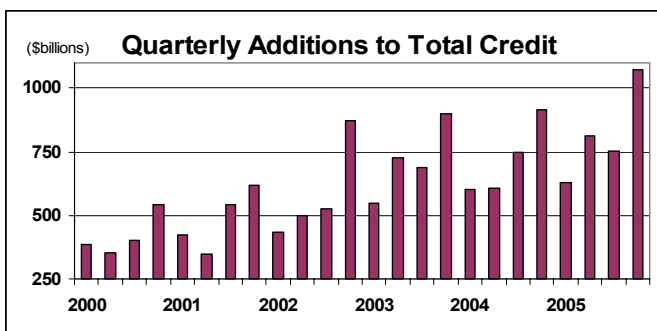
During the last State of The Union Address the President stated that that America is addicted to oil. All industrial societies are; this is not news, and Cascade has held major energy positions for years. Not mentioned but more to the point, **America is addicted to credit!**

This addiction is nothing new, and has been growing since the 1950's when the tax code was changed to make it advantageous for corporations to borrow rather than to issue stock, and as home ownership has risen. Data are widely available as the nation's credit is reported on quarterly by the Federal Reserve Board. In the latest report on credit shows a surprising jump in total credit market debt.

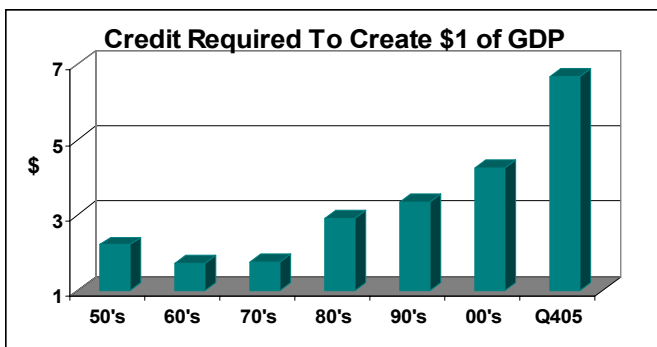
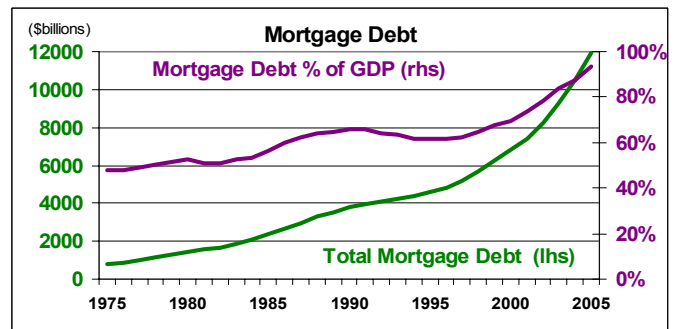
Surprising because the Fed has been tightening monetary policy by raising rates since June 2004. In a tightening cycle debt creation is supposed to slow (as the price rises) not expand. Is the Fed really tightening?



It was suggested to us by a real estate appraiser that at the late end of each building cycle, developers and builders become very anxious to build out their remaining commitments, and contra-intuitively, the supply of new units rises quickly just as demand is slowing. If this turns out to be the present case, the Fed's policy is on track and the rise in the monetary aggregates portends the Fed "looking over the valley" to stimulate a slowing economy. When this happens Cascade will once again make investments in commercial banks and other financial intermediaries. Until then we remain wary of interest sensitive firms.



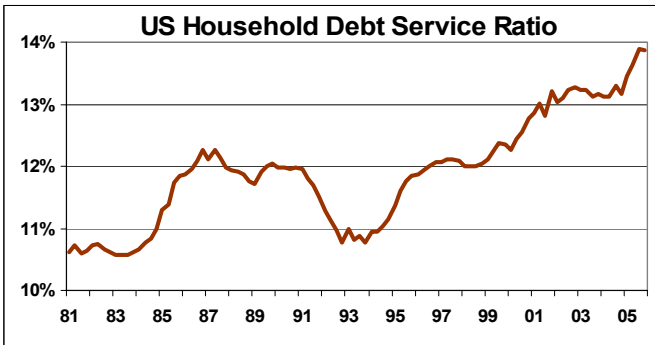
The whole point of raising rates is to slow down the economic pace a notch thereby lowering inflationary expectations and aiding economic stability. This policy seems not to be working yet. Of the \$1trillion of net new debt in the 4th Quarter, \$275 billion was government borrowing and \$410 mortgage lending.



We have shown the accelerating level of total debt to obtain each new dollar of GDP before, and the general rise of leverage in our system is known. We are taken by the fact that in the 4th quarter of 2005 the nation incurred \$6.68 of new debt for each \$1.00 of GDP growth.

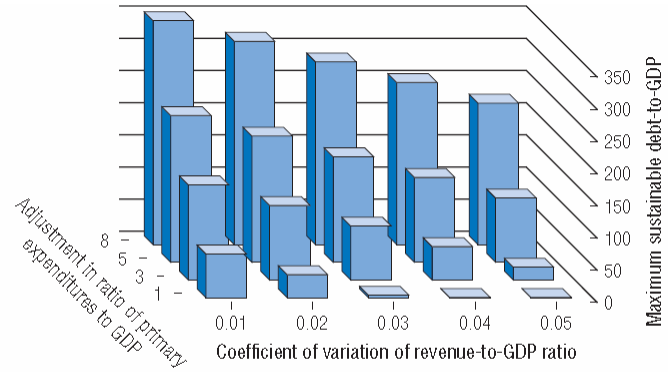
In the accounting system of the U.S. the sale price of each new home built is added to the GDP in the year sold. Thereafter, an imputed (guessed) rental value of the home is added to the GDP. Since the recession in 2001 overall consumption and residential building has accounted for 88.4% of real GDP growth. The importance of new home construction to current GDP should not be understated. It is the big pillar under our economy, and the single largest source of new jobs (including sales, financing and furnishings) since 2001. Because of this increased GDP leverage to construction any major slowing in housing will have a much graver effect on GDP than usual, and will almost certainly lead to recession.

Walter Wriston when Chairman of Citibank remarked in the 1970's that his bank did not expect sovereign governments ever to repay their loans, only make good on their interest payments. Likewise nobody really expects the Treasury of the U.S. to even pay down part of the U.S. debt (capital gains windfalls allowed a modest payment in two years before the internet bubble) let alone pay it off, but as Citibank learned in Mexico, Argentina, Brazil and countless African countries there is a limit to the ability to pay even the interest.



The leveraging of households has been rising for a decade. The strong rise in debt service starting in 2005 is mostly due to adjustable rates resetting at higher levels. It is estimated that almost 50% of the current adjustable rate mortgages will reset between now and the end of 2007. If energy prices remain high (which we expect), the combination will certainly stress many households at the margin. We expect that wage demands will rise in 2006 and 2007. How effective these demands will be is uncertain, but we expect that consumer discretionary spending is in for a troubled period, and that is why there are no retailers currently in our portfolios.

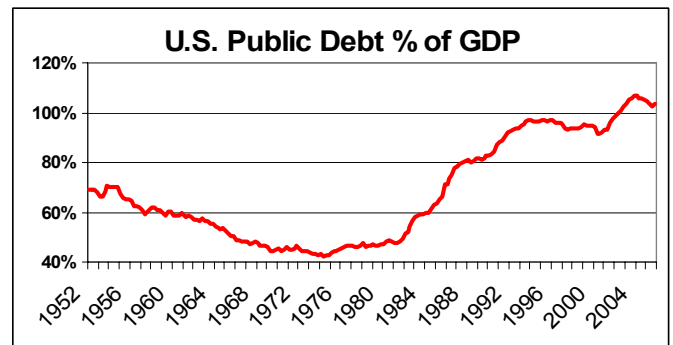
Where the debt limit is we do not know, but recent studies by the International Monetary Fund and the Federal Reserve Bank of San Francisco are instructive. When looking at the sovereign debt level of nations the International Monetary Fund uses a model known as "Value-at-Risk" or VaR which encompasses debt to GDP, revenues to GDP, variability of revenue streams etc. Through a model named Mendoza-Oviedo the maximum sustainable debt-to-GDP levels can be estimated.



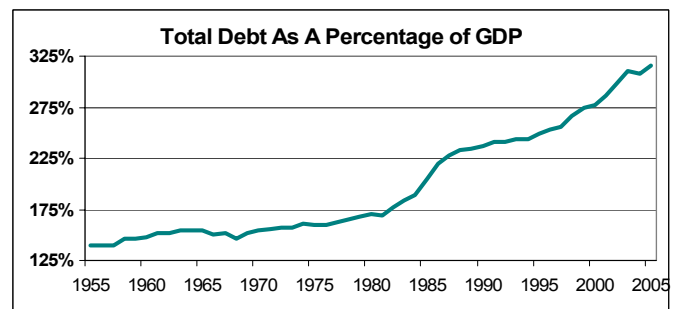
Source: IMF staff estimates.
¹Based on the Mendoza-Oviedo Model. Zeros indicate that the government can not sustain a positive debt-to-GDP ratio under these conditions.

The matrix above ranks the maximum debt to GDP ratio by the various factors we just mentioned. At the far left corner (probably Singapore with budget surpluses, stable income and free trade) the maximum amount of debt is just shy of 350% of GDP. At the right bottom corner is probably Zimbabwe or Sudan with a 0% ability to service debt.

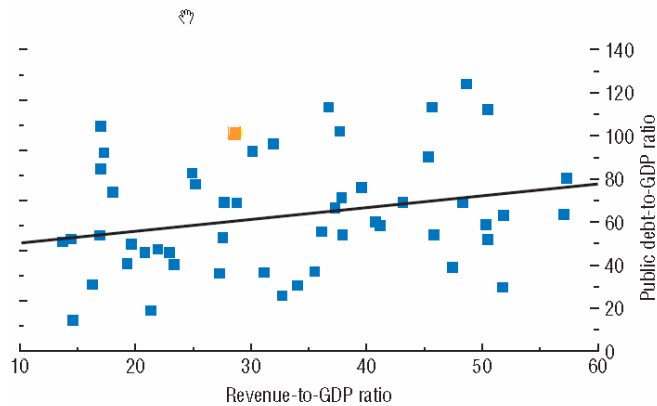
Exactly how much debt the U.S. can really sustain is unknown to Cascade, but we are now a country whose elected officials have lost all sense of spending limits. The IMF model indicates that the US could service a greater increase in the public debt, but the taxation policy would be very difficult to pass.



If we add all of the credit market debt outstanding we reach about 320% of GDP.



By way of comparison with other industrial countries, total government revenue (federal, state and local) in 2005 was \$3725 billion or 29% of GDP (although spending was higher). The US position (orange dot) in the IMF scatter chart below shows that only 5 of the 50 largest industrial nations have a higher public debt to GDP than the US, but 25 have higher public revenues to support this debt.



The bottom line: Within two or three years more than 50% of US Treasury debt will be owned by foreigners. They will be in a very strong position to demand a stable tax base that will service that debt. This in turn, will certainly require higher tax revenue. We will get lower growth and lower consumption.

We have reviewed the **2005 Financial Report of the United States Government** produced by the Treasury and our opinion is confirmed that the nation faces few if any policy choices that do not have negative outcomes.

The report starts with the typical self serving letter from the Secretary of The Treasury pointing out that tax receipts rose 15% in fiscal 2005 and that resulted in a deficit that was a lower-than-expected \$319 billion. The Executive Summary however states that “Net operating cost (deficit) was \$760 billion, which represented an *increase* of \$144 billion from the \$616 billion reported in fiscal year 2004. “Larger receipts were the main reason the budget deficit picture improved. Receipts rose by almost \$274 billion to \$2,153 billion, an increase of 14.6%, which more than offset the increase in outlays of \$179 billion to \$2,473 billion, or 7.9%.” Hello? This accounting legerdemain is certainly not Sarbanes-Oxley.

U.S. Federal Government	2005	2004
Net Operating Cost	(\$760)	(\$616)
plus Employee Benefits	232	212
plus Veterans Benefits	198	-30
other, net	11	22
Budget Deficit	(\$319)	(\$412)

On page 83 of the notes we find that “Federal employee and veteran benefits payable are recorded during the time employee services are rendered. The related liabilities for defined benefit pension plans and post-retirement health benefits and veteran’s compensation and burial benefits are recorded at estimated present value of future benefits, less any estimated present value of future normal cost contribution... Normal cost is the portion of the actuarial present value of projected benefits allocated as an expense for employee services rendered in the current year. Actuarial gains and losses (and prior service cost, if any) are recognized immediately in the year they occur, without amortization.” In other words, as interest rates rise the present value of far off pensions and benefits fall and our government credits that non-cash change against the actual dollars spent in the current year. WOW.

On page 29 we find something even more startling: The report of Mr. David M. Walker the Comptroller General of the United States through the Government Accountability Office dated December 14, 2005 and sent to the President, the President of the Senate and the Speaker of the House of Representatives.

This is the report of the auditors:

“Our report on the U.S. government’s consolidated financial statements for fiscal years 2005 and 2004 is enclosed. In summary, we found the following: “Material deficiencies in financial reporting (which also represent material weaknesses) and other limitations on the scope of our work resulted in conditions that for the ninth consecutive year, prevented us from expressing an opinion the federal government’s consolidated financial statements.....

“The federal government did not maintain effective internal control over financial reporting (including safeguarding assets) and compliance with significant laws and regulations as of September 30, 2005.

“Three major impediments to our ability to render an opinion on the consolidated financial statements continued to be (1) serious financial management problems at the Department of Defense, (2) the federal government’s inability to adequately account for and reconcile intragovernmental activity and balances between federal agencies, and (3) the federal government’s ineffective process for preparing the consolidated financial statements. Moreover, as a result of the material deficiencies we found, readers are cautioned that amounts reported in the consolidated financial statements and related notes, certain information contained in the accompanying Management’s Discussion and Analysis, and other financial management information that is taken from the same data sources as the consolidated financial statements, may not be reliable. Until the problems discussed in our audit report are adequately addressed, they will continue to have adverse implications for the federal government and the taxpayers, which are outlined in our report.

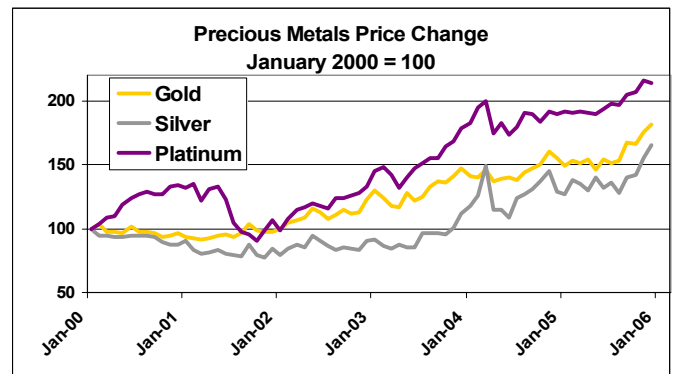
“More troubling still, the federal government’s financial condition and long-term fiscal outlook is continuing to deteriorate. While the fiscal year 2005 budget deficit was lower than 2004, it is still very high, especially given the impending retirement of the “baby boom” generation and rising health care costs. Importantly, the federal government’s accrual based operating cost increased to \$760 billion in fiscal year 2005 from \$616 billion in fiscal year 2004.

“GAO’s fiscal policy simulations illustrate that without significant changes on the spending and revenue sides of the budget, long-term deficits will encumber a growing share of federal resources and test the capacity of current and future generations to afford both today’s and tomorrow’s commitments.

“The current financial reporting model does not clearly and transparently show the wide range of responsibilities, programs, and activities that may either obligate the federal government to future spending or create an expectation for such spending. Thus, it provides a potentially unrealistic and misleading picture of the federal government’s overall performance, financial condition, and future fiscal outlook. The federal government’s gross debt in the consolidated statements was about \$8 trillion as of September 30, 2005. This number excludes such items as the gap between the present value of future promised and funded Social Security and Medicare benefits, veteran’s health care, and a range of other liabilities....Including these items, the federal government’s fiscal exposure now total more than \$46 trillion, up from about \$20 trillion in 2000. This translates into a burden of about \$156,000 per American or approximately \$375,000 per full-time worker, up from \$72,000 and \$165,000 respectively, in 2000. These amounts do not include future costs resulting from Hurricane Katrina or the conflicts in Iraq and Afghanistan. Continuing on this unsustainable path will gradually erode, if not suddenly damage, our economy, our standard of living, and ultimately our national security.

“Given the size of the projected deficit, the U.S. government will not be able to grow its way out of this problem—tough choices are required.”

The precious metals must have read this.



April 7, 2006.

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