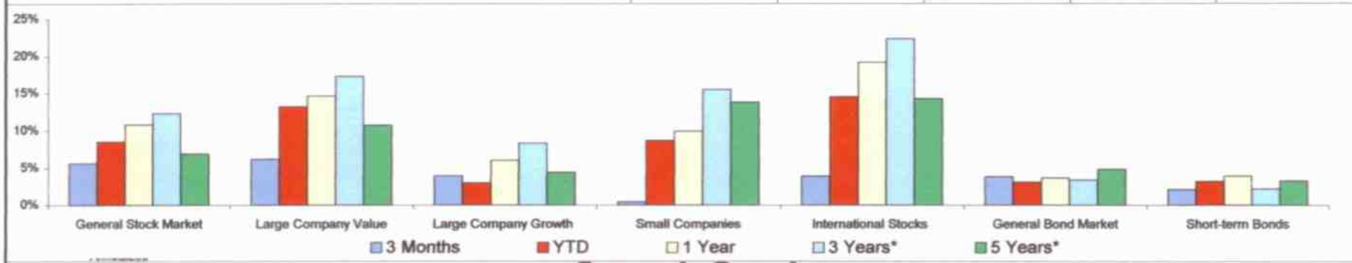
Timberline
Investment Management, LLC

9/30/2006

Market Overview

Market Description	Index	3 Months	YTD	1 Year	3 Years*	5 Years*
General Stock Market	S&P 500	5.67%	8.53%	10.79%	12.30%	6.95%
Large Company Value	Russell 1000 Value	6.22%	13.19%	14.62%	17.25%	10.73%
Large Company Growth	Russell 1000 Growth	3.94%	2.97%	6.04%	8.35%	4.42%
Small Companies	Russell 2000	0.44%	8.69%	9.92%	15.48%	13.78%
International Stocks	Morgan Stanley EAFE(US$-net)	3.93%	14.49%	19.16%	22.32%	14.26%
General Bond Market	Lehman Aggregate Bonds	3.81%	3.06%	3.67%	3.38%	4.81%
Short-term Bonds	Lehman 1-3 Yr Gov't Credit	2.07%	3.20%	3.90%	2.17%	3.22%



Economic Overview

Category	Statistic	Most Recent*	3-mo Prior	3-mo Change	12-mo Prior	12-mo Change
Long-term Rates	10-year Treasury Yield	4.64%	5.15%	-9.90%	4.34%	6.91%
Short-term Rates	Overnight Fed Funds Target	5.25%	5.25%	0.00%	3.75%	40.00%
Consumer Inflation	Consumer Price Index*	203.9	202.5	0.69%	196.4	3.82%
Producer Inflation	Producer Price Index*	167.9	165.3	1.57%	157.6	6.54%
Job Growth	Non-farm Payrolls	135613	135251	0.27%	133840	1.32%
Worker Earnings	Average Hourly Earnings	16.84	16.69	0.90%	16.19	4.01%
Economic Output	Industrial Production*	113.7	112.2	1.34%	108.6	4.70%

**Economic data for certain statistics are as of the month prior to period end. Period end data was not available at time of publication. All statistics are subject to revision. Market returns greater than 1 year are annualized.*

While the world remained complicated and uncertain, investors did notice several fundamental positives that developed during the third quarter of 2006. Much of the media focused on Middle East unrest, domestic politics, a major hedge fund snafu, a leaky oil pipe in Alaska, and a set of very abnormal speeches at the United Nations. Investors, however, favorably responded to the following items.

After 17 consecutive increases, the Federal Reserve did not raise short-term rates and signaled that it is currently comfortable with the outlook for inflation and growth. It also eased the minds of many investors worried that the Fed may overshoot and throw the economy into a recession. In addition to the stabilization of short-term rates, long-term rates actually fell and may indicate that near-term rate and inflation conditions may be more friendly. Falling oil prices transformed the hopeless outlook for high energy prices into a pleasant surprise when pump prices fell as much as 20%. Last but not the least, corporate earnings continued to grow at a nice rate.

Looking ahead. the market signals of 3Q06 may point to a more moderate outlook. Residential real estate indicators have softened in some parts of the country and it remains to be seen if spending in this area will lead to a broader slowdown. Another interesting indicator was the recent survey of local business conditions by the Philadelphia Federal Reserve Bank that produced its first negative number in quite some time (see chart on back). This survey is closely watched and does experience significant swings and revisions. The negative number, however, cannot be ignored. Lastly, long-term rates (as measured by the 10-year Treasury yield) are now lower than the overnight Fed Funds rate (see chart on back). This so-called "yield inversion" is typically a leading indicator of weaker economic conditions. Together, these observatiuons point to a market opinion that economic conditions are expected to slow.

I do not disagree with a more moderate outlook but I also believe equities will probably benefit from more comfortable rate and inflation conditions as well as better consumer sentiment driven by lower energy prices . On the other hand, serious issues with the Middle East and terrorism remain very potent and unpredictable. China's trade imbalance and currency policy did not receive much recent press but remain very major issues. Politics will create quite a bit of noise but recent gridlock on key economic issues may be the best way to predict what lawmakers may bring in the upcoming year. My outlook for modest annual equity market returns (around 7%) remains my best projection as solid fundamental developments will continue to be tempered by global uncertainties. For bonds, I no longer find long maturities to be compelling with the 10-year Treasury yield now below 5%.

I truly hope you find this commentary to be of interest and value. I also wish to thank you for your business and interest in Timberline Investment Management.

Gregg Giboney, CFA
President

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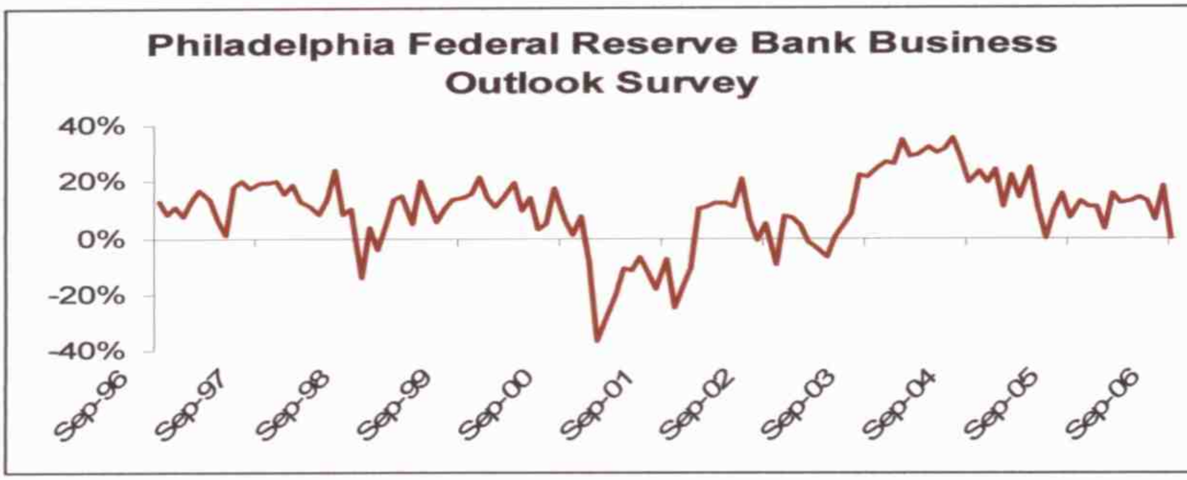
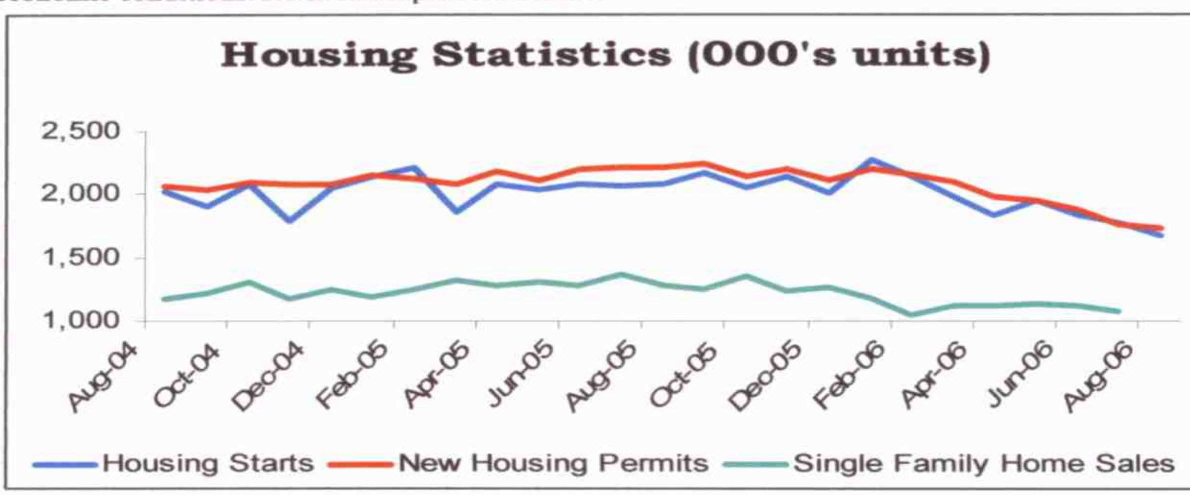
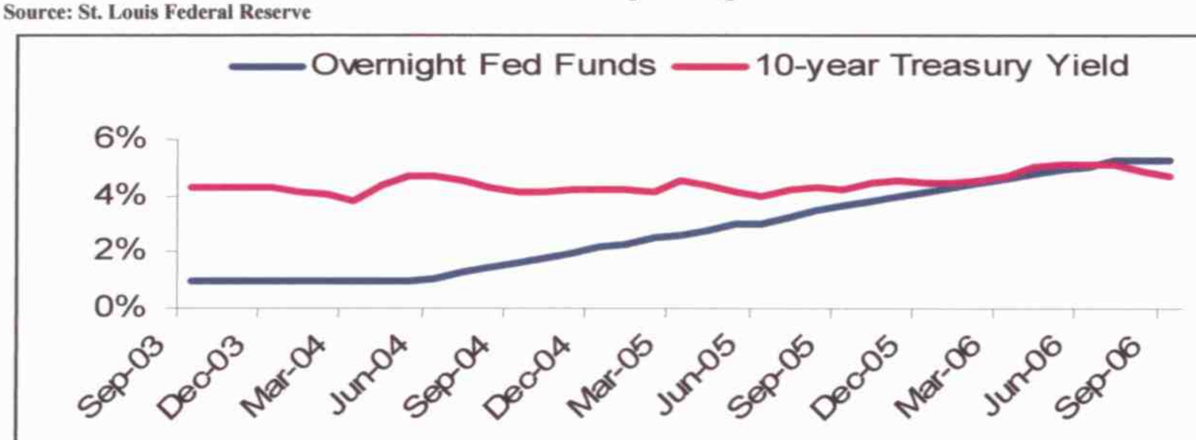
CHARTS OF INTEREST



This is also known as the Philly Fed Survey that reviews manufacturing activity in the Philadelphia area. The latest release of -.4% set into motion expectations of moderating economic conditions. **Source: Philadelphia Federal Reserve**



Along with some softer prices in certain areas of the country, declining unit volumes also indicate weaker conditions. Time will tell if the dip in long-term rates will stem the downturn.
Source: St. Louis Federal Reserve



Long-term rates that are lower than short-term rates is often indicative of slower economic expectations. Think of it this way, long-term investors are willing to invest at a lower rate anticipating that short-term rates will fall in line with a slowing economy. During 3q06, the 10-year yield topped at around 5.25% and ended around 4.70%. Fed Funds were pretty constant at around 5.25%. **Source: St. Louis Federal Reserve**

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