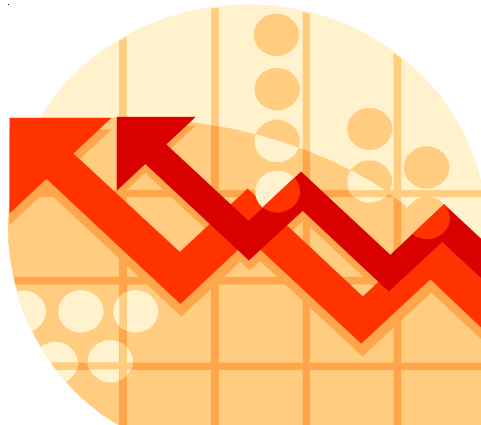


Economic Development Board


Volume 3, Issue 4, Spring 2005

Local Economic Report Series Spring 2005



Sonoma County
EDDB
Economic Development Board
www.sonomaedb.org

Presented By
Sonoma County Economic Development Board
in partnership with
Sonoma County Workforce Investment Board



Spring 2005

The Sonoma County Economic Development Board (EDB), in partnership with the Sonoma County Workforce Investment Board, is pleased to present the Spring 2005 edition of the *Sonoma County Local Economic Report*. This report has two sections. Our research partner, Economy.com, provides an analysis on the local and the national economy in the first section. This is followed by Brad Zigler's summary of the stock performance of Sonoma County companies in section II.

Key highlights from Economy.com's Local Economic Report include:

- The Sonoma County (SON) economy is expanding, with moderate growth in employment and industrial production.
- The local unemployment rate is at its lowest point since 2000. Contributing to this is strong hiring in travel and tourism, one of Sonoma County's strongest basic industries, adding more than 700 new positions this year. In addition, there is a further upside potential for leisure and corporate travel from international visitors if Asian currencies are allowed to strengthen versus the dollar.
- A rising interest rate environment poses some risk for housing markets. However, local nonresidential projects, which are less susceptible to higher interest rates, have kept construction activity strong and improved employment conditions.
- Tech-producing industries in Sonoma County continue to show mixed results. For example, optical components manufacturer JDS Uniphase is cutting 350 positions in Sonoma County as it consolidates manufacturing, while medical device maker TriVascular is searching for space to expand in the area and could add several hundred more workers.

Thank you for your continued interest in Sonoma County's economy and the Economic Development Board's research efforts. As always, if you have any questions or comments please feel free to contact me at (707) 565-7170.

Yours sincerely,



Ben Stone
EDB Director



**With Acknowledgment and Appreciation to the Underwriters of the
Economic Development Board Foundation Research Initiatives Program**
 Sonoma County Permit & Resources Management Dept. ■ Sonoma County Office of Education
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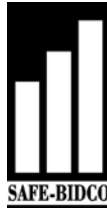
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Economic Development Board

Volume 3, Issue 4, Spring 2005

Section I:

Local Economic Report May 2005

Prepared for the Sonoma County Economic Development Board
By: Dr. Steve Cochrane of Economy.com

SONOMA COUNTY

EMPLOYMENT GROWTH RANK

Best=1 Worst=387

2004-06

159
3rd quintile

2004-09

56
1st quintile

LIFE CYCLE PHASE

Growth/Mature

Best=1 Worst=387

VITALITY
284

COST OF DOING BUSINESS

U.S.=100%

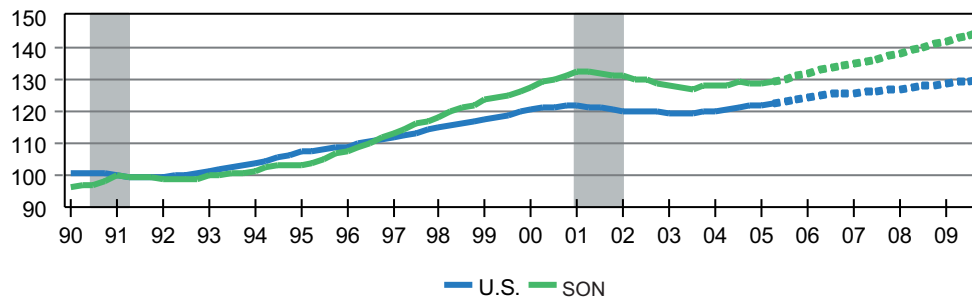
124%

COST OF LIVING

U.S.=100%

127%

Relative Employment Performance (1991=100)



1998	1999	2000	2001	2002	2003	2004	Indicators	2005	2006	2007	2008	2009
12.7	13.5	14.9	15.2	15.7	16.0	16.5	Gross Metro Product, C\$B	17.0	17.8	18.6	19.5	20.3
9.4	6.9	9.9	2.6	2.8	2.4	2.5	% Change	3.2	4.8	4.4	4.8	4.2
173.0	179.3	186.1	189.8	186.6	183.2	184.9	Total Employment (000)	186.6	191.4	195.6	200.7	206.0
4.6	3.6	3.8	2.0	-1.7	-1.8	0.9	% Change	0.9	2.6	2.2	2.6	2.7
3.3	2.7	2.6	3.0	4.5	5.0	4.5	Unemployment Rate	4.6	4.5	4.5	4.3	4.1
8.4	5.8	14.8	2.5	0.4	1.3	5.0	Personal Income Growth	5.8	6.9	6.2	6.0	5.8
445.9	453.4	460.3	465.6	465.9	466.7	473.1	Population (000)	482.3	492.8	503.5	513.2	523.3
2,098	2,348	2,013	1,717	1,350	1,503	1,359	Single-Family Permits	1,821	1,696	1,834	1,869	1,850
964	688	492	866	578	749	583	Multifamily Permits	667	534	670	718	712
210.8	239.9	317.2	384.6	430.7	510.4	570.3	Existing Home Price (\$Ths)	610.8	624.7	642.8	667.8	686.9
5,207	4,064	3,817	8,948	10,209	13,048	9,615	Mortgage Originations (\$Mil)	6,742	5,214	5,530	6,102	6,292
7.2	6.1	5.4	3.6	-1.5	-0.8	4.7	Net Migration (000)	7.3	8.6	8.6	7.6	7.7
2,173	1,627	1,158	1,183	1,223	1,300	1,267	Personal Bankruptcies	1,269	1,093	1,120	1,181	1,175

STRENGTHS & WEAKNESSES

STRENGTHS

- Highly educated workforce and attractive environmental quality.
- Diverse set of basic industries.
- Active public/private partnerships that support economic growth and quality of life initiatives.

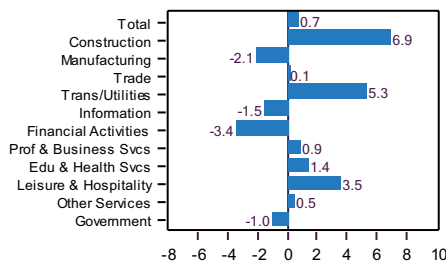
WEAKNESSES

- Very high cost of living and cost of doing business.
- Much congestion on transportation links to rest of Bay Area.
- Complex environmental regulations.

CURRENT EMPLOYMENT TRENDS

March 2005 Employment Growth

% change year ago, 3 mo. MA



FORECAST RISKS

SHORT TERM ↑ LONG TERM ↓ RISK-ADJUSTED RETURN, '04-'09 **N/A**

UPSIDE

- Dollar falls further versus Asian currencies, supporting SON's exports and international tourism.
- Domestic and overseas business investment accelerates, supporting local tech and telecom industries.

DOWNSIDE

- Housing prices correct downward in a higher interest rate environment, erasing homeowners' equity.
- Tech firms consolidate and transfer to lower cost

ANALYSIS

Recent Performance. The Sonoma County (SON) economy is expanding, with moderate growth in employment and industrial production. The economy is not firing on all cylinders yet, but certain key indicators are very positive. The unemployment rate, for example, is at its lowest since late 2001. The strongest of the area's basic industries appears to be travel and tourism, which is seeing a good pace of hiring. The wine industry is enjoying improved pricing power and rising exports. Household finances appear to be in good shape with falling personal bankruptcy filings and accelerating house-price appreciation.

Hospitality. Arguably the strongest segment of SON's basic economy, employment in leisure and hospitality industries, has risen by about 700 over the past year. The hotel occupancy rate for the Sonoma/Napa area rose to nearly 50% at the beginning of this year, up from 45% a year earlier according to PKF Consulting; room rates rose by 7.5% over this same period. With U.S. personal income growth accelerating—now up by nearly 6% over the year—and corporate profits up by over 10% for the year, the outlook for leisure and corporate travel looks better than at any time since the beginning of the 2001 recession. There is further upside potential from international visitors if Asian currencies are allowed to strengthen versus the dollar.

Technology. Tech-producing industries in SON continue to show mixed results, which is not unusual for an industry known for a large number of start-up firms and R&D activity. For example, optical components manufacturer JDS Uniphase will cut 350 positions in SON by the end of this year as it consolidates manufacturing lines elsewhere. At the same time, however, medical device maker TriVascular Engineering is searching for space to expand in the area and could add several hundred more workers as it proceeds through clinical trials and expands research.

The outlook for telecom equipment is somewhat mixed. U.S. investment spending on communications equipment is expanding once again, seeing growth over the past year of more than 11%. Telecom service providers are investing in new equipment to compete with cable and wireless, but consolidation among national service providers could offset the impact of this, limiting overall demand for telecom equipment. The outlook for medical equipment is more assured given advances in technology and expanding demand from an aging population. Upside potential is possible from a proposed tech incubator space at Agilent Technologies' former facility.

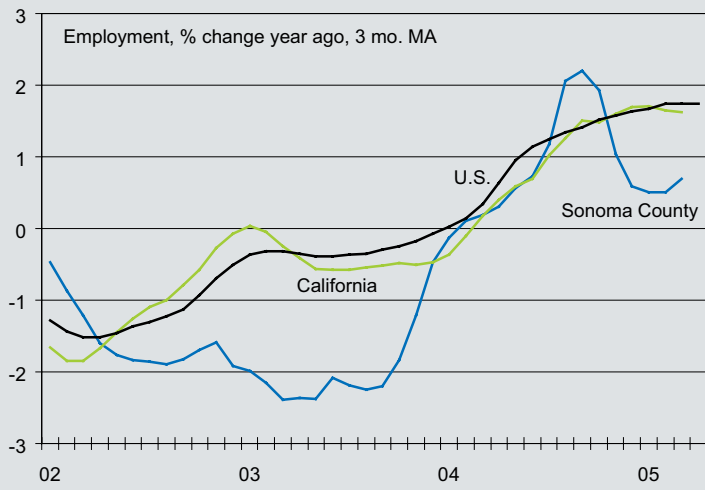
Real estate. The vacancy at the Agilent campus illustrates the tepid improvement in nonresidential real estate markets. The area's office vacancy rate shot up in the first quarter, although absorption of smaller space elsewhere has been positive, reflecting the improvement in the local economy. Office-space construction permits doubled in 2004 from 2003, indicating some optimism of further positive absorption, despite the lack of significant net gains in office-using employment. Demand growth for office space will be moderate. On the retail side, accelerating income growth and shifting demand for higher-end goods and services will increase demand for space.

The outlook for the Sonoma County economy remains good. For the first time since 2001, demand factors for all of the area's basic industries are positive. The global supply of wine is more balanced with demand, pricing power has returned and the weak dollar is boosting exports. Domestic and international travel continue to rise. Investment and R&D spending support biotech, telecom and other tech-producing industries. Rising interest rates pose some risk for housing markets, but overall, SON is ranked above average through the rest of this decade.

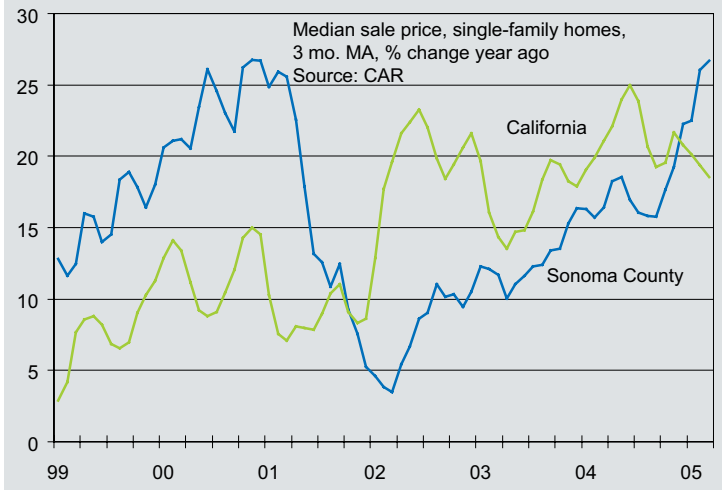
Steven G. Cochrane
May 2005

Sonoma County

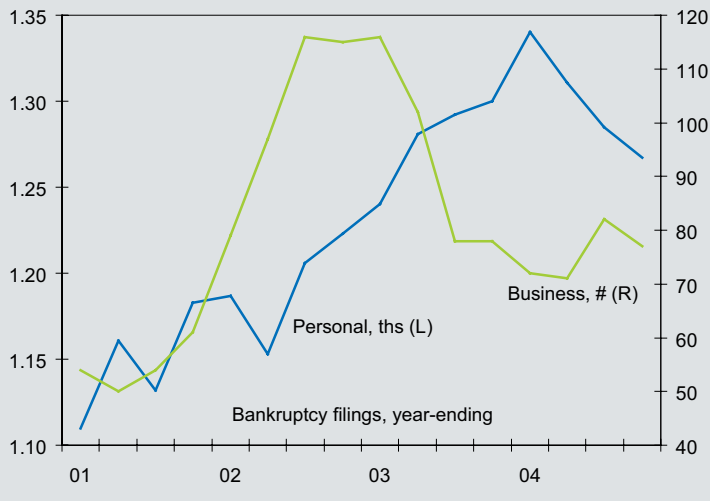
Sonoma County's Uneven Recovery



House Price Appreciation Is Hot Once Again

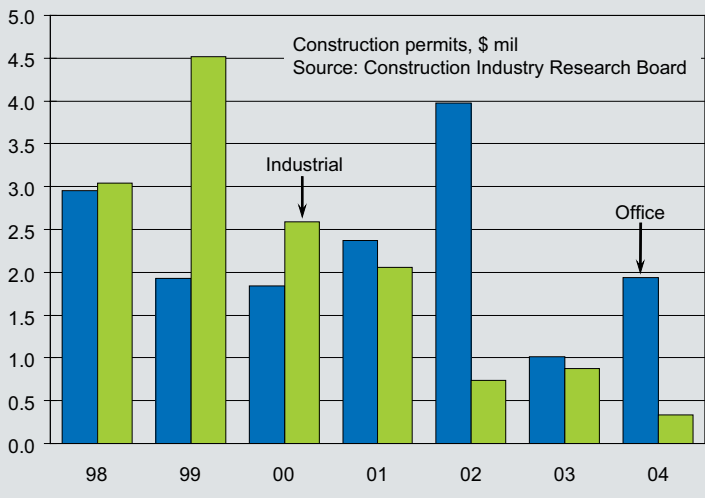


Business Bankruptcies Are Rising Again

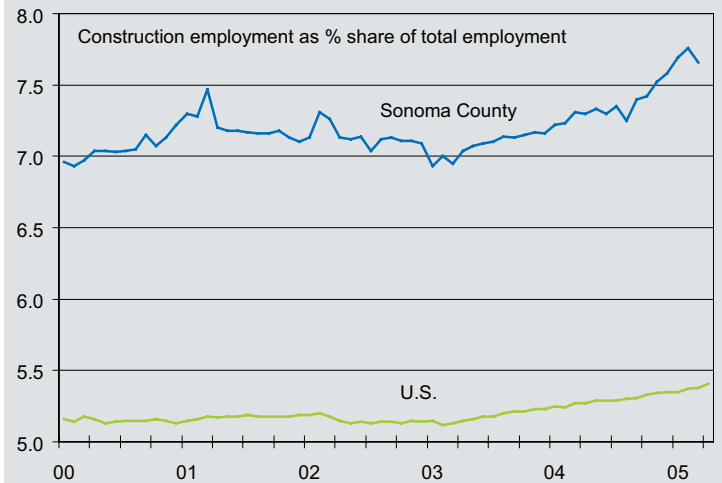


Repeating a trend that last ended in 2001, house-price appreciation in SON is soaring well ahead of the statewide average. Stronger income growth, moderate job gains and low interest rates are fueling the local market. Affordability has deteriorated and residential construction activity has not accelerated to meet demand; indeed, total residential permits in 2004 were down by 14% from 2003. There is some upside potential arising from a new internet-based permit application process in the area that may expedite construction activity.

Office Market Rebounding Slowly; Industrial Is Still Weak



Construction Is Creating Many Jobs



Even with residential permitting down over the year, nonresidential projects have kept construction activity going in SON. The acceleration in construction job gains has been remarkable in recent months, contributing to current improved employment conditions. Fortunately, nonresidential construction is less susceptible to higher interest rates. Thus, the risks to the SON economy from higher rates are somewhat lower than in other San Francisco Bay metro areas.

EMPLOYMENT & INDUSTRY

TOP EMPLOYERS

Santa Rosa Junior College	3,115
Agilent Technologies, Inc.	2,500
St. Joseph Health System	2,370
Sonoma State University	1,799
Kaiser Permanente	1,423
Optical Coating Laboratory	1,300
JDS Uniphase Corporation	1,200
Safeway, Inc.	1,218
Medtronic, AVE	1,200
Kendall-Jackson Wine Estates	900
Sutter Medical Center	859
State Farm Insurance Company	846
Albertsons, Inc.	770
Target Corporation	724
Amy's Kitchen	650
Hansel Dealer Group	650
Advanced Fibre Communications	600
SBC Communications, Inc.	600
Longs Drug Stores, Inc.	585
Cisco Systems, Inc.	550
Home Depot	550

Source: North Bay Business Journal, February 2004

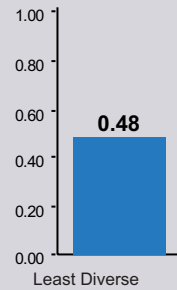
Public

Federal	1,691
State	5,569
Local	22,341

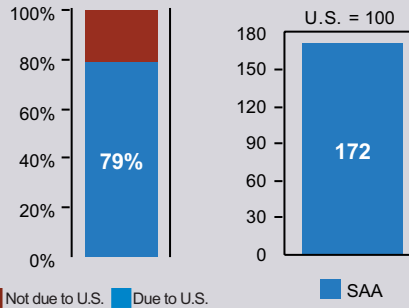
2004

INDUSTRIAL DIVERSITY

Most Diverse (U.S.)



EMPLOYMENT VOLATILITY DUE TO U.S. FLUCTUATIONS RELATIVE TO U.S.

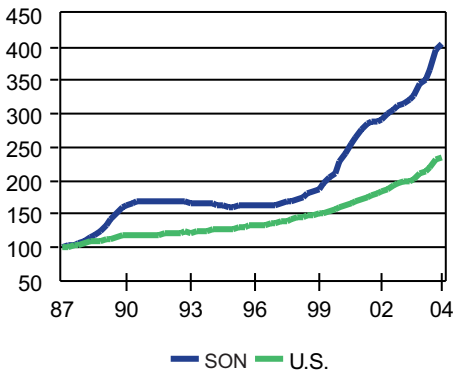


COMPARATIVE EMPLOYMENT AND INCOME

Sector	% of Total Employment			Average Annual Earnings		
	SON	CA	US	SON	CA	US
Construction	7.4%	5.8%	5.3%	\$53,490	\$54,018	\$44,373
Manufacturing	13.1%	10.5%	10.9%	\$62,321	\$70,640	\$63,129
Durable	52.7%	63.5%	62.3%	nd	\$78,393	\$65,880
Nondurable	47.3%	36.5%	37.7%	nd	\$57,502	\$58,627
Transportation/Utilities	2.1%	3.3%	3.7%	\$45,852	\$57,461	\$51,868
Wholesale Trade	3.5%	4.5%	4.3%	\$52,404	\$60,818	\$59,828
Retail Trade	12.7%	11.1%	11.4%	\$30,102	\$31,964	\$26,190
Information	2.3%	3.3%	2.4%	\$67,415	\$94,946	\$78,059
Financial Activities	5.4%	6.2%	6.1%	\$40,133	\$53,047	\$51,058
Prof. and Bus. Services	10.7%	14.4%	12.5%	\$37,240	\$50,601	\$47,411
Educ. and Health Services	12.2%	10.7%	12.9%	\$39,530	\$42,197	\$38,538
Leisure and Hosp. Services	10.9%	9.9%	9.5%	\$16,370	\$22,617	\$18,779
Other Services	3.5%	3.5%	4.1%	\$23,358	\$23,766	\$22,334
Government	16.0%	16.4%	16.4%	\$48,681	\$55,189	\$49,194

Source: Percent of total employment - Economy.com & BLS, 2004; Average annual earnings - BEA, 2002

HOUSE PRICES



Source: OFHEO, 1987Q1=100, NSA

CREDIT QUALITY

FITCH	MOODY'S
N/A	Aa2

LEADING INDUSTRIES

NAICS Industry	Employees (000)
FR Farms	11.1
7221 Full-Service Restaurants	7.2
3121 Beverage Manufacturing	6.2
4451 Grocery Stores	5.2
2360 Construction of Buildings	3.9
7211 Traveler Accommodation	3.2
5617 Services to Buildings and Dwellings	3.1
2383 Building Finishing Contractors	2.8
3345 Navig., Meas., Electromed. & Cntrl. Inst. Manuf.	2.7
3391 Medical Equipment and Supplies Manufacturing	2.6
7139 Other Amusement and Recreation Industries	2.2
PH Private Household Workers	2.2
4441 Building Material and Supplies Dealers	2.2
4411 Automobile Dealers	2.2
8111 Automotive Repair and Maintenance	1.9
High-tech employment	11.6
As % of total employment	5.8

Source: BLS, Economy.com, 2004

MIGRATION FLOWS

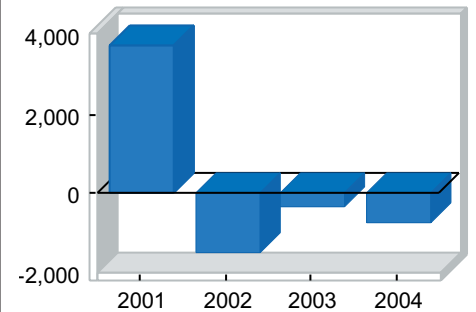
Into Sonoma County	Number of Migrants	Median Income
San Francisco CA	3,662	39,470
Oakland CA	1,233	31,625
San Jose CA	647	43,970
Sacramento CA	610	23,165
Los Angeles CA	527	19,558
Vallejo CA	439	33,552
Napa CA	395	29,999
San Diego CA	326	18,602
Riverside CA	245	22,626
Santa Ana CA	210	25,749
Total Immigration	14,659	26,425

From Sonoma County

San Francisco CA	1,940	31,988
Sacramento CA	1,524	30,729
Oakland CA	931	27,947
Vallejo CA	571	39,721
Los Angeles CA	474	18,297
Napa CA	465	30,520
San Jose CA	445	39,558
San Diego CA	434	17,673
Phoenix AZ	349	30,430
Riverside CA	317	24,758
Total Outmigration	17,318	27,050

Net Migration	-2,659	-625
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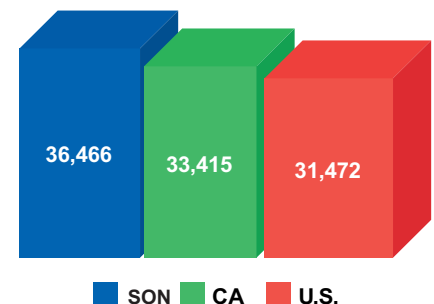
Net Migration, SAA



	2001	2002	2003	2004
Domestic	1,056	-4,084	-2,871	-3,271
Foreign	2,683	2,613	2,540	2,542
Total	3,739	-1,471	-331	-729

Source: IRS (top), 2003; Census Bureau & Economy.com, 2003

PER CAPITA INCOME



Source: Bureau of Economic Analysis, 2002

BROAD VIEW

Executive Summary

The U.S. economy ebbs and flows. Even in the middle of economic expansions, such as the current period, the economy rarely moves in a straight line. Indeed, the economy is experiencing an energy price spike-induced ebb. Real GDP growth has slowed from near 4% at the end of last year to near 3% currently.

Oil prices of over \$50 have sapped some of the strength in consumer spending. Vehicle sales have been most affected. While unit sales have held up as automakers have added more discounts to compensate for record gasoline prices, buyers are switching from larger, less energy-efficient SUVs to cars. Consumer confidence and core retail sales (which exclude spending on vehicles and gasoline) have also moderated. Lower income households, who spend more of their budgets on energy and have fewer other financial resources, are particularly worried.

Judging by the surge in inventories, a pullback by households has taken some businesses by surprise. The real inventory gain during the first quarter was over \$80 billion at an annualized rate. This is well over the \$50 billion gain estimated to be consistent with current sales growth. Manufacturing production and jobs will suffer a bit in the current quarter as businesses work to get inventories back in line with sales.

Housing boom. One constant throughout the economy's ebbs and flows in recent years has been the housing market. Housing activity has pushed steadily higher and is arguably now as strong as it has ever been. Single-family homebuilding, home sales, and real house price gains continue to shatter previous records.

The contribution of the housing boom to the economy's growth has been enormous, accounting for an estimated one-fourth of real GDP growth over the past five years. The most obvious links between housing and the broader economy are through construction activity, real estate transactions, and mortgage finance. The multiplier benefits are substantial, as this activity generates demand in numerous supplying industries and the incomes earned drive spending elsewhere in the economy.

An even more important link has been through massive mortgage equity withdrawal. Homeowners took an estimated \$700 billion out of their homes last year through home equity borrowing, cash-out refinancing, and capital gain realizations via home sales. This is up from less than \$600 billion in 2003 and

only \$250 billion in 2000. Based on Federal Reserve studies of what homeowners did with the cash raised in previous refinancing waves, approximately one-third of this cash is being used for debt repayment, one-third for home improvement and other investments, and the remainder on a wide array of consumer goods and services.

Housing is also driving broader growth via the nation's financial intermediaries. Residential mortgage loans, either whole or securitized loans, are approaching one-third of commercial bank assets. Given their currently pristine loan quality, the banking system is well capitalized and thus willing and able to provide credit to all borrowers.

Local governments flush with rising property tax revenues are also spending aggressively. This has been particularly fortuitous given the rapidly expanding demands on K-12 from the aging baby boom echo generation, and cuts in grants from financially stressed state governments.

Thickening froth. Housing will be increasingly hard-pressed to support the economy's future growth, however. While housing demand has been driven by solid fundamental forces, most importantly being low mortgage rates and the explosion in mortgage credit, it appears to be increasingly driven by speculation.

Speculation infects demand when buyers purchase an asset simply based on the expectation that the asset's historically strong price gains will be repeated long into the future. While it cannot be known for sure that speculation is driving asset demand until prices for the asset break, there are often signs.

In the housing market, one clear sign is a rising share of homes that are being purchased by investors. The investor share is indeed rising rapidly in hyped-up markets in California, Florida and in the Northeast. Another is the willingness of buyers to take on more leverage and risk to purchase a home. Interest-only mortgages, which were the domain of a handful of high-end homebuyers just a few years ago, accounted for more than one-sixth of mortgage originations during the last half of 2004 according to the Mortgage Bankers Association.

Economy.com's approach to measuring the degree of speculation in housing markets is to estimate a model of house prices based on the various factors that determine demand and supply. While no model can completely

capture all of the forces driving the housing market, if actual prices are measurably different from what the model expects, then the market may be affected by speculative fervor. Based on our approach, markets accounting for nearly one-half of the nation's housing stock now appear speculative.

Speculation is not easily wrung out of asset markets, as hardened expectations are hard to change. When expectations finally change, however, they tend to shift quickly, sending prices tumbling. There also has to be a catalyst for such a shift. Usually, one of fundamental forces driving demand and/or supply has to change. In the housing market, the likely catalyst almost certainly must be higher mortgage rates.

Conclusions. Mortgage rates are expected to rise in coming months. This can be stated with much certainty with regard to rates on adjustable mortgages, as they are tied closely to Federal Reserve policy. Policymakers are engaged in a series of tightening moves that seem set to push the funds rate target up from its current 3% to well over 4% by this time next year.

With ARM rates rising, pressure on homebuyers will build, but housing will remain resilient until fixed mortgage rates rise. Fixed rates are also expected to rise, but precisely when and by how much cannot be stated with any certainty. Fixed rates are tied to long-term Treasury bond yields, which have remained surprisingly low. The weights on long-term rates, however, including a halting job market, a lack of business borrowing, and aggressive foreign Central Bank buying, appear to be lifting. Even a small rise in fixed rates will have a substantial impact on housing activity and thus on broader economic growth.

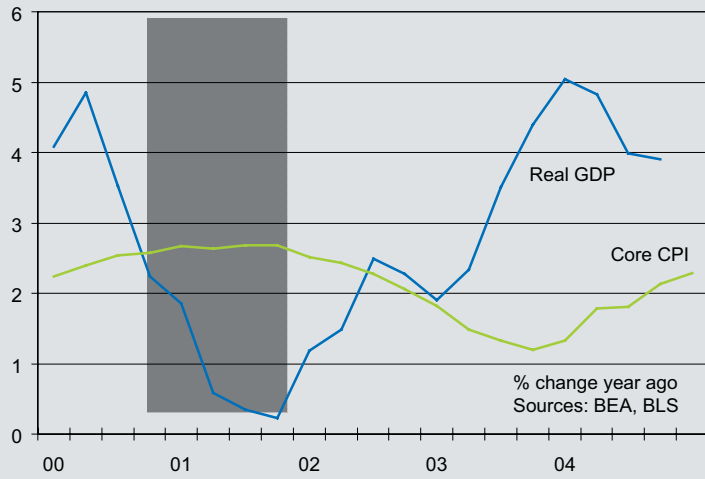
How this impending adjustment unfolds depends on when and how high long-term rates rise. If long-term rates soon begin to rise and do so moderately over an extended period, then the current expansion may stumble, but it will not falter. This is the baseline (most likely) outlook. Long-term Treasury yields are expected to move from just over 4% currently to over 5% one year from now. If long-term rates remain stubbornly low and if housing market speculation continues to grow, however, the eventual and inevitable adjustment will be much more difficult.

Mark M. Zandi
May 2005

BROAD VIEW

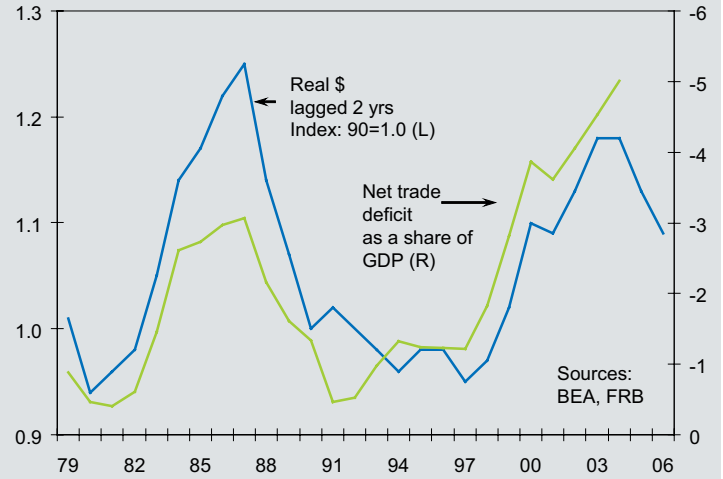
Executive Summary

The Economy Is Performing Well



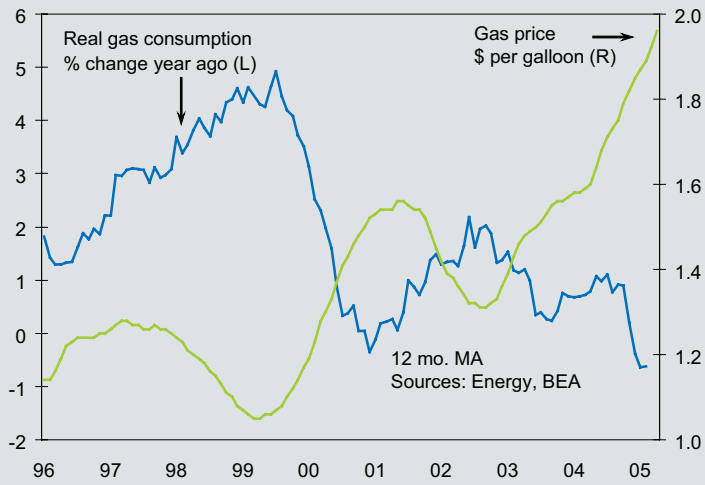
The U.S. economy is performing well, with real GDP growth close to 3% and core inflation of 2%. Growth is now near the economy's long-term potential and inflation is at the Federal Reserve Board's target. The most fundamental underpinning of this good performance is continued sturdy productivity gains. Growth has notably slowed and inflation has accelerated over the past year, however. This is largely in response to rising and now record high oil and other commodity prices. Even higher prices would be a significant threat to the economy's continued good health.

Weaker \$ Eventually Improving Trade



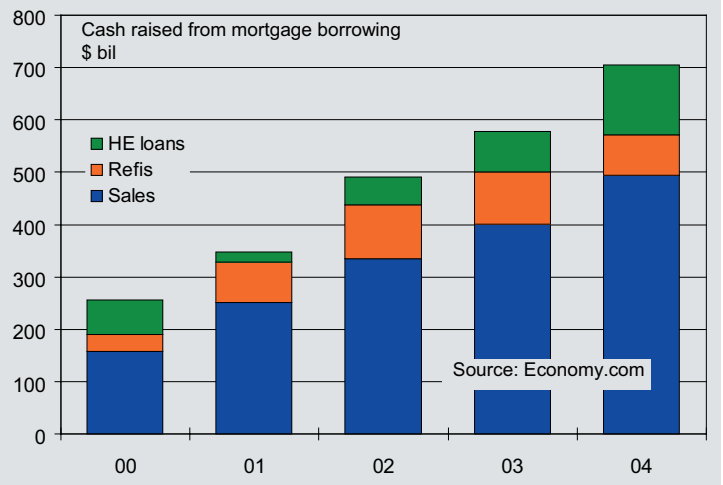
The economy should soon receive a boost from a more stable trade balance. The ballooning trade deficit has been a significant weight on growth, shaving an average of one-half percentage point from real GDP gains over the past five years. Behind expectations of a more stable trade balance is the 15% decline in the real broad trade-weighted dollar since its peak in early 2002. While historically movements in the dollar have affected trade flows with a long lag, if history is any guide, the impact of the dollar's decline should be felt this year.

Energy Prices Should Soon Moderate



Energy prices are expected to moderate over the coming year. This optimism is based on expectations that both global energy supplies will increase and global energy demand will soon soften. There is indeed already evidence of both. The number of oil and natural gas rigs operating in North America, for example, is rising rapidly, with more rigs in operation today than at any time since the early 1980s. Consumer spending on gasoline is also falling. This is a particularly strong response, given that gasoline consumption generally only falls during recessions.

Higher Rates Will Short-Circuit the Housing Cash Machine



Mortgage equity withdrawal remains an enormous source of cash for homeowners, and thus a powerful impetus for consumer spending and broader economic growth. Homeowners pulled an estimated \$700 billion from their homes in 2004 through home equity loans, cash-out refinancings, and capital gains realized on home sales. This is some \$125 billion more than in 2003. MEW is highly sensitive to fixed mortgage rates. At the current 6% fixed rate, MEW will remain robust. At even just a 7% fixed rate, however, MEW will measurably weaken. This will eventually be a substantial drag on growth.

Section II:

Sonoma County Stocks in 2005: Outperformance Threatened?

By: Brad Zigler
Santa Rosa-based writer and editor
for several financial publications

SONOMA COUNTY STOCKS IN 2005: OUTPERFORMANCE THREATENED?

This report was prepared by Brad Zigler, a Santa Rosa-based financial writer and editor. Mr. Zigler's work has appeared in the Journal of Indexes, Institutional Investor, Financial Planning, Mutual Funds, Futures, Registered Rep. and the North Bay Business Journal, among other publications. Previously the head of marketing, research and education at the Pacific Exchange and Barclays Global Investors, Mr. Zigler is the creator of the North Bay Stock Index. He holds investments in the North Bay Stock Index securities mentioned in this report.

NO IMMUNITY

If there's a lesson local investors have learned this year, it's this: Sonoma County stocks aren't immune to the forces that move the broader market. Year to date (as of May 13), the Sonoma Sector of the North Bay Stock Index (NBSI) has slipped 3.52 percent. Still, compared to the contemporaneous 5.96 percent decline in the Dow Jones Industrial Average (DJIA), local stocks continue to outperform their blue chip cousins. The NBSI, price-weighted like the DJIA, is a benchmark of more than two dozen publicly traded companies headquartered in the three counties north of the Golden Gate Bridge. The Sonoma Sector is comprised of eight NBSI firms that remain based in Sonoma County.

In a decidedly more bullish 2004, Sonoma County issues earned a whopping 13.53 percent premium over the DJIA. Clearly, the premium has contracted significantly. But perhaps more important than that is the widening in the local stock set's safety margin. The risk of owning Sonoma County stocks, as measured by the standard deviation of weekly returns, is now only 9.52 percent compared to 15.05 percent at year's end 2004. Simply put, that means there's roughly two chances out of three that Sonoma County stocks will end up within 9.52 percent—up or down—of their collective average price a year from now. Local issues were considerably more risky in the closing months of 2004.

The interplay of local risks and rewards is encapsulated in the Sonoma Sector's -0.90 Sharpe ratio¹. The Sharpe ratio represents the payback, in terms of a return over the Treasury bill rate, earned for shouldering the risk of the local stock set. The negative Sharpe ratio indicates that a risk-free investment in short-term government debt has offered a better return so far this year. By comparison, pitting the DJIA's 10.77 percent volatility against its current annualized return yields a Sharpe ratio of -1.17, some 30 percent worse than the Sonoma Sector's.

Figure 1 illustrates the year-to-date performance of the Sonoma Sector, its parent index, the NBSI, the DJIA and a job-weighted benchmark of Sonoma County's largest externally headquartered employers. Figure 2 provides details on each of the local sector's component stocks.

The median Sonoma County stock has declined 3.86 percent since the beginning of the year. Losers outpace losers by a 5-to-4 margin when the performance of now-defunct Redwood Empire Bancorp (REBC) is counted. REBC's share price, leading up to its March 1 merger with NBSI component Westamerica Bancorporation (WABC), had skidded 5.41 percent.

¹ Sharpe ratios in this report are based on *annualized* returns, not returns for the year-to-date period.

Figure 1

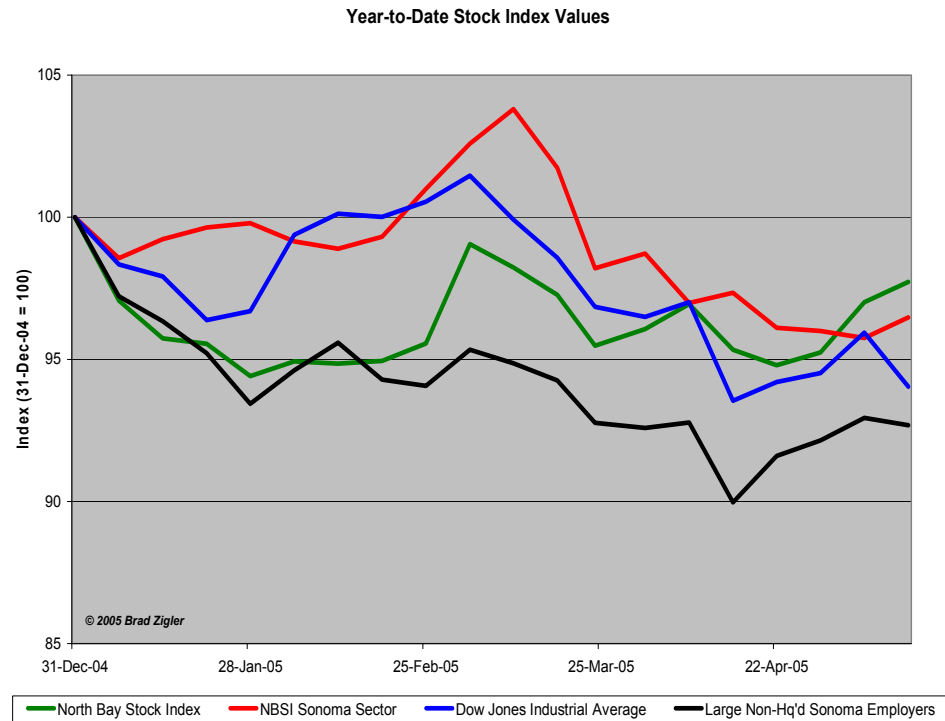


Figure 2

Sonoma Sector Component Performance

	Industry	Year-to-Date Gain/Loss ¹	Volatility	Sharpe Ratio	13-May-05 Price	Liquidity Index
Northern Empire Bancshares (NREB)	Regional Bank	23.95%	2.53%	14.74	\$26.39	\$237,783
Spectrum Organic Products, Inc. (SPOP)	Food Processing	17.31%	8.86%	2.96	\$0.60	\$7,148
SonomaWest Holdings, Inc. (SWHI)	Rental/Leasing	7.42%	6.15%	1.59	\$11.43	\$2,163
Burst.com, Inc. (BRST)	Software & Programming	3.33%	18.55%	0.16	\$1.55	\$91,014
Exchange Bank-Santa Rosa (EXSR)	Regional Bank	-3.86%	11.70%	-0.77	\$135.75	\$128,343
Redwood Empire Bancorp (REBC) ²	Regional Bank	-5.41%	--	--	--	--
Sonoma Valley Bancorp (SBNK)	Regional Bank	-15.68%	4.38%	-6.55	\$20.00	\$14,428
ZAP (ZAPZ)	Recreational Products	-22.39%	7.18%	-5.55	\$2.60	\$201,848
Tegal Corporation (TGAL)	Semiconductor Equipment	-28.83%	8.97%	-5.64	\$1.16	\$160,824
Median		-3.86%	8.02%	-0.31	\$7.02	\$109,679

¹ Returns as of 13-May-05 adjusted for dividends and splits

² Redwood Empire Bancorp (REBC) YTD return before its 01-March-05 merger with Westamerica Bancorporation (WABC)

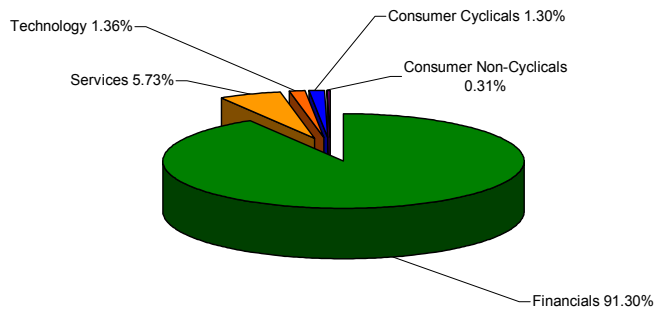
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SECTOR BREAKDOWN BY INDUSTRY

To say the Sonoma Sector is heavily concentrated in financial stocks is to utter a vast understatement. Nearly the entire price weight—91.30 percent—of the stock set comes from regional bank stocks. That figure would have been even higher had REBC not merged with WABC. At the beginning of the year, financial issues made up fully 92.50 percent of the sector's weight.

Figure 3

Sonoma Sector Industry Breakdown (Price Weighted)



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Financials

Surviving Sonoma County banks declined 1.66 percent so far this year, earning a composite -4.95 Sharpe ratio. Financial stocks now account for 75.01% of the Sonoma Sector's market capitalization.

- Northern Empire Bancshares (NREB) - Counting the effect of a five percent stock dividend paid in April, shares of Sonoma National Bank's corporate parent earned a total return of 23.95 percent year to date. The holding company's visibility among investors and analysts should increase as the result of the recent migration of NREB's share trading from the Over the Counter Bulletin Board to the Nasdaq National Market.
- Exchange Bank-Santa Rosa (EXSR) - Investors, apparently looking beyond the 19-branch financial institution's recent loan growth and expense containment measures, set the bank's stock adrift in the first few months of 2005. Adjusted for dividends, EXSR's price has slipped 3.86 percent in 2005.
- Sonoma Valley Bancorp (SBNK) - A 25-cent per share dividend brought this stock's year-to-date return to -15.68 percent. First quarter expenses for the three-branch holding company rose 14.98 percent year over year while total operating income ticked up 16.19 percent.
- Redwood Empire Bancorp (REBC) - Shares of National Bank of the Redwoods' parent ceased trading at the end of February at \$28.00, 5.41 percent under water. Marin County-based WABC paid \$11.37 in cash and .3263 shares of WABC common stock for each share of REBC.

Consumer Cyclicals

In a reversal of last year's good fortune, cyclicals have earned a dismaying -5.55 Sharpe ratio so far this year. The industry represents 10.32 percent of the Sonoma Sector's current market capitalization.

- ZAP (ZAPZ) - The Santa Rosa-based distributor of alternative fuel vehicles turned in the sector's second-worst year-to-date performance, dropping 22.39 percent. ZAP recently received federal regulatory approval to sell the German-made, environmentally friendly Smart Car in the United States. Dealer orders for the Americanized version of the car now exceed three-quarters of a billion dollars.

Technology

With a Sharpe ratio of -2.02, Sonoma County technology stocks lost an aggregate 13.42 percent since the beginning of the year. Technology stocks now represent 9.49 percent of the Sonoma Sector's market capitalization.

- Burst.com (BRST) - The Santa Rosa-based software maker's longstanding patent infringement suit was finally settled in BRST's favor. The company received \$60 million from Microsoft Corporation. (MSFT), setting the stage for a special 90 cent-per-share dividend for BRST shareholders. BRST shares have gained 3.33 percent year to date.
- Tegal Corp. (TGAL) - TGAL remains mired as the Sonoma Sector's worst-performing stock. Year to date, the share price of the plasma etch and deposition systems maker has nosedived 28.83 percent on declining revenues and widening losses.

Consumer Non-cyclicals

A current 2.96 Sharpe ratio has turned the worst reward-to-risk proposition of 2004 into the second-best performer of 2005. This segment represents 3.68 percent of the Sonoma Sector's market capitalization.

- Spectrum Organic Products, Inc. (SPOP) - The stock of the culinary oils maker rose 17.31 percent on the heels of record first quarter net sales.

Services

Now accounting for 1.49 percent of the Sonoma Sector's market capitalization, the one-stock services industry has earned a Sharpe ratio of 1.59 percent thus far this year.

- SonomaWest Holdings, Inc. (SWHI) - The property-leasing vestige of Sebastopol's Vacu-Dry managed a year-to-date gain of 7.42 percent. Operating expenses, however, still exceed rental revenues for company's commercial properties.

DIVIDENDS

Collectively, the annual dividend yield on Sonoma Sector stocks stands at 3.11 percent as of May 13. Dividends were contributed by two regional bank stocks—EXSR and SBNK. By comparison, the average annual yield on three-month Treasury bills has been 2.60 percent this year.

LIQUIDITY

In the wake of mergers and consolidation over the past two years, the mean market capitalization of Sonoma Sector stocks has been steadily shrinking. With Advanced Fibre Communications, Inc. (AFCI) and REBC on the roster last year, the average Sonoma County stock's market capitalization was \$220 million. Now, with those two stocks gone, the average market capitalization has declined to \$94 million. However, the sector's *median* market value is now \$51 million—well inside "micro-cap" territory.

That's a drawback since stock analysts typically shun coverage of micro-caps. In fact, *none* of the current sector constituents are now covered by sellside research.

Figure 4

Sonoma Sector Component Fundamentals

	Average Volume	Shares Outstanding	Market Capitalization	Price/ Earnings	Price/ Book	Dividend Yield
Northern Empire Bancshares (NREB)	7,200	2,300,000	\$284,400,000	17.76	2.97	
Spectrum Organic Products, Inc. (SPOP)	65,300	46,450,000	\$28,330,000	18.99	4.54	
SonomaWest Holdings, Inc. (SWHI)	400	1,110,000	\$11,280,000	151.43	2.49	
Burst.com, Inc. (BRST)	340,400	20,140,000	\$13,700,000	40.52	-4.51	
Exchange Bank-Santa Rosa (EXSR)	170	1,714,000	\$239,800,000	16.00	2.02	4.17%
Sonoma Valley Bancorp (SBNK)	1,100	2,160,000	\$43,000,000	20.00	2.40	2.53%
ZAP (ZAPZ)	147,900	31,090,000	\$78,040,000	-4.54	-13.24	
Tegal Corporation (TGAL)	540,700	52,810,000	\$59,150,000	-2.51	-6.91	
Median	36,250	11,220,000	\$51,075,000	18.38	2.21	3.35%

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Though "orphaned" from the sellside, Sonoma County's stocks exhibit surprising liquidity. The sector's average liquidity index, representing the size of a transaction necessary to move an issue's price by one percentage point, actually increased 6.92 percent since last year. Taking out the effect of AFCI, last year's median liquidity index was \$102,579. The median now stands at \$109,679.

INSIDER TRANSACTIONS

Like the market for their stocks, officers and directors of Sonoma County's publicly traded companies have been relatively quiet this year, at least as far as trading in their company's stocks are concerned. After grossing nearly \$5.1 million in profits from insider transactions in 2004, confirmed gains from open market sales have amounted to only \$88,432 year to date. Those gains—amounting to 79.87 percent over the stock cost base—were earned by a single SBNK director.

In February, the chairman of SPOP disposed of 300,000 shares—then worth \$156,000—of his company's stock in a non-open market transaction.

Three other companies' insiders filed plans to sell large blocks but, to date, there's been no indication that these sales have been consummated. Most significant among these is ZAPZ for which planned sales of 546,915 shares worth \$1,576,765 have been on the books since January.

ALTERNATIVE SONOMA COUNTY EQUITY INVESTMENTS

Despite being stuck in a market doldrum, Sonoma County-based stocks are faring better than the shares of large externally headquartered employers. An employment-weighted index of ten such public companies has fallen 7.32 percent so far this year (see Figure 1), yielding a -1.50 Sharpe ratio.

LOOKING FORWARD

Despite the downward drift of the market in early 2005, Sonoma County stocks continue to offer investors better returns than the broader market. Still, a negative return, however small compared to that of blue chips, is cold comfort. A more buoyant market environment, especially in the banking industry, would certainly help to polish the local stock set's brass.

Working against some Sonoma County public companies are the increased costs of doing business as the result of implementing of Sarbanes-Oxley requirements. For that reason, some local companies are looking at exit strategies, either through consolidations or by "going dark" (dropping to Pink Sheet status). The risk of further concentration in the Sonoma County stock universe therefore remains palpable.

***Note:** The foregoing information and discussion on Sonoma Sector stock performance was obtained by the County of Sonoma from Mr. Zigler and is presented for the convenience of the reader. Any opinions expressed are solely those of Mr. Zigler and not of the County of Sonoma. The information provided here is not intended to replace other stock performance reports, investment publications, and the like and should not be used as the sole source for investment decisions. You should perform your own research and evaluation before making any investment decisions. Although the information presented here is believed to be accurate, the County of Sonoma does not guarantee its accuracy and assumes no liability for investment results that may occur following your use of the information provided herein.*