Trusted Advisor

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A Tale of Two Markets

March 2000: Certified Financial Planners who are trained to counsel cautious investing feel alone and undervalued. Average Americans are making so much money playing "The Market", that they don't feel the need to pay anyone for advice. The financial media present an exciting picture of the huge profits to be made in the stock market.

July, 2002: Stock indexes fall to four year lows. Investor panic has taken the Standard & Poors index down 48% from its all time high in March of 2000, and for every dollar held in The average "growth" stock [1] investors hold only twenty two cents in their hand. [2] By any measure, this is one of the three most destructive bear markets of the past century: a once-in-a-generation event!

Many Americans have seen their dreams of a leisurely retirement, and possibly their margin of security against the costs of disability and illness evaporate in less than the time it takes to put a child through college. This Summer the stock market has felt like a tornado rampaging through a mid western neighborhood. Emerging from the storm cellar, our clients may have been unhappy to see that the windows of their home were blown out, until they looked out those windows to see that their neighbor's house was destroyed down to the foundation!

Because we have tried to avoid overexposure to any one stock sector, have used hedging techniques and have counseled diversification, recent losses suffered by discretionary accounts have been tolerable. In fact key holdings have gone up: bonds, real estate investment trusts, and a generous allocation to money market funds have provided positive returns that partially offset stock losses. More important is the <u>long term</u> performance which has provided growth of client account values or supported the costs of vacations, motor homes and medical expenses without suffering much decline. We've invited clients to make the comparison with account values of five years ago and those who have reported back to us are generally satisfied.

The curious thing for some observers is the depth of the desolation in stocks. After all, the country has had a growth slow down, some would call it a recession, but by all accounts it's been a mild one. The stock market has reacted disproportionately due to three ingredients:

- The market contained many greatly over valued stocks that simply needed to be brought back to earth.
- An expensive and unnerving war on terror has investors sitting on pins and needles.
- Lost confidence in those we used to trust: CPA's, stock analysts, business leaders are all suspect.

This bear market was widely anticipated by many, especially those espousing the "Value" investment approach. But it was incorrectly predicted every year between 1996 and 1999 while investors grew wealthy in soaring technology and biotech enterprises. Value investors like Warren Buffet were seen as irrelevant as a 45 RPM record player, a *broken* record player that whined the same old warnings. Now the stock market has once again proven that experience counts. Most of today's analysts, most media commentators and most brokers were still not out of high school when the last major bear market occurred in 1973- 1974. Like a young child diving into a deep swimming pool, these advisors could not conceive the potential danger the market holds at any given moment.

One has to live through a real, grinding long term bear market experience as an investor and as an investment professional, as did this commentator, to understand how merciless the market can be. The shadow of this experience influenced my portfolio design recommendations forever after. Given their brutal treatment by the market in recent months, one would think more folks would flock to my way of thinking, but so far, this is not so! Although I've interviewed many investor who could benefit from my advice, most of them are now paralyzed with fear: "Do I sell?" "Do I buy?" "What can I do but wait and pray?" The answer in my opinion is to subject each holding of your current portfolio to a through and unemotional review. My rule of thumb: If you are holding any stock, mutual fund or instrument that you would not purchase again today with fresh cash, then get out!

As for my existing clients, who've kept some cash handy, it's was time to do some Christmas shopping in July and August. We are pleased to be in the company of star value investors like Warren Buffet, Jim Gipson (Clipper fund), and Bill Nygren (Oakmark) who have stepped in to scoop up com-

CFP CERTIFIED FINANCIAL PLANNER™

Gary Miller has over 28 years experience in the financial services industry as both an analyst and financial advisor. Currently he provides service to clients as a CERTIFIED FINANCIAL PLANNER™ practitioner. Gary holds a certificate in Personal Financial Planning from University of California, Irvine; and is a Board member of the Orange County Chapter of the Financial Planning Association.

panies discarded in a panic by others who are ill - advised or not advised by anyone at all. Buffet has been especially active in building his holdings of natural gas pipelines. Gipson's Clipper Fund has increased its stake in Tyco International, a company that appears to be sound, but which was devalued as a reflection of the antics of its departed CEO Dennis Koslowski. Longleaf Partners, another respected value fund joined Buffet in a rare technology investment: convertible bonds offered by Level 3 Communications.

As for us, we've added to holdings in medical services and increased our stake in Clipper fund when it was down. We are seeing other bargains and expect to act again soon.

Where's "The Market" Headed?

First let's make it clear again that there is more than one "market". We advocate diversification into vehicles other than common stocks of industrial and service companies to provide optimum safety and opportunity. Still, common stocks offer a liquid opportunity to participate in many great businesses. Stock market forecasts are not something we make or believe in. We buy superior businesses believing they will reward us over time, regardless of the day to day "noise" . Yet we cannot help but offer a few thoughts about the possible direction of investor sentiment as reflected in the stock market indices:

A study of past bear markets[3] suggests that they are rarely more than three years in duration. Still, recent economic statistical releases for both the U.S. and Europe indicate the economic recovery is anemic and it is fragile. We believe it unlikely that a bull market began after the July panic, and any number of events such as another terrorist attack, could send the averages down to or below their recent four year lows. Good stock picking and prudent diversification among low-correlation assets will continue to be crucial for building or re-building wealth in the coming months and years.

New Name New Look

You've noticed the new name for our client newsletter –there's a good reason for this. Effective August 15, 2002 Gary Miller commenced doing business as "TRUSTED FINANCIAL ADVISORS". Trusted Financial is a Registered Investment Advisor[4]. For clients, little visible change has taken place. Accounts remain with a third party discount brokerage firm (we are not brokers!), and only the legal name of the advisor has been changed on the records of that broker, which allows us to continue making day to day asset allocation decisions for our clients.

The conversion to TRUSTED is meaningful to me, however. It has been over twenty years since I operated as a fully independent investment advisor. In 1979 I created *Portfolio Service of Newport Beach* and advised clients about the use of treasury bond options, a tax favored strategy that was highly profitable for about three years. Under the new Reagan administration, tax rates fell and the demand for my services declined. With the Dow Jones Industrial Average rising decisively above 1000 in 1982, I believed we were on the threshold of a major bull market, and bet my career on it.

I joined Kidder, Peabody & Co., an old-line Wall Street brokerage firm in 1983. This proved to be a good "trade". The next seventeen years taught me much about our industry and investing.

An aspect I did not appreciate were the conflicts of interest endemic to the brokerage business. Retail stock brokers are treated by management like <u>mushrooms:</u> kept in the dark and fed……well, you know the old joke! There is continual pressure to produce income for the firm, and many brokers must walk a fine line between representing their clients' best interests and keeping "The Firm" happy. I decided I wanted to be more than a stock jock. After obtaining my Certificate in Personal Financial Planning at University of California Irvine, I joined the Institute of Certified Financial Planners and began associating with other planners, most of whom do not work for Wall Street firms. I learned that there is a way to serve the client without conflicts of interest.

January 2001 was my liberation day: I joined Walker Financial Advisors and became a <u>fee only</u> financial advisor. I stopped accepting any commissions, bonuses, spiffs, back end trailers or golf outings. But there was one more step to be taken: my goal has always been to once again open my own shop and so it is with pleasure that I commenced operations as a fully independent Registered Investment Advisor on August 15. Another key reason for this transition was a desire to publish my investment performance record, which was not possible while affiliated with another advisor. I'm proud of the manner in which the portfolios I've structured have performed during this devastating Bear market (stocks), and look forward to publishing my performance for discretionary accounts, so that potential new customers can judge me by the numbers. By the way, we have a new web site: www.trustedfinancial.net. Among the features, you will be able to access current and past newsletters and link to the Schwab Institutional Website.

Thanks for your Referrals

We've enjoyed an increase in referred business of late! There is no greater compliment than to have a current client refer a potential new client. In these times more and more people are seeking answers and direction with regard to their personal finances. We are happy to speak with such people at any time, and they will be under no obligation to do business with us. Thanks again!

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(Footnotes)

[1] as represented by the NASDAQ index

[2] March 10, 2002, NASDAQ at 5048.62; July 23 2002 1129.05

[3] Stocks, Bonds, Bills and Inflation Yearbook 2000, Ibbotsen, © 2001

[4] A copy of form ADV Part II which discloses details of our business operation, personnel and fees is available upon request