Trusted Advisor

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Performance Report

We are now three quarters of the way through 2003. While I believe short term performance has little meaning to an investor (as opposed to a speculator) never the less, our quarterly report will be out in the next few days. Preliminary results for discretionary accounts, year to date weighted by size is up 10.86% and equally weighted, up 10.20%. This is right on target with the average of balanced funds, up 10.62%.

As always my goal is to be spectacularly consistent, avoiding extremes especially when equity markets are weak. As stated since December 2000, I believe we have entered an especially difficult era for U.S. stocks. Three years ago, Warren Buffet suggested that long term future returns for stocks will fall in the 7% area, and this sentiment has been echoed by other investors whom I admire, such as Bill Gross. I believe the current bull market to be a cyclical event, similar to those in the 1970's. In that decade, bull stock markets lasted 2 to 2$^{1/2}$ years and were followed by bearish cycles lasting about two years. Between 1966 and 1980, the Dow Jones Industrial Average reached 1000 but failed to meaningfully surpass this level on no less than five occasions.

It is my strong suspicion that we have entered another such era, one that will repeatedly trick investors into plowing large amounts of hard earned money into the market as the cycle nears it's end. Compare this to the relatively easy secular bull market of 1982 to 2000. During this period, the longest bear market cycle lasted less then 12 months.

Because I do not expect this historically generous 1982-2000 era to return, I devote a sizeable portion of client portfolios to income producing assets in the natural resources, real estate and foreign currency sectors, in addition to more traditional types of stocks in the service, financial and pharmaceutical arenas. These growth oriented investments are married to a diverse mix of income producing securities including bonds and preferred stocks.

The best high dividend performers by far have been Real Estate Investment trusts. Our individual selections have done well, and both Franklin Real Estate Securities Fund and Columbia Real Estate Fund are up over 20% year to date, when dividends are reinvested.

Index Investing: the Five year Record

From the perspective of the most recent five year horizon, ending September 30 2003, the advice-less strategy of "indexing" has been a failure. Even with a healthy rally in recent months, the 93 Standard & Poors Index mutual funds tracked by Barron's gained only .46% (yes, that's .0046) per year. Indexers used to claim there was no value in paying advisory fees, because most mutual fund managers under-performed the broad stock averages. This was perhaps true during the secular bull market of 1982-2000, but in the uncertain market we now face, intelligent stock picking has shown it's value: during the same five year period when index funds barely kept investors afloat, the average equity mutual fund generated 4.08% per year. Viewed from another perspective, $100,000 invested in a manager guided mutual fund from October 1, 1998 through September 30, 2003 would have risen to about $122,000. $100,000 tied up in an S&P index stock fund would today be worth $102,000.

Certified Financial Planner™

Gary Miller is in his 30th year of providing financial guidance to individuals and pension plans. He is a Registered Investment Advisor and a Certified Financial Planner ™ Practitioner. Gary holds a Certificate in Personal Financial Planning from the University of California, Irvine and has served as a Board member of the Financial Planning Association, Orange County Chapter.

For technology aficionados, the wellknown "QQQ" technology index did not come into existence until January of 1999, but in the fifty six months since it's introduction, the index is off about 30%. A more humorous index is the "KREMEY" created by *Business Week* magazine. KREMEY is a basket of ten prominent technology companies. Three years ago *Business Week* began comparing it's performance to that of donut emporium Krispie Kreme and, while acknowledging that technology index KREMEY has beaten Krispy Kreme hands down in the current year, the donut maker has performed brilliantly in the three and one half years since it became a publicly traded firm in April of 2000.

To quote *Business Week*: "If you had put $5,400 in Krispy Kreme stock when it went public at $21 a share three years ago, your investment would have grown 665% to $41,326. Putting the same sum into KREMEY would have left you with a paltry $2,017 now – a 61% long term drop, despite 2003's partial recovery."

So, my advice to anyone who thinks they can recoup the losses of recent years by guessing which technology index to buy, take two donuts and call me in the morning!

International Allocation Expanded in Client Portfolios

Most clients saw their holdings of both foreign bonds and stocks increased in recent days. After a precautionary reduction in world bonds this Summer, we felt the secular bear market for the U.S. dollar was resuming. This was particularly evident with relation to trading partner Japan. The Yen jumped to the highest level against the dollar in 3 years, despite the Bank of Japan's desperate efforts to keep the yen down throughout the month of September. Japan and China (whose Yuan does is not freely convertible) have a concerted policy of supporting their export industries by keeping their currencies artificially depressed against the dollar. If the market were allowed to freely value these three currencies, driving them upward, imports from Asia would be far more expensive in America, and perhaps the massive layoffs announced by Ford and General Motors on October 3, 2003 could have been avoided. Free transaction of goods across borders is considered by most economists to create the greatest efficiency in the world economy. Implicit in this arrangement is a similarly free currency exchange market. Right now the cards are stacked against U.S. manufacturers, who are either shifting production overseas or going out of business altogether. This holiday season, virtually any ornament you purchase will be made in China. Meanwhile, unemployment checks flow out of state treasuries each month.

That being said, my job is to assist investors to profit from the world as it is. For an American investor, foreign stock markets have special appeal: they are a means to protect buying power. According to *Barron's,* the German stock index, year to date, is up 28.75%. Measured in Euros, the market is actually up only about 13% from 3000 to about 3400. The strength of the Euro against the U.S. dollar has, therefore, boosted returns on German and other European stocks to make them competitive with U.S. market returns. This is proving true for companies traded in Japan as well. In early October I expanded client holdings of foreign stocks to the highest level in over a year to take advantage of twin bull markets in foreign stocks and foreign currencies.

Japanese Yen futures (Chicago)

Preparing Your Children for Your Death

This is not a happy topic but, like taxes, needs to be dealt with. If you have not discussed in some detail the provisions you've made for your demise with your children, this is a reminder that such a conversation is an important part of good estate planning. If your kids have an idea of your wishes and intentions, they will be better able to support your spouse during a difficult time. Such a discussion is also a measure of respect for your children.

Adult children are well aware that their parents are likely to pre-decease them. This is an emotional topic – for most children it is difficult to imagine the world without their parents. As children's financial sophistication advances and as they grow their own families, they will be making important decisions about how to provide for their spouses and children in the event of an early death or disability. This naturally leads to thinking about their own parents' situation: could a long term illness wipe our parents out financially? Will mom be able to keep her house or will she have to come live with us? Do our parents have a living trust to avoid probate? Is there any written instruction about which child gets the diamond brooch or the coin collection?

As much as such questions may haunt your children, they may be uncomfortable raising the topic. Perhaps when young children, you told them your finances were not their affair. Maybe they fear that if they raise such questions you will see them as money grubbing offspring, counting the days until your demise. These fears may prevent a very valuable communication between you and your kids. In my case, it was not until my dad was in the hospital being stabilized for open heart surgery eighteen years ago that I had the courage to ask questions and then discovered there was no living trust and the will had not been updated in two decades!

If you have not given your kids at least an outline of your financial arrangements, may I suggest that you bring up the topic? There is an excellent book available to help centralize all your vital information: ***Everything Your Heirs Need to Know***, David Magee, Dearborn Financial Publishing, Inc. The book is out of print but can be ordered from Amazon at www.amazon.com.

If my involvement in a parent-child meeting to discuss estate arrangements would help, clients can count on my support with no fee charged.