Client Bulletin
April 2004

Economic & Market Update – The economic data continues to be favorable as evidenced by the employment report released last Friday showing the U.S. economy added 308,000 jobs last month. The Conference Board's CEO Confidence Index recently hit a 20-year high. Half of all CEOs expect to hire this year vs. less than 16% a year ago. Growing corporate earnings provide the fuel for higher stock prices and generally speaking the outlook is favorable for a durable profit expansion. Last quarter, 68% of companies reported positive earnings surprises providing an excellent fundamental backdrop for stock prices. For the first quarter the Dow and NASDAQ ended down slightly, while the S&P 500 posted a gain of 1.7%. Foreign markets rallied producing solid returns for all our international stock funds. While we are cautiously optimistic, we do acknowledge certain risks. Geopolitical instability, the on-going war and loss of life in Iraq, and future terrorist attacks are issues that cannot be ignored.

The markets have begun to look forward to the Presidential election this fall. Senator John Kerry has established himself as the democratic candidate to challenge President Bush. There are a myriad of factors that will continue to influence stock prices, but we were curious how the stock market has done in previous election years. Data from *Ibbotson Associates* shows that since its inception in 1926, the S&P 500 stock index has produced a positive return in each election year, except for three. The three negative years marked the Great Depression, the beginning of World War II and the recent popping of the internet bubble.

Election Year – S&P 500 Return					
1928	43.61	1956	6.56	1984	6.27
1932	-8.19	1960	0.47	1988	16.81
1936	33.92	1964	16.48	1992	7.67
1940	-9.78	1968	11.06	1996	23.07
1944	19.75	1972	18.98	2000	-9.11
1948	5.50	1976	23.84		
1952	18.37	1980	32.42		

Given the current low levels of interest rates and inflation, along with the expanding economy and robust corporate profits, it appears likely that 2004 will add another positive year for stocks to the Presidential cycle.

Equities – Our philosophy is to use a combination of no-load stock funds and individual stocks to form the growth component in client portfolios. The mix is different for every client depending upon when they joined us along with any individual preferences. It's simply not practical to review all our holdings each quarter, so we highlight several positions of interest.

With the economy continuing to gain traction, the demand for commodities is strong. During the 80's and 90's very little money went into the productive capacity for natural resources as energy, mining, and basic materials companies languished in neglect. Inventories are down and a supply demand imbalance has developed driven by Chinese imports of raw materials. The war in Iraq and Middle East instability are keeping oil prices high and have led to record high gasoline prices in the U.S. How do we participate in these trends? Owning big integrated oil & gas companies like **BP PLC ADR**, (BP) and **ExxonMobil**, (XOM) with their global scale and steady dividends is one avenue. Another play is **BHP Billiton Ltd. ADR**, (BHP) one of the largest diversified natural resource companies in the world. They recently announced a $9 billion multi-year agreement with China's four largest steel mills to supply raw materials. The company has primary operations in Australia and is engaged in the production of iron ore, nickel, copper, diamonds, and coal. **Petrochina Co. Ltd. ADR**, (PTR) is the dominant energy provider in China and a new holding for us. They are China's top oil producer, own and operate refineries, sell and build pipelines for natural gas, and run or franchise over 15,000 service stations. **Plum Creek Timber**, (PCL) is a domestic natural resource company that is the second largest timber owner in the U.S. Lumber prices have been moving up and the company also has some joint venture projects with local developers on prime lakefront property. These stocks have all made nice moves higher, so we're reluctant to commit more money at current prices, but with many economists predicting that global growth and accommodative central bankers will produce a reflationary environment, we expect these natural resource companies to continue to do well.

Fixed Income – The fixed-income market is like a minefield these days. Anyone enamored with the past returns on bond funds and committing new money today is likely to be disappointed moving forward. When market interest rates move higher, the prices of existing bonds go down. This is exactly what happened to start off the second quarter when the strong employment report was released at the end of last week. Strong economic reports stoke the fear that the Fed may need to bump up interest rates to quell inflationary pressures later this year. We continue to like the **Metropolitan West Low-Duration Bond Fund** and **Metropolitan West Strategic Income Fund**, as both are positioned defensively against higher future interest rates. We are also using the **ProFunds Rising Rate Opportunity Fund** as a hedge against higher rates.

We have recently purchased "step-up bonds" for some accounts. This securities feature a fixed maturity date and a coupon that resets to a higher interest rate at future intervals. One example is a bond issued by the **Federal Nat'l Mortgage Assoc.** (FNMA) with a final maturity in 2018 that carries an initial coupon rate of 5%. Assuming the bond is not called later this year, the coupon resets to 6%, 7.125%, and 8.25% between 2007 and 2015.

Stock Funds – All of our equity funds posted positive results for the 1st quarter. We continue to emphasize entrepreneurial actively managed funds that are leaders in their respective category. Small company stock funds topped the charts last quarter, with **Wasatch Small Cap Value** leading the way for us. **TCW Galileo Value Opportunities** is a mid-cap blend fund that has rebounded strongly after getting stung in 2002 for an early foray back into tech stocks. Co-managers Nick Galluccio and Susan Suvall have been managing money at TCW for 19 years. In 1997, the pair launched the Value Opportunities Fund and over the past five years the fund ranks in the top 1% of its category. The managers want to see high free cash flow and strong balance sheets and divide their portfolio into four categories: companies trading below liquidation value; turnaround stories; busted-growth stocks; and emerging-growth stocks. 30% of the fund is currently dedicated to technology holdings, so expect some short-term bumps. Since the

Vanguard Capital Opportunity Fund has closed its doors again to new investors, the TCW fund is a fine substitute.

A new international fund added last quarter is the **Dodge & Cox International Stock Fund**. The fund managers favor large company value stocks and have a low turnover approach. Japan carries the largest country weighting at 26% of assets, with Sony being the top holding. We pay a transaction fee to Schwab on this fund, but get a below average expense ratio of .90%. The **Matthews Japan Fund** is another new holding that gives us direct exposure to the recovering Japanese economy with a bias toward domestically-oriented sectors.

<u>Cost Savings</u> – Effective March 1, a reduced commission schedule for our client accounts became effective with Schwab Institutional. We strive to keep costs low for our clients and are happy to report that equity trades will now be subject to commission rate of 2 ½ cents per share with a $24.95 minimum per trade.

<u>Health Savings Accounts (HSAs)</u> – These new tax-advantaged plans were legislated into existence last November when the Medicare legislation was enacted. HSAs are particularly appealing to the self-employed and those without employer-provided health insurance. HSA contributions are tax-deductible and accounts grow tax-deferred. Withdrawals are tax-free if they are used to pay qualified medical expenses. To be eligible, a person must (1) be covered by a so-called high-deductible health insurance plan (HDHP); (2) not be covered by another health plan, like a spouse's lower deductible plan at work; (3) be younger than age 65; and (4) not be claimed as a dependent on another's tax return. The HDHP must have a deductible of at least $1,000 and an out-of-pocket maximum of no more than $5,000. Double those figures for families. Annual tax-deductible contributions are limited to 100% of your HDHP deductible, with a maximum cap in 2004 of $2,600 for a single filer, or $5,150 per family. Those over age 55 are eligible for an additional $500 catch-up contribution in 2004. Withdrawals prior to age 65 for reasons other than to pay qualified medical expenses, are subject to a 10% penalty and ordinary income tax. After 65, you can withdraw funds for any purpose without penalty, though amounts not used for qualified medical expenses are taxable. We are currently investigating administrative and custodial alternatives.

<u>Happy News</u> – Congratulations to Warren and Michelle Isenberg who are the proud parents of a new baby boy, Owen Conrad, born on March 30th. Owen was 7 pounds, 9 ounces at birth and everyone is doing fine. This is their first child and after spending a week at home with his family, Warren is back at the office. Warren has been with us for six years, and as a fellow Certified Financial Planner, he makes a valuable contribution in managing our client accounts.

All of us here at WFA take our responsibilities very seriously, and we are committed to serving your interests. Please let us know if there are any financial issues you are confronting where we may be of assistance.

Scott Walker
April 8, 2004