



# Park Piedmont Advisors LLC

Registered Investment Advisor

VICTOR LEVINSON

NICK LEVINSON

## FEBRUARY 2005 COMMENTS

### IMPORTANT NOTICES:

#### TAX COST BASIS INFORMATION for 2004 SALES:

Form 1099s for 2004 have been mailed to you by your account custodian. These forms cover dividends and interest you received, as well as the proceeds from any sales. During 2004 your account most likely had two custodians, National Financial Services (NFS), through our current Broker/Dealer LaSalle Street Securities (LSS), and Bear Stearns (BS), through our previous Broker/Dealer Balis Lewittes Coleman (BLC). The Form 1099s do not contain the cost basis associated with sales. Therefore, when you receive these 1099s, if there are proceeds from sales listed, please fax (212-391-2312) or mail (110 West 40<sup>th</sup> St., NY, NY 10018) a copy of the 1099s to Lynette Carmelli at our NY administrative office, and we will supply all the necessary cost basis information to you and/or the person who prepares your tax return. This process should only be needed for the transition year 2004, as we expect to be fully integrated into the LSS/NFS tax reporting system by the end of 2005.

#### SEC DISCLOSURE DOCUMENTS: ADV PART II

As a Registered Investment Advisor with the SEC, Park Piedmont Advisors LLC (PPA) has provided each client with a copy of its required SEC Disclosure Document, ADV Part II. Among other matters, the ADV Part II describes PPA's advisory services, fees, and the business and educational backgrounds of its advisors. This is our continuing Notice, required by the SEC, that you can request a copy of PPA's ADV Part II, which we will send to you by return mail. To receive a copy, please contact Lynette Carmelli at 212-391-2323, or [lynettec@parkpiedmont.com](mailto:lynettec@parkpiedmont.com). You can also access our ADV at any time from our website, at [www.parkpiedmont.com](http://www.parkpiedmont.com).

### CONTENTS

Page 1:	Important Notices: What's in This Edition?
Pages 2-4:	Index Results for February, 2005 and Year-to-Date 2005; Also Years 1999 – 2004, and Various Other Longer Time Periods
Pages 5-11:	Investment Concepts:
Pages 5-6:	I. Update of Key Economic Indicators
Pages 7-11:	II. Current Investment Opportunities: Are There Any?
Page 12:	Investment Returns from 2000 to Present, and 1995 to Present

*Any recommendation contained in these Comments may not be suitable for all investors. Moreover, although the information contained herein has been obtained from sources believed to be reliable, its accuracy and completeness cannot be guaranteed.*

**COMMENTS: INDEX RESULTS, period ending FEBRUARY 28, 2005**

<u>STOCKS</u>	<u>YEAR</u> <u>1999</u>	<u>YEAR</u> <u>2000</u>	<u>YEAR</u> <u>2001</u>	<u>YEAR</u> <u>2002</u>	<u>YEAR</u> <u>2003</u>	<u>YEAR</u> <u>2004</u>	<u>YTD</u> <u>2005</u>	<u>CURR.</u> <u>MONTH</u>				
Vanguard Total Stock Market Index Fund (1)	23.8%	(10.6%)	(11.0%)	(21.0%)	28.4%	12.5%	(0.7%)	2.0%				
S&P 500 Index (2)	19.6%	(10.1%)	(13.0%)	(23.4%)	26.4%	9.0%	(0.7%)	1.8%				
Vanguard S&P 500 Growth Index Fund (1)	28.8%	(22.2%)	(13.0%)	(23.7%)	25.9%	7.2%	(1.9%)	1.1%				
Vanguard S&P 500 Value Index Fund (1)	12.6%	6.1%	(12.0%)	(20.9%)	32.2%	15.3%	1.2%	3.2%				
Dow Jones Industrial Average Index (2)	25.2%	(6.2%)	(7.1%)	(16.8%)	25.3%	3.2%	(0.2%)	2.5%				
NASDAQ Composite Index (2)	85.6%	(39.3%)	(21.0%)	(31.5%)	50.0%	8.6%	(5.7%)	(0.5%)				
Vanguard Midcap US Index Fund (1)	25.0%	2.6%	(4.8%)	(16.3%)	34.1%	20.4%	0.7%	3.6%				
Vanguard Smallcap US Index Fund (1)	19.6%	(4.2%)	1.0%	(21.6%)	45.6%	19.9%	(1.6%)	2.0%				
Vanguard International Index Fund (EAFE) (1)	25.3%	(15.2%)	(22.6%)	(17.5%)	40.3%	20.8%	2.9%	4.6%				
<b><u>BONDS</u></b>												
Vanguard Total Bond Market Index (1)	(0.8%)	11.3%	8.3%	8.2%	4.0%	4.2%	0.0%	(0.6%)				
Vanguard Intern. Tax-Exempt Index Fund (1)	(2.9%)	9.2%	5.0%	7.9%	4.4%	3.2%	0.1%	(0.5%)				
Vanguard High-Yield	NA	NA	NA	1.7%	17.2%	8.5%	1.0%	1.2%				
<b>%</b>	<b>1Q</b>	<b>2Q</b>	<b>3Q</b>	<b>4Q</b>	<b>1Q</b>	<b>2Q</b>	<b>3Q</b>	<b>4Q</b>	<b>1Q</b>	<b>2Q</b>	<b>3Q</b>	<b>4Q</b>
		<b><u>1999</u></b>				<b><u>2000</u></b>				<b><u>2001</u></b>		
<b>S&amp;P 500</b>	4.1	7.6	(7.7)	15.6	2.0	(3.0)	(1.3)	(7.8)	(12.1)	4.8	(13.8)	8.1
<b>NASDAQ</b>	14.6	10.0	0.0	61.0	12.4	(14.8)	(7.2)	(29.6)	(25.5)	12.9	(26.7)	18.3
<b>BONDS</b> Intern. Tax.	0.0	(0.5)	0.4	(0.7)	2.4	1.5	3.1	4.3	3.2	0.8	4.3	0.0
		<b><u>2002</u></b>				<b><u>2003</u></b>				<b><u>2004</u></b>		
<b>S&amp;P 500</b>	0.0	(13.8)	(14.1)	4.5	(1.8)	12.8	2.2	13.2	1.3	1.3	(2.4)	8.8
<b>NASDAQ</b>	(5.5)	(19.5)	(13.5)	7.0	2.5	19.2	12.1	16.2	(0.5)	2.7	(7.5)	13.9
<b>BONDS</b> Intern. Tax.	0.0	2.8	3.6	1.8	0.9	2.7	0.2	0.2	2.7	(2.6)	3.1	1.0

1) Results for Vanguard funds include dividends and fund expenses but do not reflect PPA's advisory fee.

2) Results for S&P 500, Dow Jones, and NASDAQ indexes do not reflect dividends or PPA's advisory fee.

## **FEBRUARY 2005 COMMENTS**

**STOCK** index prices for February were mostly higher. For the month, the S&P 500 gained 1.8% and the Dow Industrial Average gained 2.5%, but the NASDAQ Composite slipped 0.5%. Year-to-date, the S&P 500 is down (0.7%), the Dow down (0.2%) and the NASDAQ down (5.7%). Midcap and Smallcap indexes also gained for the month, by 3.6% and 2.0% respectively, and the Total Stock Market Index, which includes Midcap and Smallcap stocks, gained 2.0%. Within the Large Cap S&P 500, Value and Growth also gained, by 3.2% and 1.1%, respectively. The International index, which hedges currency impacts, gained the most, at 4.6%, while the REIT index gained 2.6%. YTD figures for most of these categories are included in the chart on page 2

**BOND** returns (price change plus interest) showed significant declines. The benchmark 10-year US Treasury yield closed at 4.37%, a full quarter-point higher than January's 4.14% and a return to the November, 2004 level of 4.36%. The highest yield for the past twelve months was reached in mid-May, 2004, at 4.85%. The importance of bond yields and interest rate levels are discussed in detail starting on page 7. February returns (including interest) were as follows: High-quality intermediate-term taxable bonds declined (0.6%), while high-quality intermediate-term municipal bonds declined (0.5%). Short-term taxable bonds also declined, by (0.5%), while Short-term Munis were flat. Year-to-date results are 0.0% for intermediate taxables, 0.1% for intermediate munis, (0.5%) for short term taxables, and 0.0% for short term munis. All in all, for the first two months, the price declines in all categories just about equaled the interest earned, resulting in very slight overall returns. High Yield ("Junk") taxable bonds, which outperformed high-quality bonds in 2004, gained 1.2% for the month, and are up 1.0% YTD.

Stock and bond investment results for February, for YTD 2005, and for the six years from 1999 to 2004, are set out on page 2. The stock market rally that began decisively in March, 2003 has now raised the S&P 500 by 55% from the October, 2002 low. While these gains have made investors believe again that stocks do not go down in perpetuity (a view that was widely held during the depths of the 2000-2002 bear market), the question of whether this recovery will continue is, as always, dependent on unknown future events. (Note also that after a price decline of 50%, it takes a gain of 100% to return to the previous price level. For example, the S&P 500 reached its high of 1,527 in Q1 2000, and then declined to 777 during Q4 2002, a drop of approximately 50%. From 777 to the S&P 500's current level of 1,204, there has been a gain of approx 55%, but the index is still another 323 points, or an additional 42%, from its prior high.)

In order to keep the current recovery in perspective, we continue to show the chart below, which sets out the extent of the declines measured from the highs of Q1 2000. The chart also puts these declines in the context of results since the end of 1994 (also see the figures on page 12). Note that the three indexes have positive average annual returns ranging from 9.9% to 10.7% for the ten-year and two-month period from the end of 1994 through February 2005, very much in line with long-term stock returns going back to 1926. Further, as these returns converge more and more, the idea of "regression to the mean" seems quite applicable.

**The long-term investor therefore has a very different view of the stock market's returns than those measuring returns from the highest levels.**

	<u>S&amp;P 500 (1)</u>		<u>DOW (1)</u>		<u>NASDAQ (1)</u>	
1st Qtr 2000 High	1,527		11,723		5,048	
Year End 2000	1,320	(13)%	10,785	(8)%	2,470	(51)%
April 10, 2001 Low	1,103	(28)%	9,390	(20)%	1,684	(67)%
September 21, 2001 Low	965	(37)%	8,235	(30)%	1,425	(72)%
Year End 2001	1,148	(25)%	10,020	(17)%	1,950	(61)%
October 9, 2002 Low	777	(49)%	7,286	(38)%	1,114	(78)%
Year End 2002	880	(42)%	8,342	(29)%	1,336	(73)%
Year End 2003	1,112	(27)%	10,454	(11)%	2,003	(60)%
Year End 2004	1,212	(21)%	10,783	(8)%	2,175	(57)%
February 28, 2005	1,204	(21)%	10,766	(8)%	2,052	(59)%

Context: Prior Five-Year Gains in Bull Market of 1995 - 1999:

	<u>S&amp;P 500 (1)</u>	<u>DOW (1)</u>	<u>NASDAQ (1)</u>
End 1994	459	3,834	752
End 1999	<u>1,470</u>	<u>11,500</u>	<u>4,070</u>
Gain	1,011	7,666	3,318
Avg. Ann. % Gain, '95-'99; 5 years	26.2%	24.6%	40.2%
February 2005	1,204	10,766	2,052
Gain	745	6,932	1,300
Avg. Annual %Gain, '95-02/05; 10.17 yrs	9.9%	10.7%	10.4%

1) Results for S&P 500, Dow Jones, and NASDAQ indexes do not reflect dividends or PPA's advisory fee.

## I. UPDATE OF KEY ECONOMIC INDICATORS

The strength of the overall US and world economies is one of a number of factors likely to influence the future direction of both stock and bond prices. We, along with many market observers and academics who write about the markets, believe stock and bond prices already reflect consensus expectations of economic growth. Further, we believe that even if you could accurately predict any number of actual economic figures, the market's reaction to those figures is essentially unpredictable. In any event, an understanding of the direction of current economic trends may at times be useful as a context to help understand market conditions. This section of the Comments provides an update of key economic indicators.

- (1) Gross Domestic Product (GDP) is the broadest measure of goods and services produced in the U.S. economy (GDP figures are inflation-adjusted, annualized growth rates). Full-year 2004 GDP grew 4.4%, "the highest annual growth rate since 1999." The Q4 growth rate was revised upward to 3.8% annualized, without changing the full year rate (Vanguard Economic Week in Review [VEWR], 2/21-25/05).
- (2) Employment for January grew by 146,000, "well below analysts' expectations," and December's increase was revised downward from 157,000 to 133,000 (VEWR, 1/31-2/4/05). Employment is reported as 27,000 higher than the pre-recession peak of March 2001, and 2.75 million higher than the low of May 2003 (Wall Street Journal [WSJ], 2/7/05, pg. A2).
- (3) Interest Rates rose substantially in February. The benchmark 10-year U.S. Treasury interest rate, which is set by buyers and sellers in the bond market, closed February at 4.37%, well above January's 4.14%, and December's 4.22%, and back to the level of November's 4.36%. During February, the Federal Reserve raised the short term rates it controls for the sixth time since June, 2004, to 2.5%. A more in depth discussion of the surprisingly modest rise in longer-term rates, in the face of the Federal Reserve's increases in short term rates, and such other factors as an apparent increase in inflation, a declining US dollar, and large trade and budget deficits, begins on page 7.
- (4) Inflation, as measured by the Consumer Price Index (CPI) "core" rate, which excludes the volatile food and energy sectors, rose 0.2% in January, and 2.3% for the full year 2004, up from the 1.1% rate of 2003. With food and energy included, the CPI was up only 0.1% for the month, but up 3.0% for 2004, compared to the 1.9% increase for 2003 (VEWR, 2/21-25/05; WSJ, 2/24/05, pg. A2). However, the Producer Price Index (PPI) core rate increased a much higher 0.8% in January, and 0.3% with food and energy included. The PPI for the last twelve months, all included, was 4.2% higher (VEWR, 2/14-18/05; WSJ 2/22/05, pg A2).

The CPI measures price changes of both goods and services, whereas PPI measures only the price changes of goods.

(5) Sector Economic Activity was Mixed for January

- (a) Durable goods orders (industrial and consumer) fell 0.9% in January, following an upwardly revised gain of 1.4% in December, but was higher if the volatile transportation category was excluded (WSJ, 2/25/05, pg A2). For all of 2004, the gain in durable goods orders was 10.9%, the largest gain since 1994 (WSJ, 1/28/05, pg. A2).
- (b) Industrial production was unchanged in January after three straight monthly gains. For 2004, this measure was up 4.4%, the first annual gain in industrial production since 2000. Capacity utilization is approximately 2% below the average rate covering 1972-2004 (VEWR, 2/14-18/05).
- (c) Retail Sales declined 0.3% in January, but were up 0.6% excluding auto sales. The year over year gain in retail sales was 7.2%, but the largest gain came from gasoline stations and higher gasoline prices. Retail sales are not adjusted for inflation, and include such disparate categories as gasoline sales, auto sales and non-store retailers such as the Internet (WSJ, 1/14/05, pgs. A2 and B1; also VEWR, 2/14-18/05).
- (d) Housing sales for existing homes fell in January for the second consecutive month. Median sales prices were 10.5% higher than a year earlier (VEWR, 2/21-25/05). Sales of new homes in December were essentially unchanged, but full year 2004 saw a gain of 8.9% over 2003 (VEWR, 1/31-2/4/05).
- (e) Personal Income was up 0.6% in December, before accounting for the one-time Microsoft dividend, which contributed an additional 3.1% to the gain. The income increase for all of 2004 was 5.4%. Consumer Spending was up 6.1% for 2004, including a 0.8% increase in December. Personal Savings, which excludes capital gains from stocks and homes, was not reported with these figures (WSJ, 2/1/05, pg. A2). These are the most recent reported figures for these categories.

- (6) Consumer Confidence, as measured by the Conference Board's Index, fell slightly in February. The "present situation" index rose, while the measure of consumer expectations six months from now was "more subdued" (VEWR, 2/21-25/05).
- (7) Corporate Profits for the S&P 500 companies are still being reported for Q4 2004, but a WSJ article (2/17/05) cites an expected 20% gain in Q4 profits, taking into account many companies that have already reported earnings. For the years 2003 and 2004, profit gains were substantial, averaging in excess of 20%. The article cites an expected slowdown in profits, the impact of which is discussed starting on page 8.

Overall, the economic news reported in January and February was mixed at best. As for market prices, what we know is that the many factors that influence prices gave rise to virtually no change in either stock prices or bond returns for the two months. What we don't

know, as always, is how the unpredictable, unknowable future will impact future market prices for stocks and bonds.

## **II. CURRENT INVESTMENT OPPORTUNITIES: ARE THERE ANY GOOD ONES?**

As regular readers of our Monthly Comments are aware, we rarely have a point of view on which liquid investments, such as stocks, bonds, and cash equivalents, are likely to provide a better result in a given time period. In a number of recent media articles, many such liquid investment choices have been written about unfavorably. When the “conventional wisdom,” as evidenced by these articles, turns negative regarding investment choices, we believe it is worth questioning. We are of the opinion that the “conventional wisdom” is often incorrect in its view of future investment performance, primarily because it is based on facts that are already well known and fully taken into account in the current pricing of the various investments. Further, there is, as usual, ample opinion that runs counter to the negative outlooks.

The most highly visible and widely reported fact of the past eight months has been the Federal Reserve's increasing of the short-term interest rates it controls. Since June, 2004, when the Fed Funds rate was 1%, the Fed has raised rates six times, each time in quarter point increments, so that the rate at the end of February is 2.5%. When interest rates rise, the conventional wisdom holds that, among other things: (a) the price of existing bonds declines, and the prices of longer maturity bonds declines faster than the prices of shorter maturities; (b) economic activity slows, and corporate profits come under pressure, which in turn has a negative impact on stock prices; (c) the price of the currency of the country with the increasing interest rates appreciates, as capital is drawn to that currency; and (d) inflation should be rising, which is one of the reasons the Fed raises rates in the first place.

In reviewing the actual price changes in the markets since June, 2004, we find that: (a) yields on longer maturity bonds have actually declined (to 4.37% from 4.69% at the end of June), which means these bond prices have increased; (b) stock prices, as measured by the S&P 500, are up over 6%; (c) the US dollar has continued to decline; and (d) inflation has risen, but only very slowly. One explanation for this seemingly perverse set of results is that interest rates are still historically on the low side, even after the most recent rate increases by the Fed. As reported in the WSJ (2/17/05, pg. A2), Fed Chairman Alan Greenspan, in his most recent testimony before Congress, “dwelt at length on the unusual decline in long-term bond yields since the Fed began raising short-term rates, which, he said ‘contrasts with most experience.’ He played down technical explanations such as purchases of Treasury bonds by Asian central banks, mortgage hedging, and even confidence in low inflation. He concluded the drop is ‘a conundrum,’ which may prove to be a ‘short-term aberration.’ He noted that measures of risk are unusually low across many markets, warning that ‘people experiencing long periods of relative stability are prone to excess. We thus must remain vigilant against complacency.’”

These comments by the Fed Chairman himself are certainly not a hearty endorsement of current bond pricing, particularly longer maturity bonds. But knowledgeable market participants are already keenly aware of all of these factors, and still the ten-year treasury yield is below the levels reached last June. Further, let us remember that the same Alan Greenspan thought the stock market was "irrationally exuberant" in December 1996 when the Dow Jones Average reached 6,600. As we now know, in March, 2000, that figure peaked at 11,723, and never fell below 7,286 even at the bottom of the three year bear market from 2000 to 2002.

In the "Portfolios, Etc." article in the Sunday NY Times Financial section (2/20/05, pg 5), the author begins: "When Alan Greenspan says he cannot explain why longer-term interest rates are so low, what's an investor to do? Take cover." The remainder of the article cites a number of analysts and bond portfolio managers who are avoiding longer term bonds. Sample quotes from the article include: "You should always be wary when the central bank says an asset price is aberrant." "He (referring to Greenspan) is supposed to have all the information, and he is saying he doesn't know why. Why commit capital to a long-term investment when you don't understand why it's valued that way?"

There are other opinions, however. In an article on long-term rates (2/18/05, pg. C4), the WSJ states that "the historically low level of long-term interest rates around the world stems from a host of real factors supporting prices...among them is the desire for yield in what remains an environment of low global returns,...and a backdrop of quiescent global inflation."

If most of the media, along with the Fed Chairman, is down on longer term bonds, what about shorter term bonds? Those prices have declined modestly as short term rates have risen, but these declines have been in line with what would be expected as short term rates rise.

Moving from BONDS to STOCKS, the negatives continue. In an article on corporate profits (2/17/05, pg. A2), the WSJ reported that after two years of excellent profit growth (averaging approximately 20% each year), "there are signs of slower growth ahead....Factors expected to slow earnings growth include the slowing of demand in the economy...a moderation in the surge of the price of energy and raw materials which contributed heavily to profits last year... and reduced consumer spending." While these factors are cited as negatives in the article, each one can also be viewed as turned into a positive: Slower demand in the economy would likely lead to fewer and/or smaller interest rate increases; a moderation of surging energy and raw material prices would reduce the fear of inflation, and lower costs for many businesses; and reduced consumer spending would also likely lead to lower inflation and interest rates. While it seems likely that profit growth will slow from the rapid rate of the past two years, it is also fair to say that this likelihood is well known in the marketplace, and that stock prices therefore reflect this knowledge.

In another recent WSJ article on stock prices (2/22/05, pg. C1), the major point was that the strong gains in oil stocks could mean bad news for the stock market in general. "The best-known period of strength for oil stocks came in the 1970s, when they became the biggest sector in the S&P 500 index. Yet high oil prices and inflation during that period were disastrous for other stocks." On the other side of this position, the article also states that "many investors think the oil-stock rally may almost be over... that oil prices are due to sag back toward \$35 as economic growth cools down – good news for the rest of the market but bad for oil stocks." For every position there is a counter position, and market prices at any point in time reflect all these different points of view.

Stock prices in general are a reflection of the underlying earnings of the companies and the multiple that all market participants apply to those earnings. This relationship of stock price to company earnings is referred to as the P/E ratio. The current P/E on the S&P 500's earnings of the past twelve months is approximately 20, somewhat high by historical standards but arguably appropriate because of still historically low interest rates. A WSJ article headlined "High Valuations Hamper Stocks" (1/24/05, pg. C1) observes that "high valuation doesn't necessarily mean that stocks are going to go down or that you don't want to buy them...but it does mean that there is high risk. If something goes wrong, there's a long way down before a stock finds fundamental support." Further, since the stock market is a forward-looking pricing mechanism, it is really investor's expectations about future profits that drives stock prices going forward. Whether the current P/E proves to be too high, too low, or just right, it is clear that investors as a group have expectations for future profitability, and that whether these expectations come to pass or not is primarily a function of the unknowable future.

What of various market sectors that have outperformed the broad stock market over the past few years? Does the media find any of these market segments attractive? SMALL CAP STOCKS have outperformed large cap stocks significantly over the past five years, posting an average annualized return of positive 5% compared to an annualized 3% decline for large caps (WSJ, 2/16/05, pg. D2). The article states that "small cap stocks have historically traded at a multiple of their earnings that's about 20% below that of big caps, but that currently large cap stocks were trading at less than 19 times earnings over the past 12 months, compared to more than 25 times earnings for small caps." One manager is cited as thinking that "small caps' steep prices and their potentially underwhelming profits could become a lethal combination." So it seems fair to say that small cap stocks are not being highly endorsed.

REITs (Real Estate Investment Trusts) have also been excellent performers over the past few years, "outperforming the broader sock market each year since 2000 and rewarding yield-seeking investors with healthy dividends" (WSJ, 2/22/05, pg. D1). The article continues: "Analysts are warning REIT investors to brace themselves for a ride that will continue to be bumpy", citing concerns ranging from "their prices have gotten ahead of themselves" to rising interest rates. And in fact REIT prices declined by 9% during January. But prices rose almost 3% in February, and there are other commentators who are more positively inclined, citing a stronger economy that will lead to lower vacancy rates and higher rents.

While on the subject of real estate, the WSJ reported that home price appreciation “skyrocketed” at the end of 2004, and that the median family home price was 8.4% higher than in the year earlier quarter (2/16/05, pg. D4). So perhaps at least this investment, although not among the liquid choices we recommend for our clients’ portfolios, is well reviewed. Not in this article, however, which states that “the housing market’s continued growth has surprised some economists who thought, last year at this time, which home prices were headed for a fall. Many of these people still believe prices will drop this year, as expected mortgage-rate increases kick in.” One economist compares housing prices to stock prices in the late 1990s, noting that housing prices have grown 40% since 1995, adjusted for inflation, “the steepest rise in five decades.”

What about HEDGE FUNDS? In an article entitled “Concerns Grow About Prospects of Hedge Funds” (12/15/04, pg. D1), the WSJ led with the statement that “Hedge funds have been one of the hottest investment vehicles during recent years, given their record of posting often impressive gains even in down markets. But a growing chorus of Wall Street advisers is cautioning individual investors to pare back their exposure to the funds. Already, returns are diminishing as a growing number of hedge funds chase the same investments and strategies.” The article continued: “To some Wall Street veterans, the situation is reminiscent of the tail end of the tech boom in the 1990s, when individual investors flocked into the market late in the game, beguiled by the promise of outsized returns, only to post losses after investing at the top. The problems include too much money chasing the same opportunities, a growing shortage of top managers, high fees and a tougher performance environment. In addition, the returns as reported by hedge funds may be inflated, according to recent academic studies.” (See the NY Times “Economic Scene” article by Princeton Professor Alan Kruger (12/9/04), which reviews the various biases in the reporting of hedge fund returns.) And another WSJ article (2/16/05, pg. A6), discussing the recent trend of hedge funds to become more active in impacting the decision-making of the companies in which they invest, stated that “hedge funds have become victims of their success, attracting more money and more competition, resulting in lower returns.”

JUNK BONDS have also done well in recent years. But the NY Times, in its Sunday Financial section (11/28/04, pg. 7), stated that “the prices that investors have paid (recently) are high and the yields they have offered are relatively low.” The article also offered this observation: “Froth (i.e., high prices) in the new-issue (junk bond) market, however, does not mean that investors should abandon high yield bonds. It means that investors just need to be cautious...as they are still likely to be a place to be next year, since when interest rates are rising, the higher yields provided by junk bonds can offset the concurrent decline in bond prices.” The article also discussed the fact that the yield spread between junk bonds and high quality ten-year Treasuries had narrowed to a level which, when reached in the past, had indicated reduced future returns for this asset category.

INTERNATIONAL INVESTING, aided by the declining US dollar, has been a popular, successful strategy of late. But one major country, Japan, was the subject of a WSJ article (2/24/05, pg. C18) that started: "Would you want to invest in a country that's in a recession, plagued with deflation, beset with a shrinking trade surplus and populated by consumers who don't consume much?" The article discussed Japanese stocks trading at approximately the same P/Es as US stocks, but that lower interest rates in Japan could support higher P/Es (a positive comment). It is also worth noting that the slower growth economies of Japan and Europe are the homes of stronger currencies relative to the US dollar. In the current time frame, the main problem confronting the US currency is the huge balance of trade deficit, based on the US importing far more than it exports. While this deficit does have to be financed, it is also understood that US imports are critically important to the foreign countries that export to the US. Just this past week, a 1.6% one day decline in the Dow Jones Industrials, and a 1.4% decline in the value of the dollar, were attributed to the notion that South Korea may begin to reduce its purchases of US Treasury debt. By the end of the week, however, most of these declines had been erased, and media attention went elsewhere.

Even amidst all of these negative observations, there are still optimists. In a WSJ editorial titled "Economy 'in the Zone'" (2/16/05, pg. A14), the authors state that "Investors are beginning to suspect that the favorable financial environment may be sustained, despite consensus forecasts suggesting that recent market gains have been too good to last. More than anything else, the key to the outlook is whether low inflation can be maintained through a combination of fundamental forces and Fed resolve....Pessimistic pundits emphasize the dangers lurking in unsustainable trade and payment imbalances, excessive liquidity, savings shortfalls, dollar overhangs and global reflation....(But) with core inflation anchored below 2%, with economic growth solid, and with the fed funds rate headed towards neutrality, investors' optimistic suspicions about favorable financial market trends are more likely to prove correct than are the downbeat warnings of the consensus."

What then is our view of all this negative commentary, and the few rays of optimism? We continue to believe that the media's main concern is selling its publications and broadcasts, and that fear and negativity are powerful influences that get people to tune in and act. And action is what Wall Street craves the most, because every action constitutes another transaction on which some small amount of money is left behind for those who handle the transactions. Our focus on arriving at an asset allocation appropriate to a person's specific circumstances, and then maintaining that allocation through the cyclical ups and downs that are a continuing fact of life in financial markets, is not what sells papers, or gets people to tune in, or generates many transactions. We understand very well that people's circumstances change. We advocate rebalancing when allocations change significantly based on relative market prices, and we occasionally identify new investment opportunities that we recommend incorporating into our client's portfolios. Above all, however, we are adherents to a point of view that tends to look beyond the short-term market price movements and their purported reasons, and to focus instead on the asset allocation that provides our clients a reasonable opportunity to reach their financial objectives with the least amount of risk.

S&P 500 (1)                      DOW JONES (1)                      NASDAQ (1)

1) Results for S&P 500, Dow Jones, and NASDAQ indexes do not reflect dividends or PPA's advisory fee.

**I. Figures From Period Starting 2000 (% Figures Are Cumulative Declines From 1/01/00)**

Start of 2000	1,470		11,500		4,070	
End of 2000	1,320	(10.1)%	10,785	(6.2)%	2,470	(39.3)%
Sept. 21, 2001 <u>Low</u>	965	(34.3)%	8,235	(28.4)%	1,425	(65.0)%
End of 2001	1,148	(21.9)%	10,020	(12.9)%	1,950	(52.0)%
Oct. 9, 2002 <u>Low</u>	777	(47.1)%	7,286	(36.6)%	1,114	(72.6)%
End of 2002	880	(40.1)%	8,342	(27.5)%	1,336	(67.2)%
End of 2003	1,112	(24.3)%	10,454	(9.1)%	2,003	(50.8)%
End of 2004	1,212	(17.5)%	10,783	(6.2)%	2,175	(46.5)%
Feb 28, 2005	1,204	(18.1)%	10,766	(6.4)%	2,052	(49.6)%

**II. Figures From Period Starting 1995 (% Figures Are Gains From 1/01/95)**

Start of 1995	459		3,834		752	
End of 1999	<u>1,470</u>		<u>11,500</u>		<u>4,070</u>	
5 Year Gain; Annualized %	1,011	26.1%	7,666	24.6%	3,318	40.2%
End of 2001	<u>1,148</u>		<u>10,020</u>		<u>1,950</u>	
7 Year Gain; Annualized %	689	14.0%	6,186	14.7%	1,198	14.6%
End of 2002	<u>880</u>		<u>8,342</u>		<u>1,336</u>	
8 Year Gain; Annualized %	421	8.5%	4,508	10.2%	584	7.5%
End of 2003	<u>1,112</u>		<u>10,454</u>		<u>2,003</u>	
9 Year Gain; Annualized %	653	10.3%	6,620	11.8%	1,251	11.5%
End of 2004	<u>1,212</u>		<u>10,783</u>		<u>2,175</u>	
10 Year Gain; Annualized %	753	10.2%	6,949	10.9%	1,423	11.2%
February 28, 2005	<u>1,204</u>		<u>10,766</u>		<u>2,052</u>	
10.17 Yr Gain; Annualized %	745	9.9%	6,932	10.7%	1,300	10.4%

A handwritten signature in black ink, appearing to read 'Vic Levinson', with a long horizontal line extending to the right.

**Victor Levinson**

A handwritten signature in black ink, appearing to read 'Nick Levinson', written in a cursive style.

**Nicholas Levinson**