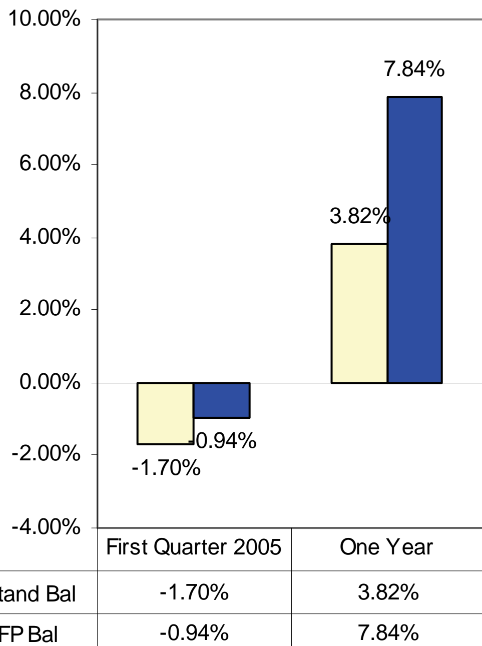
SKAGGS FINANCIAL PLANNING, LLC

Investment Perspective

First Quarter 2005

"Everybody gets so much information all day long that they lose their common sense" -- **Gertrude Stein**

SFP Core Strategies*	Quarter 1	One Year
US S&P 500 (Enhanced)	-2.73%	5.03%
US Large Value	0.19%	14.03%
US Micro Cap	-6.43%	4.06%
US Small Value	-2.90%	13.39%
US Equity Real Estate	-6.93%	9.73%
International Large Value	0.30%	20.45%
International Small Cap	5.02%	21.55%
International Small Value	6.65%	26.17%
Emerging Markets	0.86%	22.43%
Emerg Mkts Small Cap	1.67%	20.09%
Emerging Mkts Value	2.79%	29.48%
Ultra Short Fixed Income	0.18%	0.52%
Shrt/Inter Global Fixed Inc	-0.75%	-0.78%
SFP Model Portfolios		
SFP Income Portfolio	-0.76%	5.11%
SFP Balanced Portfolio	-0.94%	7.84%
Non SFP Std Balanced	-1.70%	3.82%
SFP Aggressive Growth	-1.09%	10.55%



	First Quarter 2005	One Year
Stand Bal	-1.70%	3.82%
SFP Bal	-0.94%	7.84%

Earnings are up at a company, but the stock falls. Employment levels fall, but the market rallies. How can investors ever understand such contradictory results?

The short answer: it can be done, but it takes some hard thinking that goes beyond the obvious. And doing this kind of thinking is what smart investing is all about.

Let's look at 2004 and the start of 2005. If 2004 ended with a bang in the stock market, 2005 began with a fizzle.

The combined results from Skaggs Financial Planning, LLC (SFP) strategies were essentially flat. While there were some bright spots, the overall model portfolios gave back about 1 percent.

On the positive side, international stocks continued to perform well, extending their dominance. In particular, international small company stocks in developed markets provided a nice return - up over 5 percent for the quarter. Emerging markets stocks also provided respectable returns of around 2 percent. U.S. stocks, on the other hand, were generally down. Hardest hit were publicly traded real estate securities and small company stocks. These lost over 6 percent. Large U.S. companies were down around 2 percent and large value, with the best domestic returns, was flat. (Please see chart to the left).

The relative performance of our portfolios was much better. For the quarter, the SFP Balanced Portfolio was down only .94 percent, while the non-SFP Standard Balanced Portfolio lost 1.7 percent, nearly a full percentage difference. Annually, this is about 3 percent; for a $1 million dollar portfolio, this would amount to an extra $30,000 over a year. The actual results for the past year are even better. The SFP Balanced Portfolio has outperformed by just over 4 percent (7.84 percent vs. 3.82 percent). While it is never fun to report negative results, these relative returns continue to exceed our expectations. It's also nice to beat the average in both up and down markets, but obviously, this will not always be the case.

These short-term fluctuations for many investors are a mystery. While it's easy to understand that in the long run, investing in businesses should provide better returns than a savings account, the shorter term results can seem nonsensical. Want an example of these kinds of contradictory returns? You don't have to look any further than Microsoft.

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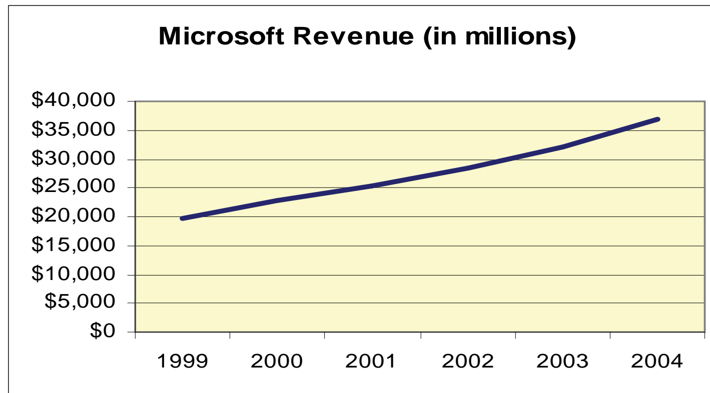
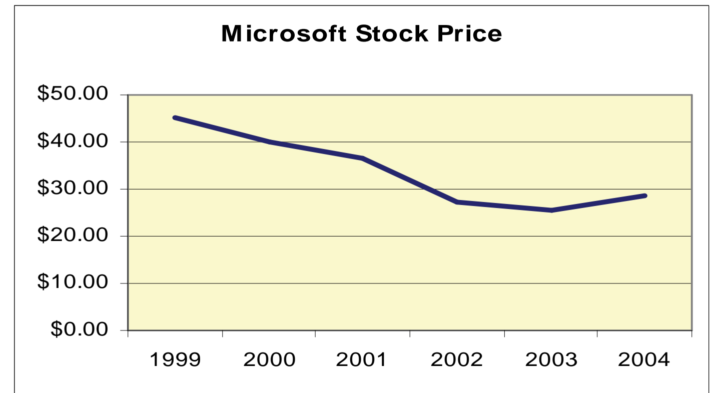
From the chart below left, you can see that Microsoft's revenues have consistently grown since 1999. How has the stock price reacted? It's fallen. In comparing the chart of Microsoft's stock price below to the revenues, in fact, you can see there is no apparent relationship between stock price and revenue. This is a very difficult, but important, lesson for investors to grasp. The economic performance of a business doesn't necessarily relate to changes in the value of that business – the stock price.





One way to get your arms around this contradictory fact is to understand the workings of the market. While it is a bit of a simplification, you can think of the stock market as a giant auction. Here, millions of people come to buy and sell, and through this process, prices are established.

For instance, I may be willing to buy Microsoft at $20, but others are willing to pay as much as $25 for it. Obviously, no seller will take my $20 when they can get $25 from others. And they may want even more. Perhaps no sellers are willing to sell below $26. In this case, the stock wouldn't trade. So there would be buyers at $25, the bid price, and sellers at $26, the ask price, but no trading would take place. For simplicity, the news would report the value of Microsoft at the previous price a trade actually occurred, but as long as there was a separation between the two prices (the spread) nothing would happen.

Now imagine we could talk to the buyers and sellers of Microsoft back in '99. We would likely hear that the prices they were willing to buy and sell Microsoft were related to the revenues that were **expected** in the coming years. Sellers would say that they were not willing to sell for under $45 because they believed Microsoft would have great revenues going forward. The buyers would use the same logic to justify the high price they were willing to pay. In other words, the expectations for the future would have already been built into the price. While revenue is only one factor, it would be reasonable to assume that investors in 1999 had higher expectations for Microsoft than would actually occur. For this reason, the stock price fell while revenues continued to be strong.

As investors, we're continually bombarded with information about business conditions. We may hear things from the news media or we may experience it in our everyday lives, which may or may not be correct. A trip to the local mall may reveal certain stores are packed. The intuitive conclusion is that these retail stocks will do well. Or we may take a look at rising gas prices and conclude that a company that manufactures equipment for hybrid cars will do well and those stocks will prosper. But it's important to ignore these conclusions when we invest in the market, because there are a whole lot of other things that come into play regarding the performance of a stock.

Remember that there are billions of dollars at stake in the financial markets on a daily basis. Buyers and sellers with vast resources have already factored the current environment and future expectations into today's prices. Unless you are smarter than the best on Wall Street, you have a direct line to Miss Cleo, it is important to focus on factors that consistently add value – tax efficiency, costs, diversification to name a few.

Best wishes for renewal this spring season, and continued financial success.

Brian J. Skaggs, CFP

The information in this newsletter should not be construed as investment advice. Investment advice is only given in the context of individualized interactions that ideally result in the development of a continually evolving financial plan. *Total returns as measured by the performance of associated DFA portfolios - advisor fees not included. This information is believed to be reliable, but we do not guarantee the accuracy of the information. Past performance is no guarantee of future performance.