

## Investment Perspective

Fourth Quarter 2005

“If you focus on results, you will never change. If you focus on change, you will get results.” -- [Jack Dixon](#)

SFP Core Strategies*	Quarter 4	
	2005	One Year
US S&P 500 (Enhanced)	1.67%	3.58%
US Large Value	1.32%	10.24%
US Micro Cap	1.78%	5.69%
US Small Value	1.51%	7.79%
US Equity Real Estate	2.16%	13.16%
International Large Value	5.10%	15.29%
International Small Cap	6.58%	21.96%
International Small Value	5.90%	23.24%
Emerging Markets	7.70%	29.85%
Emerg Mkts Small Cap	8.58%	25.74%
Emerging Mkts Value	6.97%	30.80%
Ultra Short Fixed Income	0.71%	2.30%
Shrt/Inter Global Fixed Inc	0.07%	1.73%
<b>SFP Model Portfolios</b>		
SFP Income Portfolio	1.39%	5.81%
SFP Balanced Portfolio	1.98%	7.91%
Non SFP Std Balanced	1.38%	3.59%
SFP Aggressive Growth	2.52%	9.69%

Way back in early 2004, I reported to you that none of the SFP (Skaggs Financial Planning) Core Strategies experienced losses for 2003. At the time we noted that this is something a financial advisor doesn't get to report too often. Our investment strategies are, after all, made up of very different companies.

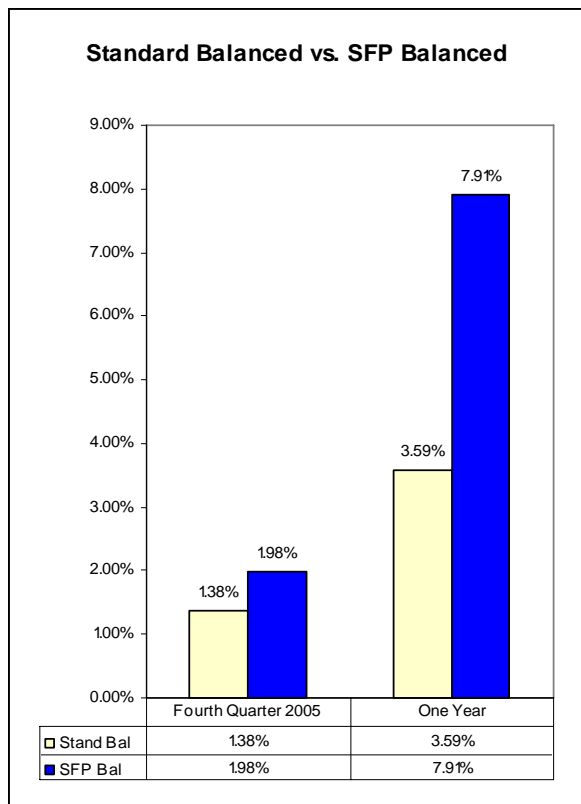
The U.S. Large Cap fund holds companies such as Microsoft and General Electric - which trade in the greatest financial market in the universe - while the Emerging Markets Small Cap fund holds companies such as Jaks Resources, a timber company in Malaysia, and Alpargatas, a shoe manufacturer in Argentina, companies which don't exactly trade on the most prominent financial exchanges.

Despite the diversity, we were fortunate enough to repeat the positive report the following year. All investment strategies finished 2004 in the black. Now 2005 is in the history books and yes, all thirteen strategies were profitable for the year – another newsletter without red ink! (Please see the performance table to the left.)

The international markets outperformed domestic counterparts for a fourth year in a row. Our international value portfolio provided quite a nice return of 15.29 percent; while our US based S&P 500 strategy just outpaced inflation by turning in 3.58 percent.

While these stocks based in the international developed markets fared well, the developing markets continued to be red hot. The SFP Emerging Markets strategy was up 29.85 percent. This follows returns of 29.90 percent and 60.18 percent in 2004 and 2003, respectively. That's a three-year return of 170 percent!

The only downside of these lopsided but positive returns was that we were often forced rebalance portfolios through sales, and in doing so, we realized some capital gains without being able to offset them with losses. This will result in a larger 2005 tax bill for some of our clients. Of course, we always consider the tax impact while managing your portfolios. The goal is to maximize net returns, while not producing big numbers that end up lining Uncle Sam's pocket.



The domestic side ended positively as well. Although the Dow Jones Industrial Average was down for the year, our U.S. Large Value and the U.S. Small Value funds returned 10.24 percent and 7.79 percent, respectively. U.S. equity real estate continued to produce, ending a sixth consecutive year of positive results which amounted to cumulative returns for the period of more than 200 percent. We are glad we remained committed to this holding, even though, as we noted in the Q3 2004 Investment Perspective newsletter, these returns are almost certainly not sustainable.

While small and value company returns continued to out-pace the returns of large companies and growth companies throughout 2005, the differences have not been as pronounced as they were during 2003 and 2004. This was particularly true of smallest of the smallest publicly traded companies, the micro cap stocks. In this area, our strategy produced 5.69 percent while the S&P 500 returned just under 5 percent for the year. Mid-cap stocks, those that are too small for the S&P 500 but too large to be considered true small caps, saw a lot of action for the year. While we do have some newer strategies that incorporate this market segment, they are not included in our core portfolios.

Our commitment to value stock investing was a strong component of our performance for the entire year, but it was a drag on performance for the fourth quarter. Fortunately, strong quarterly international returns across the spectrum more than made up for the weakness in the value numbers. For the year our SFP Balanced Portfolio produced gross returns of 7.91 percent, while a typical portfolio, as measured by the Non SFP Standard Balanced Portfolio, returned a gross 3.59 percent. (Please see the performance chart on page one.)

After subtracting for inflation, fees and taxes that an investor would likely pay, the typical balanced portfolio was really flat for the year, while the investor in the stocks of the Dow Jones Industrial Average lost money. Our balanced portfolio, however, netted a real return after likely taxes of around 4 percent. While not terribly exciting, this is a respectable return that matches up closely with our long-term expectations.

Even with these continued strong returns, I sometimes cringe in reporting results. Investors often focus too much on past returns. It is important not to reinforce any inference that returns should be the primary measuring stick for judging performance.

In judging an investment manager, investors usually look at the one, three, and five year returns. But how many, however, look at the underlying expenses, the actual companies represented in a portfolio, the concentrations and how the portfolio has changed over time or the level of company turnover in the portfolio? They assume that if the numbers are good these other processes are good. But that's a big mistake.

The problem is that over periods even long as five and ten years, the randomness in the market is generally the overriding factor in determining returns. For instance, the portion of a portfolio invested in stocks versus bonds will largely determine returns, not the individual security selections of an investment manager. Playing cards is similar. On any given hand, the cards that are dealt will largely determine the outcome.

This does not mean that skill of the players is inconsequential, but it does imply that judging a player based on the outcome of the last few hands is misdirected. It is much more important to base judgment on the decisions of the player.

Similarly, the investment process and not returns are paramount. This will continue to be our focus and we will not become complacent in the good fortune of our recent past.

Thanks for another great year and best wishes for 2006!

Sincerely,

*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.