

## Investment Perspective

Second Quarter 2004

**“I don’t look to jump over 7-foot bars: I look around for 1-foot bars that I can step over.”-- [Warren Buffet](#)**

SFP Core Strategies*	Quarter 2	
	2004	One Year
US S&P 500 (Enhanced)	0.75%	18.00%
US Large Value	1.83%	27.97
US Micro Cap	0.14%	40.12
US Small Value	3.70%	50.04
US Equity Real Estate	-5.51%	26.32%
International Large Value	1.98%	44.06%
International Small Cap	0.37%	46.13%
International Small Value	-0.13%	48.98%
Emerging Markets	-5.83%	32.07%
Emerg Mkts Small Cap	-8.86%	35.92%
Emerging Mkts Value	-8.15%	43.55%
Ultra Short Fixed Income	-0.54%	0.54%
Shrt/Inter Global Fixed Inc	-3.26%	-1.14%
<b>SFP Model Portfolios</b>		
SFP Income Portfolio	-1.39%	12.18%
SFP Balanced Portfolio	-1.02%	18.89%
Non SFP Std Balanced	-0.59%	10.04%
SFP Aggressive Growth	-0.40%	26.28%

Over the previous four quarters, this newsletter routinely cautioned investors not to become too accustomed to the overwhelming and pervasive positive numbers that we have been able to report. During this time, of the thirteen strategies listed below, we have seen only two slightly negative returns. The second quarter has changed this and was characterized by a more typical mix of positive and negative results. On the whole, our model portfolios generated negative results for the quarter, albeit not too dramatically. Please see the table below.

The performance was most negatively impacted by our fixed-income exposure, specifically the short-intermediate bond allocation. The relatively strong economic news of the quarter put to rest any lingering fears of deflation; increasingly, concerns have focused on possible inflation. This sparked upward movement for interest rates and resulted in fixed income value declines. However, we were somewhat protected in this regard by our limited bond maturities of 2.2 to 3.7 years. Additionally, the negative results have not wiped out our significant one year returns.

The relative performance of our portfolios was also negative. For example, the SFP Balanced Portfolio was down 1.02 percent versus a loss of 0.59 percent for a typical balanced portfolio. Although our value stock tilt continued to reward us, the relative performance was hurt by our small, foreign, and real estate exposure. It would be easy to dismiss these returns as expected based on recent positive performance. After all, the one year return of our Emerging Markets Value strategy was 98.4 percent, as of last quarter. Surely, this was due for a change. We hear similar sentiment every day from market commentators. They use terms like “profit taking” and “bargain hunting” to explain market movements. These statements imply a connection between different periods; today’s profit taking was a reaction to previous rallies. The implication is that results should have been expected and even predicted.

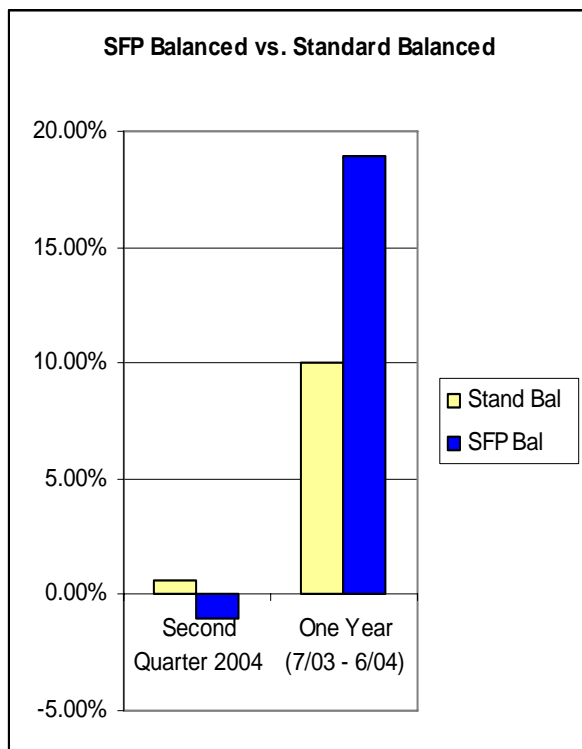
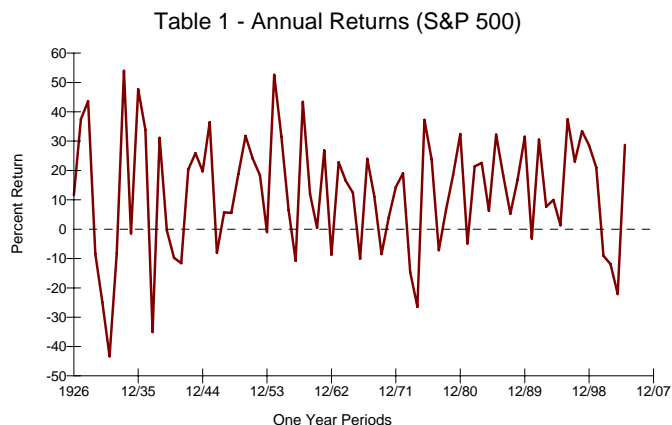
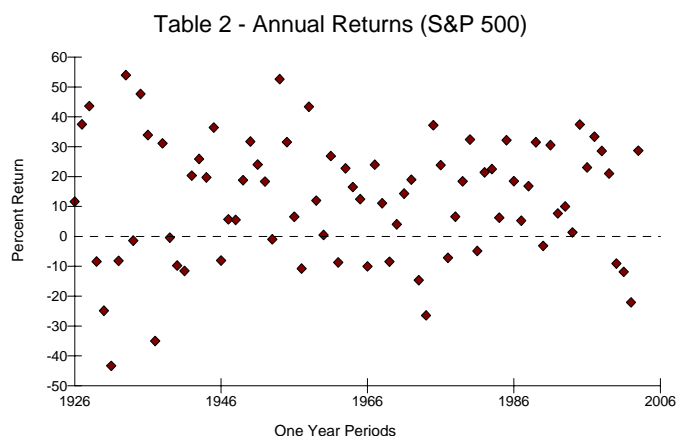


Table 1 plots the individual annual returns of the S&P 500 Index (U.S. large company stocks) back to 1926, and it is a good illustration of the connection between different time periods. Returns clearly have an up and down pattern. It does seem that you should be able to predict moves and profit by selling or buying accordingly. While returns do tend to move toward the averages, the notion that this occurs in a predictable way that can lead investors to better returns is deceptive.

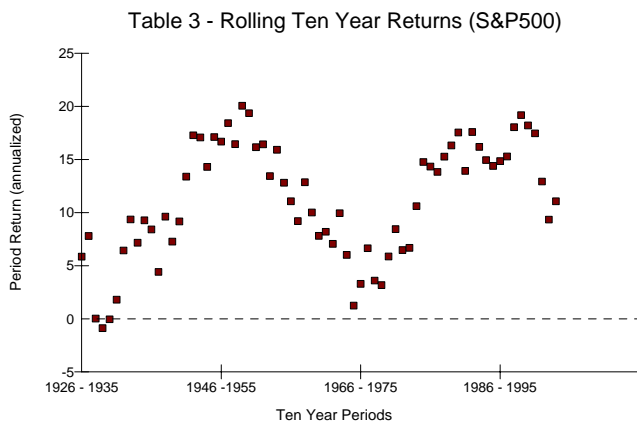


Let's look at the raw data in Table 2 by removing the lines from Table 1. The data is exactly the same, but notice how the patterns disappear. Annual returns are seen as they truly are, much more random. In fact, the connecting lines in Table 1 are meaningless; they contain absolutely no data. Much in the same way Table 1's lines make an apparent connection between different periods. We naturally want to make predictions based on recent experience.



Try covering a portion of Table 2 and make predictions about the next returns. Is viewing the past data useful? Is it more useful than trying to predict the next roll of a die based on the previous roll? While making the connections is emotionally appealing, doing so often causes you to lose site of important factors.

For the most part, return periods should be viewed as separate and independent from each other. Fortunately, making the connections and predicting the next trend is unnecessary for successful investing. By stretching Table 2's one-year holding period out to a more appropriate time frame, such as ten years, we can in Table 3 that returns are much more predictable, and that virtually all of the negative market results disappear. If we invest appropriately, the returns are basically there for the taking.



While the market commentators make their perilous connections and tell us which way inflation, interest rates, and the overall markets are heading, we will maintain our disciplined investment approach, keep our eyes on the important factors and, most importantly, build appropriate portfolios in the context of your financial goals.

Best wishes for a fun and safe summer!

*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 funds - advisor fees not included in strategy performance. Advisor fees are not subtracted from model portfolio performance. This information is believed to be reliable, but we do not guarantee the accuracy of the information. **Past performance is not an indication or guarantee of future performance.**