SKAGGS FINANCIAL PLANNING, LLC

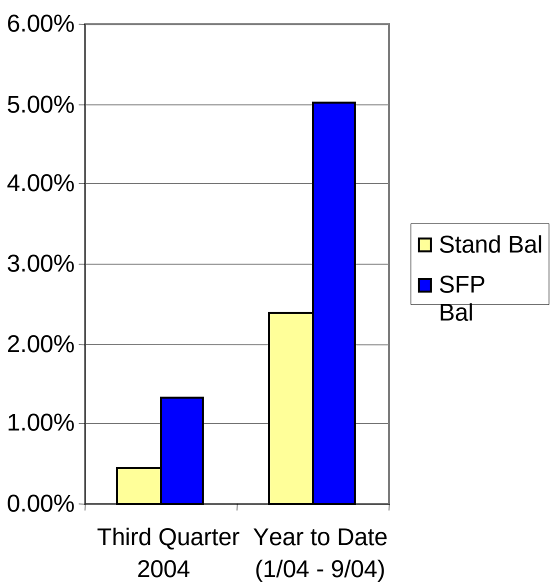
Investment Perspective

Third Quarter 2004

"There are 10^{11} stars in the galaxy. That used to be a huge number. But it's only a hundred billion. It's less than the national deficit! We used to call them astronomical numbers. Now we should call them economical numbers."-- Richard Feynman

SFP Core Strategies*	Quarter 3 2004	Year to Date
US S&P 500 (Enhanced)	-1.57%	1.09%
US Large Value	-0.27%	5.49%
US Micro Cap	-4.13%	2.01%
US Small Value	-2.14%	8.96%
US Equity Real Estate	8.03%	14.34%
International Large Value	0.62%	10.04%
International Small Cap	-0.48%	12.99%
International Small Value	0.31%	14.14%
Emerging Markets	8.43%	9.27%
Emerg Mkts Small Cap	9.74%	9.14%
Emerging Mkts Value	12.76%	14.72%
Ultra Short Fixed Income	0.66%	0.66%
Shrt/Inter Global Fixed Inc	2.92%	2.49%
SFP Model Portfolios		
SFP Income Portfolio	1.54%	3.98%
SFP Balanced Portfolio	1.33%	5.03%
Non SFP Std Balanced	0.46%	2.39%
SFP Aggressive Growth	0.86%	6.03%

SFP Balanced vs. Standard Balanced



In comparison with the second quarter, the theme of last quarter has been role reversal. In nearly every market segment that generated negative returns last quarter, positive returns were registered for the third quarter - and vice versa. The quarter was characterized by negative returns for the U.S. stock market, flat returns for the developed international equity markets, decent returns for fixed income, and phenomenal returns in developing countries. Broadly, our model portfolios produced positive returns, but not excitingly so.

While our overall, relative quarterly performance was quite good, we were hurt by our exposure to smaller companies in the developed markets. Fortunately, our U.S. value exposure, international exposure, and the small and value positions in the emerging markets overcompensated for the weakness in U.S. small company returns. Please see the results listed in the table below.

Year-to-date, our relative performance has been even stronger. The main component of a typical investor's portfolio, the large U.S. companies that make up the S&P 500, has continued its pattern of underperformance. For most investors, this concentration has led to weak results for the year. This can be seen in the performance of the Standard Balanced Portfolio, which has eked out a 2.39 percent return, while the Skaggs Financial Planning, LLC Balanced Portfolio has turned in a respectful 5.03 percent. Obviously, we are thrilled with the 110-percent higher return of our portfolio. Please see the chart below for relative performance.

The Equity Real Estate segment continues to be an interesting area. After a modest pullback last quarter, the sector roared back and registered an 8.03 percent quarterly return, as measured by our Equity Real Estate strategy. In fact, this strategy has registered a 20.69 percent annualized return since the bursting of the tech bubble in March of 2000. If you had invested $100,000 in this strategy for these last 4-½ years, it would be worth $236,770 today. This is worth striving for.

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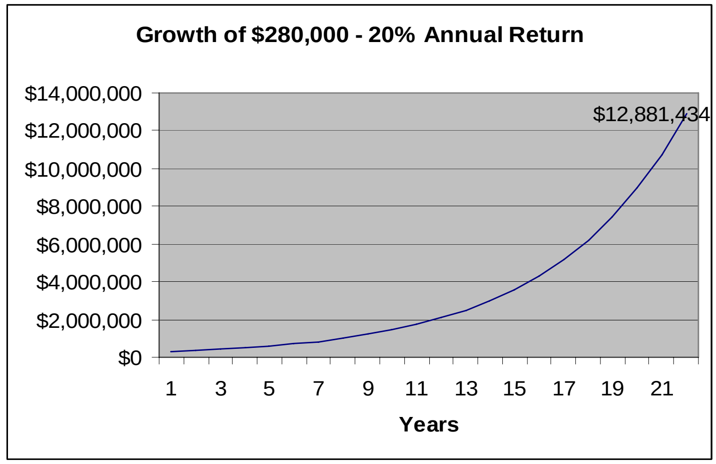
The problem is that these returns are not sustainable. One can see from the chart to the right that an investment of $280,000 growing at 20 percent for twenty years would net almost $13 million. Looking at this another way, if you could drop $280,000 in your favorite newborn's account and earn 20 percent annually, it would grow to over $56 billon by the time they reached the Social Security retirement age. (Hello Bill Gates!)



We are not overly concerned with these unsustainable returns for various. reasons: the risk in our Equity Real Estate strategy is mitigated by its varied holdings that represent properties diversified with respect to both geography and property type; strong returns are often followed by moderate, but still respectable, returns; and SFP's investment philosophy dictates that we take profits from strong performing segments and spread them across the broader portfolio. For instance, the SFP Aggressive Model Portfolio maintains an Equity Real Estate holding of 6 percent and maintains this weighting. Simply stated, we start diversified and stay diversified.

Residential real estate holdings, on the other hand, are difficult to diversify and do concern us. We have noticed a growing investor willingness to forget fundamentals in this area. The $280,000 investment we mentioned is roughly equivalent to Seattle's median home price and double digit returns in residential real estate have become common in many areas. These returns cannot continue indefinitely. Seattle's median home price in twenty years will not be $13 million. Despite this fact, many investors are turning away from stock and bond markets to chase these returns and the illusionary safety of property investments.

While we are not suggesting that individuals sell their primary residence and rent, we do see parallels reminiscent of the tech bubble. Are these new property investors questioning whether personal income levels can sustain these growth rates? Are they aware that homeownership rates are now the highest in U.S. history? Do they wonder what will happen as the baby-boomers age and eventually downsize? Are they concerned about the tremendous. amount of equity that has been pulled out through refinancing, essentially leaving banks as the primary owners of real estate? Are they concerned about how higher interest rates could affect home affordability? Are they concerned with their inability to diversify residential real estate holdings? No, they don't even ask the questions.

Growth was supposedly guaranteed during the tech bubble because the Internet was the future. Today, the current wisdom is land values can only go up because they are not making any more of it. That's the current rational for forgetting fundamentals, for ignoring the questions. It is the rational used to conclude that somehow the market for real estate is unlike all other markets that can decline. We disagree and urge investors not to forget the lessons of the past. Accordingly, we will continue to stick with a structured, disciplined, and <u>diversified</u> investment philosophy.

Best wishes for a joyful holiday season,

Brian J. Skaggs, CFP