

Investment Perspective

Third Quarter 2005

“Not to be absolutely certain is, I think, one of the essential things in rationality.” -- [Bertrand Russell](#)

SFP Core Strategies*	Quarter 3	
	2005	One Year
US S&P 500 (Enhanced)	3.18%	12.16%
US Large Value	5.69%	21.96%
US Micro Cap	6.78%	20.52%
US Small Value	6.16%	22.20%
US Equity Real Estate	3.75%	27.94%
International Large Value	10.91%	28.38%
International Small Cap	10.76%	32.58%
International Small Value	10.37%	37.42%
Emerging Markets	15.54%	43.33%
Emerg Mkts Small Cap	13.13%	36.76%
Emerging Mkts Value	17.73%	48.73%
Ultra Short Fixed Income	0.51%	1.80%
Shrt/Int Global Fixed Inc	-0.49%	2.07%
SFP Model Portfolios		
SFP Income Portfolio	2.73%	10.39%
SFP Balanced Portfolio	4.22%	14.85%
Non SFP Std Balanced	1.62%	8.05%
SFP Aggressive Growth	5.65%	19.05%

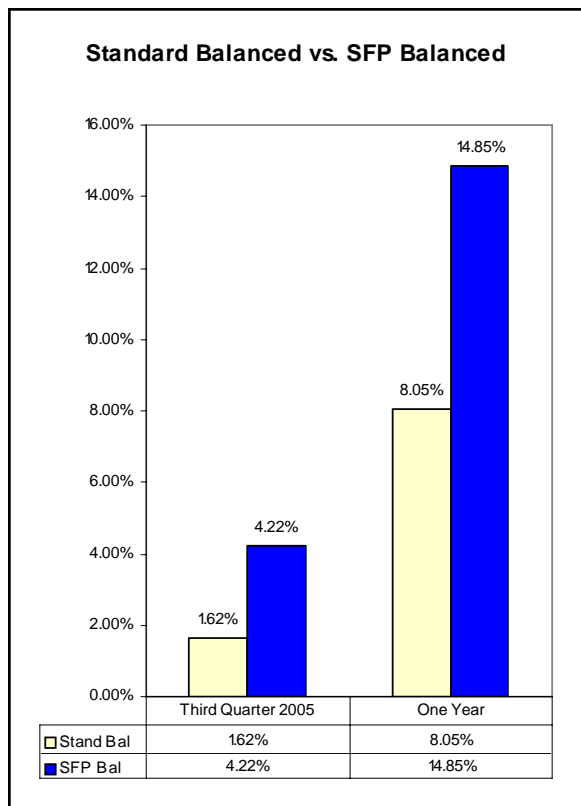
Perhaps the most common question I get from people when they find out that I'm a financial advisor is this: "Where do you think the market is heading?"

Ask me something easy, why don't you! This last quarter saw terrorist bombings in London, two additional rate increases by the Federal Reserve, crude oil prices hitting record levels, consumer sentiment hitting a thirteen-year low, two major US airlines filing for bankruptcy, and hurricanes that inflicted severe loss of life and countless billions of dollars in damage. Would I expect the market to react by turning in the best quarterly performance of the year? Not in the slightest, but that's exactly what happened.

We saw positive performance for the quarter in nearly every segment of the capital markets. (Please see the performance chart to the left.) Overall, the performance from our model SFP Balanced Portfolio was 4.22 percent. While the 40 percent of this portfolio that is dedicated to conservative bond investments struggled against rising interest rates to turn in an essentially flat performance, the businesses that make up the other 60 percent excelled, contributing to the very respectable returns for the quarter.

The pattern of out-performance in the international markets continued, while the dominance of small company and value stocks in the United States defied most analyst predictions that the larger growth stocks would take leadership. This pattern contributed to the relative out-performance of our portfolios.

The outstanding 4.22 percent performance for our balanced portfolio compared to a decent 1.62 percent for Non SFP Standard Balanced portfolio. The one-year comparison is 14.85 percent vs. 8.05 percent, respectively. While on a nominal basis this additional 6.8 percent is quite significant - and would amount to an additional \$68,000 of return on a \$1 million portfolio - the out-performance is even greater in real terms.



After subtracting out inflation at 3.6 percent and an additional 1 percent for advisory fees, the resulting real one-year returns for the Skaggs Financial Planning, LLC Balanced Portfolio would have been 10.25 percent vs. a real return after fees of 3.45 percent for the standard portfolio. This is a 297-percent increase in real returns; nearly triple the real earnings for the last year. While we know that our portfolios will under perform at times, it is nice to be this far ahead of the game.

A close second to the commonly asked market direction question is this: “Which stocks do you like now?” Added together, these two questions sum up the common misperception of what is important to succeed in the stock market. The events of this last quarter and the market’s reaction illustrate the futility of guessing the market’s direction. And by looking at an example of stock picking and applying common sense, we can see the pointlessness of this practice.

I’ll give you the short form. Let’s say that ABC Inc.’s stock is selling for \$20 per share. After studying the stock, an investor decides that the shares are attractive and makes a purchase. What the investor is really saying is that the supply and demand forces that determine the price of the shares in the market place are not working and the \$20 price is incorrectly low. Now after the purchase has been made, the investor waits for the market to correct its mistake and drive the price higher, allowing for a nice profit. The problem with the logic here is that on one hand, the investor has to believe that the market does not price securities correctly. On the other hand, the investor must depend on the market correcting itself and pricing securities accurately in the future.

Individuals following this market strategy are often put in an awkward position that can be seen by looking at Microsoft and Starbucks, two local favorites. Let’s say that two years ago, you, like many analysts at the time, decided that the market price was incorrectly low for Microsoft and made a purchase at \$27.80, the closing price on September 30th of 2003. Now two years later, Microsoft has barely moved. The closing price on September 30th was \$25.73. Or how about Starbucks? You purchased shares for \$62.36 at the beginning of 2005 and now a share is down to \$50.10. While you have been waiting for the market to correct the perceived mistake in pricing, you have missed out on tremendous gains in the overall capital markets. Do you throw in the towel now and lock in their relative losses or do you continue to wait? After all, the relative price is now even cheaper. How long do you wait for a market that does not price securities correctly to start pricing securities correctly? You can see the thorny issues involved.

A better approach is to avoid this philosophy and to assume the markets do work. Obviously, prices for individual stocks fluctuate, sometimes dramatically. If you enjoy participating in the fortunes of a particular company or just want to do some gambling in the capital markets, go right ahead. I occasionally do it myself. But for the serious money you entrust to us, we will continue to avoid market speculation and provide broad capital market investments.

I hope these examples helped you understand a little better about the most sensible and smart ways to invest your hard-earned money. As always, doesn’t hesitate to contact me with questions. I wish you a most happy and prosperous fall and coming holiday season.

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.