

Investment Perspective

Third Quarter 2006

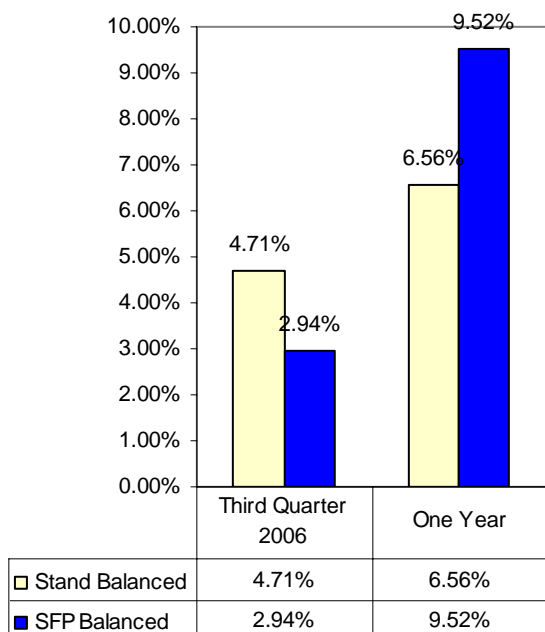
“Many a small thing has been made large by the right kind of advertising.” -- [Mark Twain](#)

SFP Core Strategies*	Quarter 2	
	2006	One Year
US S&P 500 (Enhanced)	5.58%	9.71%
US Large Value	2.90%	12.71%
US Micro Cap	-0.21%	7.92%
US Small Value	-0.70%	12.02%
US Equity Real Estate	9.21%	26.83%
International Large Value	6.47%	25.84%
International Small Cap	2.29%	18.18%
International Small Value	3.15%	19.77%
Emerging Markets	6.42%	18.67%
Emerg Mkts Small Cap	8.78%	23.24%
Emerging Mkts Value	6.33%	24.22%
Ultra Short Fixed Income	1.34%	4.19%
Shrt/Inter Global Fixed Inc	1.94%	2.91%
SFP Model Portfolios		
SFP Income Portfolio	2.43%	7.07%
SFP Balanced Portfolio	2.94%	9.52%
Non SFP Std Balanced	4.71%	6.56%
SFP Aggressive Growth	3.35%	11.96%

Absolute performance for the third quarter was very strong. The Skaggs Financial Planning Balanced portfolio returned 2.94 percent. If annualized, this return would amount to 12.29 percent, which is far above our long-term expectations for the portfolio of about 7 percent after fees and expenses. Areas of strength in the markets included real estate securities and emerging market equities. And after years of positive predictions, large growth stocks finally did well.

Our relative performance was weak for the quarter. The Standard Balanced portfolio, likely to be held by the typical investor, returned 4.71 percent compared to our SFP Balanced Portfolio return of 2.94 percent. This underperformance was primarily due to the relative weakness in small company stocks both domestically and in the developed international markets and our relatively strong weighting in this area. Adding to the weakness was our Large Value strategy. Based on most conventional indexes, the US value stocks did rather well. Our strategy is on average smaller than the conventional indexes and is much more concentrated in the value area than commercial indexes. While this usually leads to out-performance, this was not the case in the third quarter. On the Fixed Income side, the Standard Balanced Portfolio benefited from the combination of its relatively long maturities and the decline in interest rates.

Standard Balanced vs. SFP Balanced



Whenever it comes time to look at results for the quarter, it can be a bit hard not get swept away by short-term thinking. How did my portfolio do in the last few months? Are the Fed's recent decisions on interest rates (up or down, you fill in the blank) going to affect me? Is it time to test the high-tech waters again?

But as most of our clients know, that kind of thinking doesn't lead to long-term success. Here, we rely on patience and common sense in our investment management, a strategy that leads to success in our portfolios.

Sadly, that's far from true for many investors. Pretty frequently when I meet a new client, I hear concerns about investments made elsewhere with promised returns that simply never materialized. Many of these folks might call themselves the average type of investors, hardworking people who simply want a decent return on their money. Often times, these folks invested based on advertised returns, but somehow that money never ended up in their pocket. Investing was like playing the shell game: these investors saw the ball but rarely picked the right shell. All they got was disappointment.

Dalbar Inc., a company that studies investor behavior, has quantified the returns of such a mythological average investor. In its *2004 Quantitative Analysis of Investor Behavior*, Dalbar concluded that over the past 20 or so years, the average investor clocked a surprisingly low rate of return, eking out only 0.6 percent per year above inflation over the period. That's right, less than 1 percent per year. And this does not include income tax!

There is a new tool that should help such average investors and their advisors. Morningstar, a mutual-fund rating company, announced a new statistic that helps to quantify the difference between advertised returns and returns that actually ended up in investor's pockets. The Morningstar "success ratio" is based on return calculation that actually looks at how the funds' investors really fare and compares that to the advertised returns. Here are some top performing fund families.

<u>Selected Mutual Fund Families</u>	<u>Morningstar "Success Ratio" (1996-2005)</u>
Dimensional Fund Advisors (DFA)	109%
Dodge & Cox	98%
American Funds	95%
Franklin Templeton	94%
Fidelity	91%
Vanguard	86%

Dimensional Fund Advisors, or DFA, topped Morningstar's list, with the highest success ratio of any mutual fund family, 109 percent. The average passively managed mutual fund's ratio was about 78 percent. This means that the actual return for investors in the average fund was only 78 percent of the advertised return. The Morningstar Managing Director Don Phillips cited DFA as a fund family that has not only successfully managed its investments, but also enhanced its investors' overall success by encouraging investors to ignore short-term market trends.¹ This led to investor returns that were actually greater than the advertised returns.

You'll probably recognize DFA's name – but not because of its advertisements. DFA doesn't advertise, not even to financial advisors. Its sole focus is to provide institutional investors and select advisors with efficient exposure to various investment markets. That is closely aligned with our goal of addressing your financial service needs and a primary reason that DFA is a top choice when we build your portfolios.

We understand that capturing market returns will not always be fun – we do after all capture periodic declines as well as positive moves. In the light of difficult times, it will be tempting to battle the markets to avoid losses or increase your gains, but we know this brings with it the type of inefficiencies that have left the Average Investor without long-term gains. If you have a friend, relative or professional acquaintance whom you suspect might be experiencing such disappointment in his or her investments, we'd be obliged if you'd pass the name of our firm along.

May you enjoy a happy and prosperous fall.

Sincerely,

Brian J. Skaggs, CFP

¹Raymond Fazzi, "Fund Returns: Theory vs. Experience," *Financial Advisor*, September 2006