QuarterNotes

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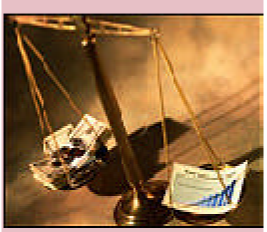
Quips for the Quarter

"Your success in investing will depend in part on your character and guts, and in part on your ability to realize, at the height of ebullience and the depth of despair alike, that this, too, shall pass."
-John Bogle

Money is made when you buy stocks on weakness and stocks in distress - not when they are in high demand.

"I would never bet against the American Economy"
Peter Lynch 6/2002



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Economy Shows Signs of Recovery - Portfolios Will Too

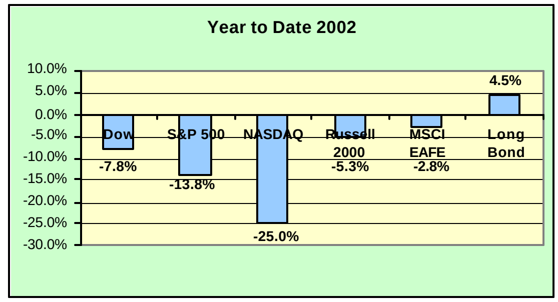
Nothing good can be said about the quarter just passed except that it's over. The Dow fell 11% , S&P dropped an additional 13.7%. The technology heavy NASDAQ 100 plummeted more than 27%. Irrational exuberance has been replaced by irrational pessimism. If we haven't seen the bottom yet, we are certainly near it.

Since 1960 only two quarters have been worse; both were followed by strong market gains. Legitimate concerns exist including high levels of consumer and corporate debt and low savings rates which contribute reliance on foreign investors in our markets. In addition news of corporate corruption has caused a crisis of confidence.

Market fundamentals look better. Real earnings are coming back, unemployment is down. Interest rates remain at 40 year lows. Sentiment is quite pessimestic, normally a bullish sign. Billions of dollars are parked in money markets, earning next to nothing. We need time to recover from the hangover of the excesses of the last two years.

Fear will turn into greed as soon as there is a hint that the markets have turned and no one will ring a bell when it does, so we need to remain positioned now in preparation. This is certainly no time to panic and sell out as inexperienced investors are prone to do in a depressed markets. That kind of capitulation frequently signals a bottom.

Earning 1% in money funds and 4% in bonds, investors seeking higher returns will eventually return to stocks. Investors who are well diversified and maintain equity holdings will profit as demand for equities improves.



Foreign Economies Gaining Ground

The US has become the world's largest debtor, and foreign investors own $1.5 trillion in corporate equity, $1.3 trillion in bonds and $600 billion in Treasuries. We import more than we export. We consume more than we produce and we attract capital from all who have sought safety in US dollar investments.

There is a danger that at some point, foreign investors will not want to put more funds into dollar-based holdings. This imbalance is one of the reasons for the falling US dollar.

Last year, America's current account deficit was nearly twice as large as the current account surpluses of the rest of the developed countries. Why is this a problem? In feeding US demand, other countries have failed to sell their goods at home and to other non-US consumers.

Imbalances tend to self-correct. There are three areas where we can look for changes to occur:

1) US economic growth slowing- economic analysts believe that the US economy will grow in line with historical GDP growth - approximately 5%;

2) Falling US Dollar- a "soft landing" decline of 5% per year for the near term would not hurt consumers too much and would do wonders for exports;

3) Foreign Economic Growth- Europe is poised for above trend, but not sizzling, growth; there are promising prospects for emerging economies like Russia and Pacific Rim countries (especially China and India); and Japan must implement true reforms,

These factors make a strong case for maintaining full international exposure in order to exploit these economic trends.

Things we can do when markets are bad

Manage Taxes:

Harvest losses

Capture profits on run up holdings

Diversify:

No over-concentration 5% maximum rule Forces "Buy Low Sell High" discipline

Watch the Dollar:

A strong dollar has meant weak returns for foreign stocks

As the dollar has weakened against the Euro and the Yen, fully allocate international positions.

Look for currency appreciation to enhance stock growth

Monitor Interest Rates:

Be aware of duration of bond portfolios. The longer duration, the greater interest sensitivity. There will be more risk if interest rates begin to rise.

Ladder bond portfolios

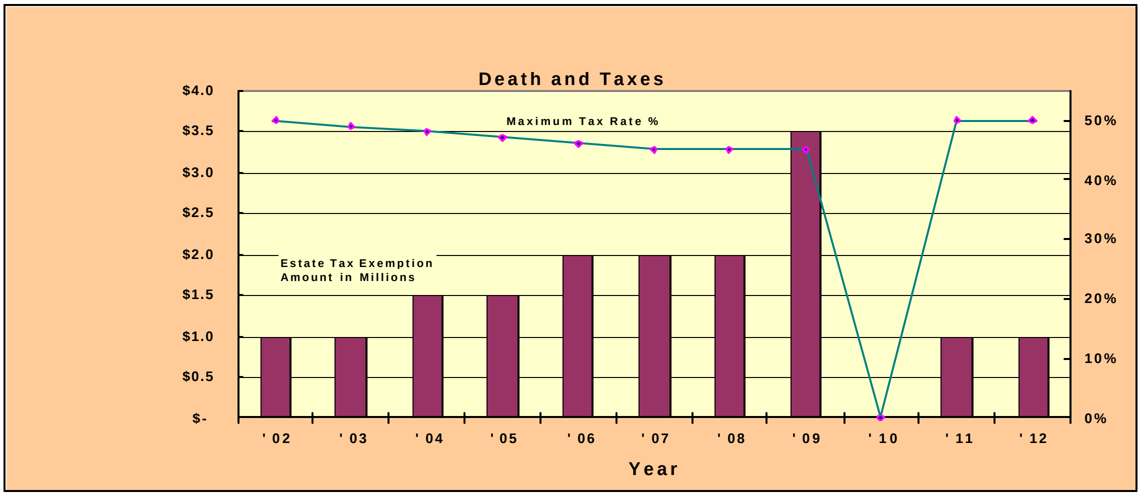
Death & Taxes - What's the Latest on Estate Tax Changes

We are still faced with an uncertain planning environment when it comes to estate taxes. The Tax Relief Act of 2001 decreased the so-called "death tax" until 2010 when it is fully repealed. However, in 2011 with the sunset provisions, estate taxes return to their 2002 level.

The unified gift and estate tax credit amounts, $1 million for each of the next two years, will gradually rise to $3.5 million by 2009. At the same time the tax rate will drop from the current 50% maximum to 45%. *(See graph)*

In May, the US House of Representatives voted for the second time to make the repeal permanent. However, in June the Senate rejected the repeal. With mounting federal deficits, it is unlikely that in 2010, when estate taxes are scheduled to be gone, they will be.

Congressional watchers believe the estate tax will continue in some form. Estate planning attorneys' best guess is that the higher credits and lowered tax rates will just be extended, perhaps at the $3.5 million level. Estates in excess of that figure are expected to be taxed at a rate of 45% or lower.



The Economy

The US economy is emerging from a relatively mild recession. Companies simply stopped producing and sold off goods at substantially reduced prices. This depressed profits, reduced demand for labor and materials, and rapidly decreased capital spending by businesses. In order for the recovery to fully take hold, capital spending has to pick up, inventories have to be rebuilt and profitability must be restored. This takes confidence, which has been undermined by a weak stock market and traumatic world events.

There are, however, signs of true economic recovery. Housing is strong, both for existing and new home sales due to low interest rates and the tax advantages. Consumer confidence in June came in better than expected. The elimination of zero per cent financing on autos decreased durable goods spending, however, chain-store sales have rebounded. Consumer spending has continued to grow at 3%. Productivity growth continues to

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(Economy from column one)

surpass expectations. Gross Domestic Product (GDP) grew at 6.1% in the first quarter. Growth estimates for the second quarter are 3%. In addition factory orders were up 1.2% in April which is the fifth straight month of rising orders. Even, the unemployment rate, a lagging economic indicator, dropped from April's 6.0% to 5.8% in May.

Normally, the stock market is a leading indicator of renewed economic expansion. However, in this cycle there is an unusual disconnect between what is a real recovery and the behavior in the equity markets.

The American economy is remarkably resilient. Thousands of companies are making honest profits using a highly productive work force and innovative technology. Profitability is returning, as will ultimately investor confidence and stock prices.