HOLMES R. OSBORNE III, Inc.
A BETTER WAY TO MANAGE MONEY
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What is a Better Way to Manage Money?

We differentiate our services from other firms in several ways. Number one, we are professional money managers. We have the credentials and experience to make investment decisions.

The second difference is that we dollar cost average into the market. When a portfolio is brought to us, it is invested in cash and safe, short-term bonds. We then begin carefully picking investments for our clients. The types of investments that we are looking for are publicly traded stocks and bonds. By patiently making investments, we are not haphazardly rushing into the market. We feel that this method truly diversifies a client's portfolio and does not leave their money totally influenced by the stock market.

We do not invest in mutual funds because we feel their fees are too high and that mutual funds are at the mercy of the market they specialize in. If a person owns a mutual fund, they own hundreds of stocks and bonds inside of that fund. If the markets drop, their fund will certainly drop too. We concentrate on a fewer number of stocks and bonds. By doing this, we feel that we will have more control over our investments. Regarding fees, ours are a fraction of what many mutual funds charge.

Investments

We make investments in stocks and bond that are undervalued. Some of these investments will be held for many years. Others, for a short while. We search the globe for the best values. First, we look at the balance sheet and determine the assets and liabilities of a company. Next, we determine if the stock is fairly valued. The total portfolio of a client will match their risk profile.

The first type of investment that we are looking for is in companies that are growing at a high rate of return. The types of companies that we are looking for are the next Wal-Mart or Home Depot. We will make investments in these companies and hold them for many years. They will start out as regional companies and expand. When a company is being managed correctly, everything falls in place. The debt levels are low. Profits are consistently rising. Their goods and services are competitive.

We monitor a number of these companies and determine when the right time to buy is. We do not rush in because you can lose money in the stock market even in a good company. We patiently wait and then make our investment.

The next type of companies that we are looking for are undervalued in the stock market. Often times, when there is news that is not flattering to a company, the stock will fall. Last year, we made an investment in McDonalds.

The news was that with obesity lawsuits, McDonalds could face extensive litigation. The stock dropped to $14 a share. The land alone was worth $9 a share. We saw value and made the investment. We sold at close to $21 a share and made about a 45% return in a few months. We chose not to hold onto the stock because McDonalds is not a growth company. There is a McDonalds on every corner in America.

People say that you should buy a stock and hold on forever. That is not always the case. One can find mispricings in the stock market. That is why it is called a market. Even the famous Warren Buffett, known as one of the greatest investors of all time, makes short term investments in underpriced stocks.

We will also look abroad for values. Companies that we consider all-American are often times owned by foreigners such as Miller Beer, Chrysler and Farmers Insurance. All are owned by companies that are traded on non-American stock exchanges. We will include these types of companies in a portfolio to add to returns and diversification.

Microsoft

Recently, we have been buying Microsoft for clients. Every type of bad news has been circulating about the company. The European Union has brought up anti-trust violations. Investors are concerned about competition. Microsoft is in the headlines every day for something.

However, Microsoft is sitting on about $52 billion in cash. This is the equivalent of about $5 a share in cash. Since Microsoft trades currently at $26 a share, it is trading at 5 times what it holds in cash. This is rare for a technology company, especially Microsoft.

Microsoft is one of the most superbly managed companies in the world. If you had invested $9000 in 1986, you would now have $2,600,000. We feel that Bill Gates and his team will prevail, as they have in the past.

We plan on holding this company until it rises into the mid $30 range. If it rises to $35 a share, we will make close to a 40% return.

Unum-Provident

Unum-Provident specializes in health, life, disability, and long-term care insurance. The disability division has been losing the company millions of dollars due to the difficult insurance environment. The stock is trading at about $14 a share. However, the book value is $22 a share.

Book value is a way to measure the equity in a company. As an example, if you put down $10,000 on a $100,000 home, you would have to borrow $90,000. You would immediately have $10,000 equity in this home. This would be like buying that $10,000 in equity for $5,000. The same thing basically applies to stocks.

Unum-Provident's stock is actually trading at less than what the equity in the company is worth. This is a rarity in today's market. Many companies trade at several times their equity. We have been buying Unum-Provident as well.

HMA

Health Management Associates manages hospitals and is headquartered in Naples, Florida. We do not recommend buying at this time but do think that this is one of the best growth companies available. The stock trades at about $22 a share. The last time we recommended HMA was in 1999 at $8 a share.

HMA is in a unique position because it operates hospitals in rural communities. They have somewhat of a monopoly because patients must use the local hospital and do not have the variety that an urban area offers. Another plus is that the aging baby boomers will require more medical care in the years to come.

For people who already own this stock, I would recommend holding for many years. This is the type of company that can grow at a compound rate of 15%+. For those who do not own this stock, I would recommend they wait. HMA is too expensive to buy now.

2004 Tax Guide for Investors

Capital Gains Tax

Tax bracket	Less than 12 months	Greater than 12 months
10% & 15%	ordinary income	5%
higher bracket	ordinary income	15%

Qualified Retirement Plans

401K & 403 B	$13,000
Catch up for 401K & 403 B	3,000
Simples 401K	9,000
Catch-up for Simples 401K	1,500
SEP	41,000
IRAs	3,000
Catch-up on IRAs	500

Catch-ups are available to contributors over age 50

Qualified Dividends

Tax bracket	Tax
10% and 15%	5%
Higher brackets	15%

Estate Exclusions

$1,500,000

Standard Deductions

Married	$3100
Single	$3100

Distributions at Retirement

IRA	Ordinary income
Roth IRA	Tax free
Annuity	Ordinary income on gains

Standard Deductions

Married	$9,700
Single	$4,850

Kiddie Tax

First	$800	No tax
Next	$800	10% tax
Amounts over	$1,600	Parents Rate

Maximum Compensation Subject to FICA

Social Security	$87,900
Medicare	No limit

California Real Estate Market

Like real estate around the country, the California real estate market has been booming. School teachers and blue collar workers live in $750,000 homes in Los Angeles. They are able to do this because they bought into the market many years ago and watched their real estate rise in value as the city grew in population. With interest rates so low, people are able to afford more home for less dollars in house payments. The risk involved is that as interest rates rise, a given house payment will buy less home. As an example, if a couple has $2000 that they can afford for a 30 year mortgage at 6%, they can buy a $333,583 home. However, if rates rise by 1%, their $2000 can only buy a $300,736 house. If rates rise to 8%, their $2000 can only buy a $272,463 home.

This is the risk involved with investing in real estate. As interest rates rise, demand can dampen. What has been keeping this market going is that existing home owners are rolling their equity into new homes and raising their mortgage payments to buy million dollar homes.

The second risk involved in real estate is leverage. Leverage is when you borrow to make an investment. When prices rise, your profits are amplified because you borrowed money. When prices fall, you can lose your shirt because of the money you owe. Look at the stock market crash of 1929--all the stocks that were bought on margin helped create the situation. After the crash, the Federal Reserve changed margin requirements so investors cannot borrow so much when buying stocks. We do not employ leverage when investing at our firm.

What the Los Angeles market does have in its favor is that there is a limited supply. Ocean is on one side and state park on the other. There is only so much land available and that land is already occupied. This makes a favorable situation if you already own in this market. But our question is, "has the real estate market reached its peak?" We will know in a few years.

Experience

Holmes Osborne began his career as a financial consultant for Merrill Lynch Private Client Group in Naples, Florida. At Merrill Lynch Mr. Osborne assisted clients in asset management and estate planning. After Naples, Mr. Osborne managed trust portfolios for Merrill Lynch Trust Company (a division of Merrill Lynch's mutual fund division) in Boca Raton, Florida. The trust department managed over $1 billion in clients' assets. After Florida, Mr. Osborne worked in management for Farmers Insurance Group in Los Angeles, California.

Mr. Osborne has a degree in finance from the Martin J. Whitman School of Management at Syracuse University. Licenses held are Series 7, 63, 65, and 26. Member of the Association for Investment Management and Research and Los Angeles Society of Financial Analysts. Mr. Osborne is also President of the Syracuse Alumni of Southern California.

Fidelity Investments
http://www.fidelityinvestments.com

Clients' assets are held in custody at Fidelity Investments. At Fidelity, clients may have online access and will receive monthly statements.

LLoyd's
http://www.lloyds.com

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