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A BETTER WAY TO MANAGE MONEY
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Our portfolios having been doing quite well recently. Our biggest winner is auto parts manufacturer **Toyota Motor Industries**. It is up 50-60%. **UnumProvident**, the insurance company is up 40-50%. Ohio-based property and casualty insurer **State Auto** is up 15%. For the rest of the performance, I'll just list the original purchases and exclude newer clients whose performance may differ. In some instances, I'll purchase a stock over several months and newer clients will have a different cost basis.

Los Angeles based insurer **Mercury General** is up 8%. Shoe retailer **Finish Line** is up 15%. Apartment real estate investment trust **United Dominion** is up about 10% including dividends. Our two dogs are **Krispy Kreme** and **Helen of Troy**. Krispy Kreme is down 45%. Helen of Troy is down 28%. Helen has been punished because it had an off quarter and Krispy Kreme has had a lot of bad news. Helen is a long term hold and we will hold Krispy Kreme while it turns things around.

Since our last newsletter, I have bought and sold quite a few stocks. **Aegon** was sold for over a 20% gain. I sold Aegon because it reached a price where I felt the stock was fairly valued. We did buy another Dutch company, **ING**. ING is in banking and insurance. The stock has about a 5% dividend yield. Like Aegon, I feel that this stock is undervalued and will sell it when I feel that it is properly valued.

Two other value stocks bought were **IDT** and **Audiovoxx**. IDT is a long-distance telecommunications company and Audiovoxx makes stereos and cell phones. IDT has about $9 a share in cash and trades for $11.50. Audiovoxx has about $7 a share in cash and trades for over $14. It is rare that you will find stocks that trade at such a steep discount.

A company that I feel will do quite well in the next few years is the **CIT Group**. The CIT Group arranges loans and leases for large companies. Right now, many companies hold an unprecedented amount of cash on their balance sheets. Mutual fund managers will make management deploy this cash somehow either as a dividend or an investment. I feel that companies would rather invest their cash in new equipment rather than pay a dividend and the CIT Group stands to profit from this.

A well known company that we bought is **Pier One**. Pier One owns retail home furnishing stores. The company has faced increasing competition from IKEA, Target, and Cost Plus. Warren Buffet bought this stock at a much higher price but lost money on it.

What is enticing is that it has a 4.3% dividend yield. A dividend yield this high is quite rare and I feel it indicates that the company is undervalued. If the stock rose high enough so that the dividend was 3%, the stock would equal $13.33. That would equal a profit of 41%. Let's hope that we are fortunate enough to have this happen. I am only interested in this stock because of this high dividend yield.

The last new addition to the portfolio is French auto maker **Peugeot**. Peugeot trades at a discount to book value (the equity in the company). I will hold onto this stock until it rises above book value. In addition, I feel that the European stock market will have another strong year as it has in the past few years.

What is the thesis of these investment choices?

Basically, we have two types of investments in stocks: those to be held for the long term and those to be disposed of when they reach a certain value. The long term holds are Mercury General, State Auto, Finish Line, and Helen of Troy. I feel that these companies will do well in any environment and will outperform the overall stock market. The rest of the stocks will be held for a few months or years and sold, hopefully at a profit, when they reach what I feel is a fair value for the stock.

What is the goal?

The goal is to provide a positive return so that clients will have money to pay for objectives such as retirement income, a dream vacation, or a nursing home. All of these cost more as inflation rises.

I don't invest in index funds because I feel that this portfolio will outperform index funds and that the costs will be less than what most mutual funds charge.

I like to invest in individual stocks because I feel that I have greater control of certain situations. Of course, stocks are influenced by the overall market but if you can put together a good portfolio, hopefully, you can do well in a bear market or outperform in a bull market. (Remember, bear means go down and bull means go up.)

Third Avenue Value Fund

The fund had another strong year, 16.5%. Since the inception of this fund on November 1, 1990, the annual return has been 16.9%. That is phenomenal! *Barron's* rated this fund in the top 20 for performance in the past 15 years. I use this fund for smaller accounts that are not appropriate for individual stocks and bonds.

Outlook for 2006

I don't really know where the market, oil, or gold will go. I do feel that real estate is overvalued and the European stock market is undervalued. Also, interest rates have been rising which means that our short-term bonds and money market will offer a higher yield. I do predict that rates will keep rising, as I have indicated in past newsletters.

Tax Guide for Investors 2006

Plan **Amount**

1. Traditional IRA or Roth…$4,000, catch up* is $5,000
2. 401k, 403B, or 457….$15,000, catch up is $20,000
3. Simple IRA…$10,000, catch up is $12,500
4. SEP…$44,000 or 25% of income
5. Keogh…$44,000 or 20% of income
6. 529…$120,000 per couple (parents, grand parents, etc.)
7. The taxable maximum for social security is $94,200
8. Gift tax exemption is $12,000
9. Standard deduction is $10,300 for joint and $5,150 for single filers
10. Kiddie tax exemption is $850
11. Mileage deduction for a business is $.445

*Catch up is available for people over the age of 50

What is better: Traditional or Roth IRA

In a traditional IRA, contributions are tax deductible. However, one must pay taxes when they withdraw the money. Also, they must make mandatory withdrawals at age 70 1/2. Roth contributions are not tax deductible but one does not pay taxes on the withdrawals. Also, there are no mandatory withdrawals on Roth IRAs.

For most investors, the traditional IRA is the better choice. Let us assume that a person spends all of his money from his paycheck and has no money in savings. At the end of the year, this person receives a $5000 bonus. If they choose a Roth IRA, they will lose part of this $5000 to taxes so their contribution amount is less. However, if they choose a traditional IRA, the contribution is fully tax-deductible and they can contribute the full amount.

You might look at this example and conclude that the person who chose the traditional must pay taxes when they withdraw the money. That is true, however; when most people withdraw money from an IRA, they are retired. When they are retired, they most likely will be in a lower tax bracket than when they were working. The tax savings when contributing would supersede the taxes paid when withdrawing.

This was the result of a study done by a professor in conjunction with the CFA Society (Chartered Financial Analyst).

Experience for Holmes Osborne, CFA

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. Upon leaving 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 CFA Society and Los Angeles Society of Financial Analysts and holder of the Chartered Financial Analyst designation. Mr. Osborne is President of the Syracuse University Alumni Association of Southern California and a member of the Malibu Chamber of Commerce.

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.

All clients' information is kept in the strictest confidentiality.

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