



July 2006

### **Second Quarter Drop**

The second quarter for 2006 has not been too kind. The Dow Jones Industrial Average ended the quarter 559 points from its high set a few weeks ago. Commodities are down, international markets are down, and just about everything else is down too.

The reason why is that the market is concerned about inflation and interest rates. As inflation (the cost of goods and services) rises, the Federal Reserve must raise interest rates to fight inflation. Higher interest rates will raise the cost of borrowing for corporations and hurt profits. Higher interest rates will make housing less affordable. Inflation will make investing less attractive for foreigners investing in the U.S. because their investments will depreciate thus hurting the dollar. This can beget more inflation with an increase in foreign prices.

### **Take Heart!**

I am a huge believer in demographics. The Baby Boom is the largest segment of the population this country has ever seen. This generation was born between 1946 and 1964. As people reach their forties and fifties, they begin producing and spending at the highest levels of their lives. In their sixties they begin to retire and spend less. This effect has driven the economy in the 1980's, 90's, and today.

The reason the economy was so weak in the 1970's was that the people of the World War II generation were beginning to retire and most Baby Boomers were in their teens, twenties, and thirties. Certainly not top producing years for an individual. There were not enough skilled workers to fill the shoes of the retirees in the 1970's. However, that changed in the 1980's as the Baby Boomers aged and gained more experience.

I feel that this economy has room to grow. There are still millions of Baby Boomers born in the 1950's and 1960's who have productive years ahead. They will keep driving the economy for a few more years. We will then turn our attention to what products Baby Boomers will be interested in, such as health care, retirement villages, and other senior goods and services.

### **Mercury General Shareholder Meeting**

On May 10, Mercury General held its annual shareholders' meeting in Los Angeles. I had the opportunity to chat with founder George Joseph. Mr. Joseph stated that the company is investing in new computer systems that will keep it more competitive. He also said that, more than ever, this is a time of high competition in the insurance business. **MCY** is still expanding across the U.S. and is one of the top companies in the prop-

erty and casualty business. We will sit back and collect our 3.5% dividend and wait and see.

### **Wesco Meeting**

For the second time, I attended the **Wesco** Annual Shareholders' meeting in Pasadena. Warren Buffet's partner, Charlie Munger, is the CEO of Wesco. You might remember from the summer 2004 newsletter that I took Mr. Munger's picture.

The meeting was highly attended by some of the best money managers in the world who came to hear the sage's advice. The most famous meeting is for **Berkshire Hathaway** in Omaha.

Mr. Munger feels that the money university endowments invest in is over diversified. People are investing in areas just to be diversified even though the investments might be bad choices. He spoke of endowments investing in Sub-Saharan Africa. As an example, Munger said that if someone was pitching an investment idea to Warren Buffet, Buffet would compare it to **Wells Fargo**. If the investment was riskier or more difficult to understand than Wells Fargo, he did not want to be in it.

Munger was bearish on junk bonds. Advised on not borrowing too much money when developing property or running a business. I have always noticed that Munger and Buffet are always quick to tell you what they don't like but never tell you what they do like. My clients do not own any shares in Wesco or Berkshire Hathaway.

### **Trip to Federal Reserve**

Along with the Los Angeles Chapter of the National Association of Business Economists, I had the opportunity to visit the Los Angeles branch of the San Francisco Federal Reserve. This is where billions of dollars in cash and coins are stored. We had a chance to see all of this money on pallets that are controlled by robotic arms. Needless to say, security was tight.

Also, the Reserve processes checks. So when you write a check to someone, the Reserve can act as an intermediary and make sure the check clears .

### **What Fees are You Paying?**

Do you know how much in fees you are paying on your mutual funds? Probably not. You can check by going to *Yahoo Finance* and entering the name of your mutual fund. If you are paying over 1.5%, it's probably too much.

Another product with high fees are variable annuities. These products are insurance combined with investments. The client is guaranteed that their beneficiaries will get at least what they put into the policy. However, fees are usually in the high 2% to 3% range. You can't touch the money until 59 1/2 without a penalty. Furthermore, the gains are taxed as ordinary income (meaning as if it were on your W-2 Form). So not only are the fees high but also it is not friendly come tax time when you withdraw the money.

## Quarterly Update

Along with the rest of the global markets, our portfolios decreased from their highs set in the spring. **Pier One** is down because of another off quarter in earnings. The good news is that they are looking at a possible sale. This could boost the stock.

We sold **Peugeot** at a small profit of about 6% to make way for **Tesco**. Tesco is a British supermarket chain that has a large presence in Europe. It is going to open several stores in California. Warren Buffet bought some shares but when this news was announced, the stock price did not react because of the weak overall market.

Our profits in **Toyota Industries** decreased as the Japanese market pulled back. Another long hold, **UnumProvident**, has also pulled back because of profit warnings

I am happy to announce that we bought one of my favorite companies, **HMA**. Health Management Associates runs hospitals in rural communities. Its advantage is that most people in these areas will not drive into the city but will go to the local hospital. HMA enters these communities and buys hospitals and puts in its own management team. In the past few years, HMA has had phenomenal growth but has since slowed. I feel that with the aging Baby Boomer demographic, health care will be in high demand.

We sold the Dutch financial company **ING**. Our profit with dividends was 24%. Not bad for just a

few months.

**The Finish Line** is down as much as 27% in some portfolios because FINL's sales have decreased. Right now, European brands such as Puma and Adidas are in style, especially with the World Cup influence. The Finish Line specializes in American brands such as Nike. I feel that fads come and go. Eventually, the American brands will be back in style and because The Finish Line keeps building stores, they will be in the right place to profit when American is in style again.

Our insurance companies have been stalling as people wait for the hurricane and tornado season this fall. Insurers in these areas have more than doubled their premiums. If global warming is in effect, these companies might have a rough year. If last year was just an anomaly, then they will be o.k.

We own **Mercury General**, **State Auto Financial**, and **American Safety Insurance** in the property and casualty business. Other insurers that we own include **UnumProvident** and **Universal Financial**.

## Rents to Increase

With interest rates rising and prices in some real estate falling, now is a good time to be a landlord. As housing becomes less affordable, landlords raise rent. Also with inflation, landlords raise rent too. This industry looks favorable in the next few years.

### **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 holder of the Chartered Financial Analyst designation. Mr. Osborne is also a member of the National Association of Business Economists and Los Angeles Venture Capital Association.

### ***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 confidence. Mr. Osborne can be reached at 310-452-0910.

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