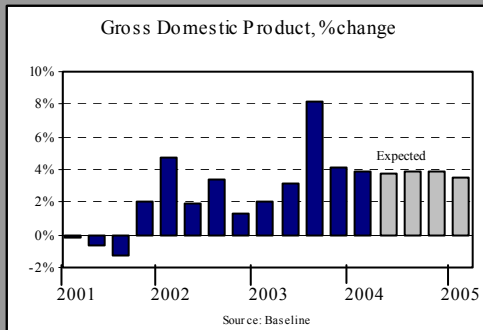


Second Quarter 2004 Highlights

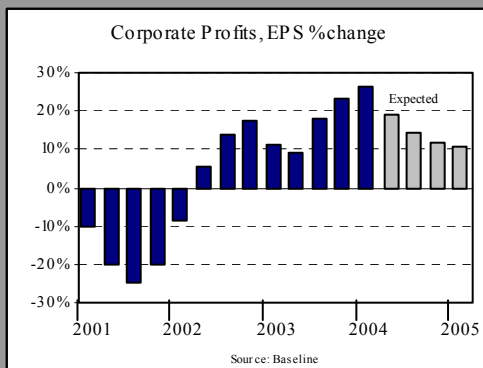
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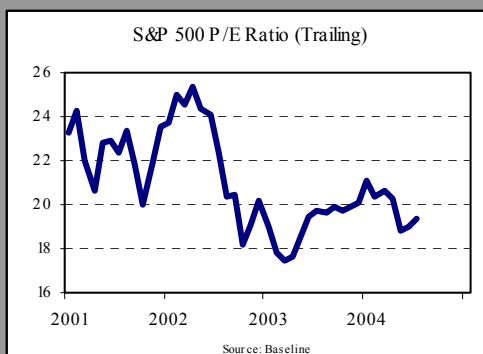
Economic Growth Is No Longer A Question



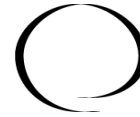
Employment Is Beginning To Pick-up



Profit Growth May Be Peaking



Valuations Are Attractive



OSBORNE PARTNERS

Capital Management

580 California Street, Suite 1900
San Francisco, CA 94104
(415) 362-5637
Fax (415) 362-5996

Inflation Versus Pricing Power

By Charles D. Osborne
& Brett J. Prior, CFA

The recent increase in interest rates by the Federal Reserve is designed to restrain any future inflation. We have not experienced significant inflation for twenty years, but the ghost lingers on. One aspect of an inflationary environment is that companies can easily raise prices because people expect it.

In this recovery of tepid growth and lingering high unemployment, the ability to raise prices is very valuable. Some industries, especially commodity providers, have had such demand that price increases have been steady and steep. Others such as telephone services are still in the doldrums. What industries can now raise prices? Industries that have differentiated products that provide substantial benefits (pharmaceuticals for example) may have some room, while broad competition in many industries will limit price increases. Pricing power is an elusive component because of this.

Although pricing power is not strictly an economic term, it has come to mean a specific company or industry's ability to raise prices without losing market share. It is clearly different than inflation which is a macro event. Strong demand and a friendly environment are the key components in the pricing formula. Car companies used to be able to annually increase prices as new models created a buzz. This is no longer the case for a variety of reasons. Worldwide competition keeps a lid on price increases, unless there is specific demand. The hot new hybrid cars, for example, have pricing power. But in most cases the wide availability of excess labor or plant capacity keeps a lid on prices.

World trade means world competition in all areas. Plant capacity should no longer be measured nationally because as we all know, much is outsourced or built overseas. This is also true about labor. This week I had a problem with my home DSL line and spoke to the SBC call center, which happens to be in India. They could not handle it so they transferred me to a call center in the Philippines. Everyone has a story like this. This portability of plant and labor can create excess supply in the U.S., which can only be absorbed by worldwide increase in demand.

We assume that capital forces will work to create this demand, but meanwhile we focus on the specific. There are trends in each industry that

allow certain companies pricing power. Whole Foods, for example, can charge a premium to Safeway because it is perceived to be healthier, and thus does not compete with bulk retailers like Wal-Mart. Pfizer can get more for its proprietary drugs because they are patent protected and the aging population requires them. Harley Davidson gets a premium for its motorcycles, etc.

Whether inflation comes back or not, specific companies with strong products or services will always have pricing power. They lose that power as competition surfaces or demand fades (see Krispy Kreme). It is our job to identify those companies with this power, as these are the companies that will do well, even in an inflationary setting. It should be noted that there is often a disconnect between a company's ability to raise prices, and its ability to improve its profitability. For example, in the case of food manufacturers – even though they have raised prices by 10% over the last year, their costs to acquire raw materials have probably risen at an even higher rate. The result is a squeeze on profit margins – which is bad news for investors. For this reason we look for companies that are able to increase prices at a faster pace than their underlying costs. After all, higher margins drive higher profits – and higher profits drive higher stock prices.

When the Fed Raises Interest Rates, Sell All Bonds

By Justin W. McNichols

So often, what becomes prevailing wisdom on Wall Street is based on scant or imprecise evidence. We are constantly amused to hear the many Wall Street clichés and sayings that are in fact false.

“Sell in May and go away” – false in many years.
 “Don't own stocks during the worst month, October” – false.
 “Don't own energy or healthcare stocks in an election year” – false.
 “The Fed won't raise rates in an election year” – false.

Investors simply accept the myth as fact, without performing the analysis to confirm the widespread belief.

On June 30th, we began the latest cliché. “Fed interest rate hikes are bad for bonds”. On the surface, this one looks elementary. When rates rise, bond prices fall. Simple, right? Not necessarily.

Over the last twenty-five years, the Federal Reserve has initiated interest rate increases six times. During each of these periods, US Treasury yields began to rise prior to the actual

announced increase. Even in early 1994, which most describe as a surprise rate hike, interest rates actually bottomed five months before the “surprise”. So what does history show us, and how does today's bond market compare?

History shows interest rates rise approximately 55% from trough to peak during rate hike cycles. The duration is usually around 13-16 months. For example, during the last rate hike in June 1999, interest rates moved from 4.40% to 6.60% (up 50%). Although the first Fed hike was on June 30th 1999, the move in rates started in September 1998 and lasted through January 2000 (16 months).

Today, although the Fed raised rates on June 30th, bond yields actually bottomed in May 2003. The move in rates, although off of historic lows, has been stunning in that interest rates increased from 3.10% to 4.80% (up over 50%) before the Fed had made any moves. And coincidentally, the duration has been about 13 months.

In conclusion, based on historical fact, we can deduce that the bulk of the interest rate increase is behind us. Unless the economy continues to strengthen well beyond current expectations, it would not surprise us if we were more than halfway through the present cycle of rising interest rates.

So, the next time you hear a Wall Street cliché, it may signal another period when the herd runs in the wrong direction.

*Sources: OPCM.

Out Performing At All Costs— Are You Getting What You Pay For?

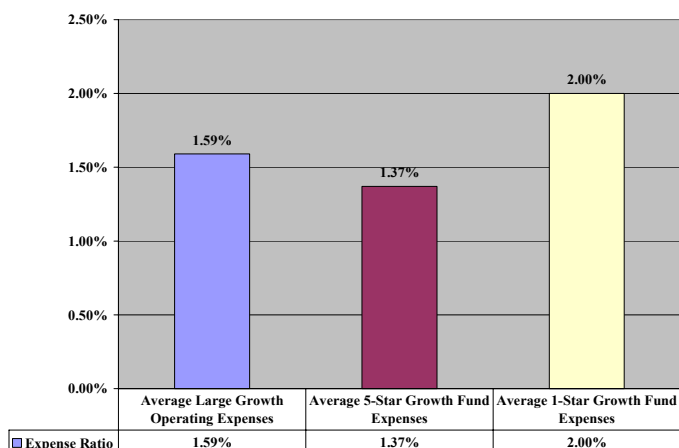
*By Kirk Michie
& Shannon S. Gallo, CFP®*

Elliott Spitzer, New York's now famous (infamous?) Attorney General has recently turned his attention from abuses of power in corporate America and on Wall Street to mutual fund fees, and more complete disclosure of the costs of research and portfolio management. To many in the industry, this initially appeared to have been politically motivated, and without much merit. After all, most Funds charge about the same percentages or amounts, right?

As it turns out, there's a lot more to this story, and it directly touches on the core issues of why investors should pay investment management fees at all.

The most common measurement of the cost of doing business with a mutual fund company is estimated by the “Operating Expense”, which is outlined in the Prospectus of all funds, and updated regularly by the fund companies, and several third party data sources. To examine the question above, we examined data from Morningstar (publisher of the ubiquitous “Star Ratings” system), chose the area of greatest familiarity to Osborne Partners (Large Cap Growth) and applied considerable academic rigor. Here’s what we found:

At present, there are 1512 funds classified by Morningstar as “Domestic Stock”, and within the “Large Growth” category, our screening netted 80 of those funds receiving the coveted 5-Star rating for superiority in both performance and risk control. In essence, at any given point in time, these are the funds ranked highest in their Peer Group. At the other end of the spectrum, our screens uncovered 100 funds that only earned 1-Star, or were ranked in the bottom of performance and risk control against their Peers. All other Large Growth Funds rated between 2-Stars & 4-Stars, with the majority receiving the average of 3-Stars.



So, the better funds had lower fees - coincidental? Actually, though Morningstar doesn’t specifically rank funds based upon fees, there is consideration given to the value delivered, and other means of screening for this data.

The Lesson: *Keeping expenses low is a necessary, but not sufficient condition for investment success.*

To make this murkier still, the Expense Ratio would typically include 12b-1 fees, management fees, administrative fees, operating costs, and other asset based costs associated with mutual funds. Here, however are some of the charges not included in these calculations:

Commissions & Brokerage Spreads - Paid to Brokers to

execute trades on behalf of the fund, these fees are not typically included the listed Expense Ratio, and can add substantially to the cost of owning the fund. An article that appeared in the Wall Street Journal on March 17th of this year entitled *Deciphering Funds’ Hidden Costs* estimates these charges for the 15 highest-cost funds adding as much as 2% or more to the total Expense Ratio. In the same story, a source at Lipper says that brokerage costs add about 0.41% to the average equity fund. When combined with an Expense Ratio of 1.59%, that means that investors are typically giving up 2% per year prior to earning any return from the average mutual fund.

Soft Dollars - Directly related to the above category, fund managers sometimes pay their brokers more than they have to in order to receive additional services from the broker, like research, data, or technology. These barter arrangements may ultimately benefit clients, though many industry watchers remain skeptical.

Shelf Space Payments & Re-allowances – These are payments made by fund families (the umbrella organizations that offer mutual funds) to brokers to sell or give preferential treatment to their products. These fees will typically come from up front sales charges, or deferred sales loads so that investors are aware of the fee they’re paying in most cases, though they are seldom informed of these arrangements in specific terms. Inasmuch as these charges are explicit, the industry defends them, yet they hardly speak to the objectivity of the advisors who recommend them.

The Lesson: *Maintaining an awareness of the expenses in your portfolio will likely take more vigilance than can be satisfied with fund sales literature. Digging deeper will help investors to be better informed, and to control costs.*

In any business endeavor, labor, skill, and performance are valued, and services will be priced accordingly. It provides incentive to the service provider and a means of distinction for customers and clients. To that, while we do not sponsor or offer mutual funds per se, we do believe that investment and wealth management are skills, and that practitioners like our firm and its best competitors earn their fees. As long as all fees, charges, and special arrangements are disclosed, investors have a level playing field, and can make their choices accordingly.

Mr. Spitzer may have political motivations, and may be less than subtle in his approach, but the omelet he’s making will require breaking a few eggs, and that’s probably not a bad thing.

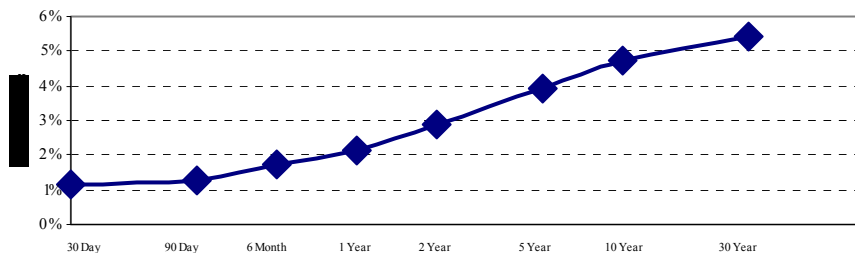
Fixed Income Round-Up

By Robert C. Gillooly, CFA
& Brett J. Prior, CFA

Treasury Yield Curve 6/29/04

June 28, 2004

	<u>Yield</u>
Average Money Market	0.95%
5 Year AAA Muni Bond	3.29%
5 Year AAA Corp Bond	4.53%
10 Year AAA Muni Bond	4.24%
10 Year AAA Corp Bond	5.51%
30 Year Fixed Rate Mortgage	5.86%



After a surprise rally in the first quarter of the year, the long end of the yield curve corrected as most strategists' anticipated. The 10 year Treasury Note now stands at 4.70%, having risen almost a full percentage point since our last update.

Employment concerns are on the backburner while the debate over future inflation has taken the forefront of investors' thoughts, albeit without much data of real concern. As our Memorandum goes to press today on June 30th, the Fed has announced they will raise short term interest rates by .25%, a widely anticipated decision and seemingly well accepted by the markets.

The 10 year Treasury Note, however, has already anticipated this move which is precisely why it has had such a dramatic change over the past 90 days. The good news is that money market rates have yet to make a significant move upward, and we anticipate that they will rise imminently. Should the current economic trends continue, it appears most of the bond market correction has transpired now leaving the prospect of improving money market rates.

Keeping Your Financial House In Order

By Shannon S. Gallo, CFP®

I recently was married in May and along with my wedding came a review of my financial house. If it has been years since your last review or you have had a change in family status, it is important to make sure your financial documents are updated.

1. Ask these basic questions — What assets do I own and who will inherit them? Whom would you want to handle your financial affairs if you are incapacitated? Who will make medical decisions on your behalf if you are not able? If you don't have an answer for all these questions or the answers have changed, you have some work to do.
2. Take Inventory — Prepare a list of your investments, bank accounts, other assets, income sources, mortgages, insurance policies, credit cards, etc. Determine how title is held on the respective accounts and for transfer on death accounts, who is/are the beneficiaries. In your inventory list, don't forget to include the names and phone numbers of your accountant, lawyer, doctors and insurance agents to be referenced in one area for ease and efficiency.
3. Wills and Trusts — At the very least, everyone should have a will. This is the one document that tells everyone where your assets should go when you are deceased and is the best place to name a guardian for your children. If you have a Trust, you still need a Will to take care of all of your assets that may fall outside of the Trust. The advantage of having a Trust in conjunction with a Will is it allows conditions to be placed on how and when assets are distributed, minimizes delay in the distribution, avoids the publicity of probate and the administrative costs.
4. Power of Attorney – During life, if you become disabled or seriously ill, naming another individual as your agent will allow them to handle your financial affairs and make decisions on your behalf. Naming a Power of Attorney also gives you control of when the named individual is able to act on your behalf, immediately or upon the occurrence of disability or injury.
5. Living Will — A directive to your physician describing your wishes in regards to your medical treatment if you should become terminally ill or permanently unconscious.

Edward Young noted, "All men think all men mortal, but themselves." Take the time to get your financial documents in order or update the ones you already have before the end of the year.