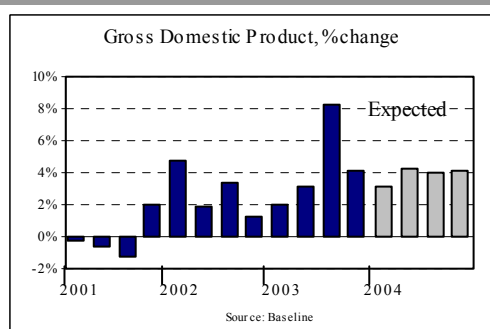
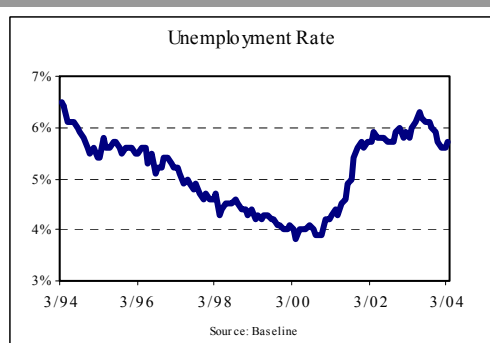


First Quarter 2004 Highlights

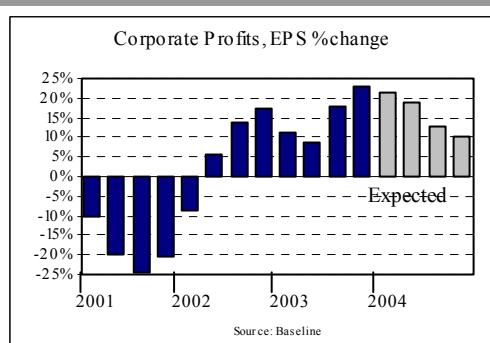
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Issue 18



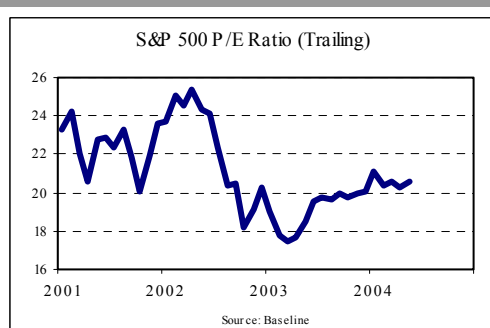
Economy Is Still Expanding



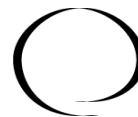
Unemployment Proves To Be A Lingering Problem



Profit Growth Is Still Strong



Valuations Still Reasonable



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Jobs and Outsourcing

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

The recovery that has been ongoing in the U.S. since November 2001 has often been labeled as a “jobless” recovery. As investors, this is a major concern as the correlation of jobs and the stock market is extremely high. Over 2.7mm jobs were lost during the downturn, and after 28 months of economic improvement – less than one million jobs have been created. In the effort to explain this less-than-stellar job market, many experts have cited continued “outsourcing” as a prime suspect. While this trend is relevant, the magnitude of its impact is often overlooked or overstated. To gain a better perspective on this issue, it is helpful to review the underlying statistics.

First, how many and what types of jobs were lost in the latest downturn?

At the economic peak (March 2001), there were 132.5mm people on US nonfarm payrolls. At the bottom (August 2003), there were 129.8mm people on

payroll – or a net loss of 2.7mm jobs. Manufacturing was the hardest hit, showing a loss of 3.6mm jobs over the same period. But, construction payrolls remained basically unchanged, and jobs in the services sector actually grew by 800,000.

In the last seven months since the employment situation bottomed, we have added roughly 900,000 jobs in the services sector, while another 200,000 goods-producing jobs were lost. The message here is clear – manufacturing jobs are going away (either to automation or to low-cost nations), but services jobs are holding strong. Nonetheless, the net addition of 700,000 jobs seems insufficient when compared to the loss of 2.7mm. So, why haven't more jobs been created in the two years since the recession ended?

There are several factors at work here. First, this recovery has operated in “fits and starts”. This inconsistent nature of the recovery has hurt hiring managers' confidence – and lead them to postpone hiring decisions. Second, many companies are still working through the rampant overspending of the bubble years. Third, more workers are self-employed – which means that they are not counted in surveys based on payroll data. Finally, outsourcing has had an impact. Of the total 2.7mm jobs lost, it is estimated that between 250,000 to 500,000 of these job losses were due to offshoring.

Outsourcing is a significant trend,

and many industries will be effected. Manufacturing has been hard hit, and this trend is likely to continue. Jobs that are not location-dependent (ie call centers, computer services, and transcription services) are also prime candidates for offshoring. But outsourcing also offers several benefits to the US. First, consumers benefit as the goods and services we purchase cost less, which effectively increases disposable income. Second, US companies are able to reduce costs, and increase profits – which is good news for shareholders. Finally, many foreign companies and consumers outsource services work to US companies. For example in 2003, foreign companies and consumers purchased \$59 billion more in services from the US, than the US purchased from abroad. This data highlights the fact that outsourcing is truly a two-way street – hurting the US in areas where we are not cost-competitive, but benefiting the US in other areas where we maintain a competitive edge.

It is our belief that outsourcing is a positive and inevitable outcome of free markets. Companies will always attempt to reduce costs by moving jobs to areas that are the most cost efficient. Outsourcing is not new – and history shows that countries that are able to innovate will always find new areas in which they have a comparative advantage. The job market will recover with the economy. It is affected by many factors such as business confidence, post-bubble fears, and contract consulting. Outsourcing is also a factor, but not as significant as widely perceived.

Why Well Informed Does Not Equal Success - Behavioral Finance and Investment Pitfalls

By Kirk Michie

With the advent of greater technology, more financial news, lower trading costs, and plentiful choices, investors should be better equipped and more successful than ever before in handling their own portfolios.

The question is, *why aren't they?*

After all, every major brokerage firm provides online research and cutting edge tools to build and manage your own investments. Indeed, between the talking heads of CNBC, the pundits in Money magazine, and the bountiful resources available over the internet, self directed investing should have eclipsed professional management long ago. Yet the investing

public continues to look for the proverbial “Atkins Diet” of portfolio management success, but it’s the returns that keep getting *too thin*, and virtually no one feels they’re getting *too rich* – a painful spin on an old story. Let’s examine the primary causes, as they are well documented, though seldom followed.

The Five Greatest Investor Mistakes

1. Trading Too Often; In recent research completed by Terrence Odean (U.C. Berkeley/Hass School of Business), a disciple of Daniel Kahneman, winner of last year’s Nobel Prize in economics, found that the most active traders underperformed their passive counterparts by as much as 7% per year. Over the course of a decade, that differential would amount to \$967,000 for every \$1 Million invested by the patient market participant. Though one of the primary issues is the cost of trading, the incidental elements of chasing performance (see next point), and overconfidence are significant contributors. Indeed, a survey of approximately 10,000 brokerage accounts (performed in 1999) found that investments “sold” by active traders went on to out perform stocks “purchased” by 3.6% per year!

(The Fix – As the old saying goes, “...measure twice, cut once...” – meaning do your research thoroughly, and keep turnover low.)

2. Chasing Performance; Human beings are inherently optimistic, and somewhat competitive, and those two characteristics lead many investors astray in choosing their investments and their investment advisors. As we highlighted in our last quarterly piece, returns of individual investors are dramatically lower than that of both active/professional managers, and the underlying indices as well. Even with that knowledge, market participants continue to assume that switching more often, and pursuing last years winners will be a successful strategy, particularly common when choosing mutual funds.

(The Fix – Stick w/ long term track records, trust your due diligence, and keep your eye on the horizon.)

3. Overconfidence; The best investors historically remain somewhat humbled by both the complexity, and capriciousness of the financial markets. Oddly though, many of the worst investors suffer from transitory insights or predictions that they’ve “figured out the market”. Frankly, if Warren Buffet retains his humility after having become the second wealthiest American (all through investing), then the average investor would do well to follow his example. Likewise that of famed portfolio manager Peter Lynch, retired Manager of the Fidelity Magellan Fund, believed in investing in things

you understand, and to have a discipline about valuation, time horizon, and making allowance for mistakes. I'm reminded of two sage pieces of wisdom, both from Warren Buffet, which I'll paraphrase here:

- You never know who's naked until the tide goes out.
- If you've been in the game for 20 minutes, and you're still trying to figure out who the patsy is, then you're the patsy.

In short, beware of certainty – the market will humble you, and your net worth will suffer for your experience.

(**The Fix** – Markets cycle, and trends change, but over the long term things tend to even out – beware of making too much of transitory information, and stick to what's worked in the past.)

4. Loss Aversion; Over the past several years, the importance of Behavioral Finance has gained acceptance in the realm of professional investors. It has culminated with the Nobel Prize award in economics granted to Daniel Kahneman (Princeton), and Amos Tversky (posthumously) last year, for their pioneering work on this subject in the late 70s and forward. Professors Kahneman and Tversky found that loss aversion was disproportionate to the opportunity for gain in the average investor by as much as a 3-to-1 ratio. What that means, in simplest terms is that for an investor to view a commitment of their capital to be attractive, he/she would typically have to perceive there to be a \$3000 reward for every \$1000 invested – on the other hand, if the chance of loss were equal to the opportunity for gain, or even double the initial investment, most people would pass. When considering the stock market's historically upward bias, especially for long term investors, this aversion leads to disproportionate emphasis on near term safety, even at the cost of longer term security. Oddly, combined with the overconfidence discussed previously, these two very normal characteristics leave the average investor somewhat frozen between extremes.

(**The Fix** – Take the long term view, assess the returns and risks that history provides, and build the asset allocation that meets your objectives over the long run, at an acceptable level of risk in the short run.)

5. Lack of Discipline; Virtually all investors have some awareness of the concept of asset allocation, or at least the phrase itself, but few have the appropriate commitment to the concept to ensure consistent success and acceptable risk control in their portfolios. Indeed, some might argue that the most important role that professional investment advisors play is to develop, rebalance, and maintain an appropriate mix of stocks, bonds, and cash for their clients. Studies have attributed as much as 90%+ of investment return to asset allocation choices. The average investor, however still spends more

time attempting to develop the right method of 'beating the market' (see #2 above), switching investments too often (see #1 above), and then abandoning hope at the worst possible time (see #4 above) resulting in disenchantment and lost return or capital.

(**The Fix** – Develop a plan based upon sound fundamentals that have worked over the long term, and while closely monitoring your plan, err on the side of maintaining your course.)

Meet Christie Holmes OPCM's Newest Addition



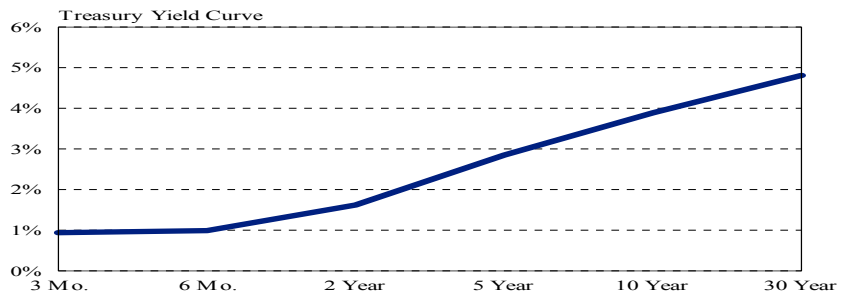
Christie Holmes joins Osborne Partners as a Portfolio Administrator and will assist the firm in the areas of Client Service and Client Development. Before coming to Osborne Partners, Christie worked as a Sales Assistant at Oppenheimer & Co.

After graduating from UC San Diego in 1999, Christie came back to her roots in the Bay Area, and has been living in San Francisco for 3 years. Christie has been in the financial industry working in the private client arena for 4 years, beginning her tenure at Hambrecht & Quist in early 2000. Outside of the office, Christie enjoys long walks, yoga, music, and spending time with friends and family. Please join us in welcoming her to the firm.

Fixed Income Round-Up

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

| <u>Yield</u> | <u>03/31/04</u> |
|-----------------------------|-----------------|
| Average Money Market | 0.80% |
| 5 Year AAA Muni Bond | 2.50% |
| 5 Year AAA Corp Bond | 3.35% |
| 10 Year AAA Muni Bond | 3.64% |
| 10 Year AAA Corp Bond | 4.68% |
| 30 Year Fixed Rate Mortgage | 5.20% |



The bond market surprised investors and rallied in the first quarter of 2004 lowering the UST 10 year note by 36 BPS to yield 3.68%. The focus of the bond market has revolved around weekly employment numbers, which have remained lackluster at best. As long as employment remains weak, bond investors are suggesting inflation will remain below long-term trend and thus they are driving yields lower.

OPCM research suggests a positive correlation between growth of employment and rising bond yields, which leads us to believe that even under the current tepid increases in employment, bond yields cannot continue to decline for an extended period of time. In the current market environment, we believe maturities ranging in the two to three year range are the most attractive in the yield curve.

Last Minute Tax Check-Up

By Shannon S. Gallo, CFP®

Planning ahead is the key to simplifying your taxes and maximizing your retirement savings. As you prepare your taxes, review how much of your income you deferred into your 401(k) and if you are not contributing the \$13,000 maximum per year, consider increasing your contribution by 1-3% per year to keep pace with annual salary increases. Also consider making a Traditional IRA contribution or a Roth IRA contribution. Here are a few things to keep in mind when making contributions to an IRA or Roth IRA:

- If you participate in an Employer Sponsored Qualified Retirement Plan, such as a 401(k), your AGI must be below \$65,000 to make a deductible contribution. Deductibility is phased out between \$65,000-\$75,000.
- If you are married and your spouse does not work, or they did not participate in a qualified plan while employed, they can make a deductible contribution of \$3,000 given your Joint AGI is below \$150,000. Deductibility is phased out between \$150,000-160,000.
- If you are NOT eligible to make deductible contribution, due to your participation in your 401(k) plan, and if your AGI falls below the \$150,000 range, make a \$3,000 Roth IRA contribution.
- Keep in mind, you can always make a non-deductible contribution to a contributory IRA but do not mix deductible and non-deductible contributions in the same account.

Reminder: April 15th is the deadline for making contributions to an IRA for tax year 2003, even if you file an extension. Remember to designate which tax year the contribution applies, 2003 or 2004, and at the same time take a few minutes to update and review your IRA beneficiaries.

2004 Annual Limits

| | |
|--------------------------------------|-------------------------------------|
| IRA or Roth IRA Contributions | \$3,000 |
| IRA or Roth Catch-up Contributions * | \$500 |
| 401(k) Plans | \$13,000 |
| 401(k) Catch-up Contribution * | \$3,000 |
| SEP | Lesser of \$40,000 or 25% of income |

*Individuals over age 50 can make additional catch-up contributions.