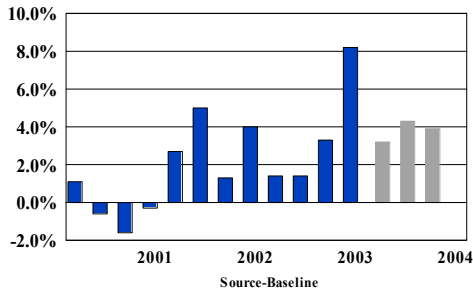


Fourth Quarter 2003 Highlights

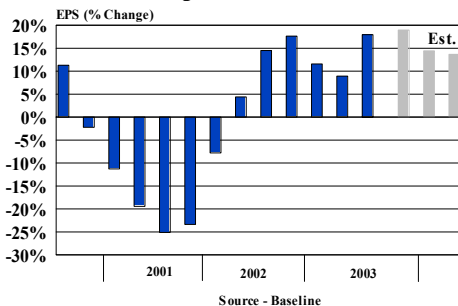
January 2004
Issue 17

Gross Domestic Product



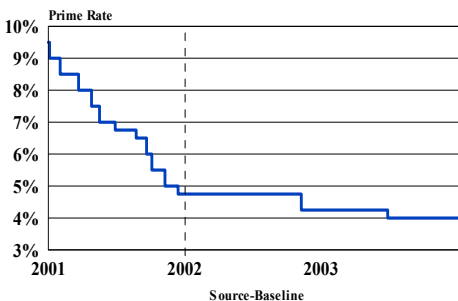
GDP Unexpectedly Spiked in Q'3

Corporate Profits



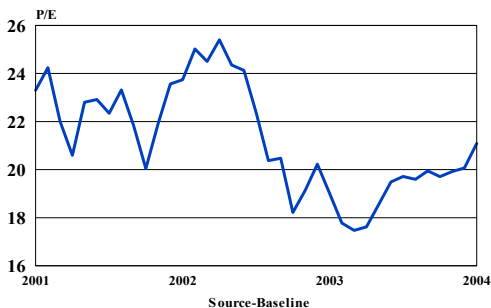
Resulting In Robust Corporate Profits

Interest Rates

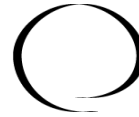


Low Interest Rates Helped Propel The Economy

S&P 500 P/E Ratio



Valuation Remains At Reasonable Levels



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The Dollar and The Market

By Charles D. Osborne

The economy by almost every measure is improving. Profits are improving, employment is rising, and both capital and consumer spending are moving up. The stock market has recovered and our deficits, trade and budget, seem manageable for now. Interest rates are expected to remain low, and there is little movement in prices, inflationary or deflationary. With all these positive trends, why is the dollar dropping, and what does that mean to investors?

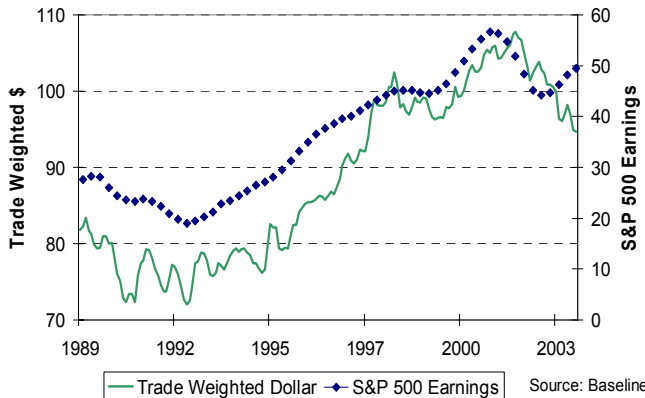
Currencies reflect economic fundamentals such as GDP growth, interest rates, employment, and trade and budget balances. If these factors are negative, currencies weaken until this process bolsters the economy through improved exports or until a crisis occurs, which happened in Russia in 1998. A lower currency helps exports improve due to cheaper overseas prices, and multi-national corporations' repatriated profits are higher when put in local currency terms. However, if the drop in the currency becomes disorderly, then interest

rates need to be raised in order to stabilize it. Consequently, higher interest rates offset any positive gains reaped from stronger exports.

Currently in the case of the dollar, there are other factors at play. The United States continues to maintain its' position as the dominant economy in the world. Gold and oil, for example, are priced in dollars, and several countries including China, fix their currency to the dollar. Furthermore, foreigners have \$1.5 Trillion more invested in the U. S. than we do abroad, serving as evidence of the fact that we are a safe haven in uncertain times. The combination of our leading economic position and the importance of our capital markets bode well for long-term stability of our currency vis a vis the rest of the world.

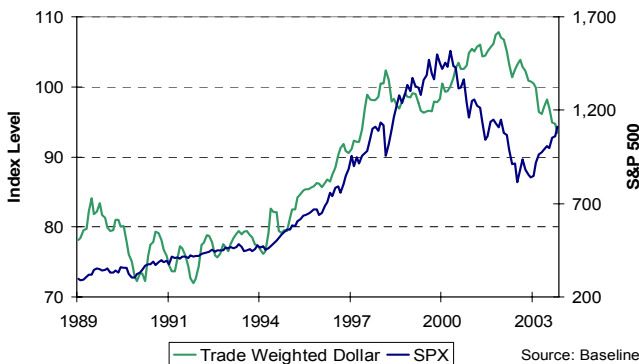
In the past, the coincident correlation of the stock market and the value of our currency has been over 90%. This means that it is very difficult to have positive stock market returns without a strong U.S. dollar. Given the weakening dollar and the improving stock market over the past nine months, this relationship appears to have not held true. But the good news is, the dollar has even a higher correlation with earnings, 94%, and in this case, earnings lead the value of the dollar. This relationship leads us to believe that in our currently improving earnings environment, the dollar will soon follow.

Trade Weighted \$ and S&P 500 Earnings
Correlation = 0.97 with an 8 month lag



“The market generally moves with the dollar”

Trade Weighted \$ and S&P 500
Correlation = 0.90



“Corporate earnings lead the dollar higher”

Perhaps the only really negative scenario, besides the rising cost of Champagne, would be if foreign investors lost confidence in our economy. In this scenario, foreign investors withdraw funds from the U.S. markets, causing interest rates to climb. We believe this is unlikely, as among other things mentioned, the U.S. continues to provide the only real growth in the world. Over the 1995 to 2002 period, the United States accounted for 96% of the cumulative increase in world GDP, basically three times its 32% share in the global economy. For investors worldwide, the U. S. is still the engine of economic growth.

It is a dance with many partners following the cause and effects of currency changes. If the U.S. were not the dominant economic power in the 21st century, this recent drop in our currency, after a seven year rise, would be a problem. But the solid fundamental growth of our extremely well managed economy should provide happy returns for investors for years to come.

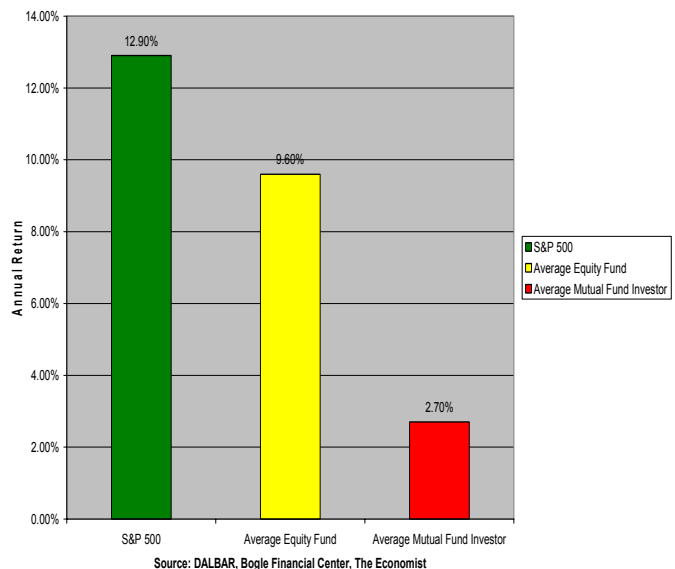
Chasing Performance; Prudence vs. Speculation

By Kirk Michie

As investors review their returns from 2003, and contemplate short term modifications to longer term planning objectives, a cautionary note is worth sounding – don’t chase performance, and be mindful of your goals. The S&P 500 Index posted its highest return in six years, and many investors will utilize that hurdle to judge the performance of their own portfolios.

Oftentimes, investors get caught up in the “greed” elements of bull market advances, and switch investment strategies to generate greater returns. Conversely, these same investors fall prey to the “fear” elements of bear market sell offs, and reduce their commitments to equities to avoid further losses. While neither reaction is abnormal, history shows both to be imprudent. Let’s observe a bit of data to make this point. Over the period 1984-2002, the U.S. Equity Market advanced by 12.9% per year on average, yet the average mutual fund produced only 9.6%. The difference between the “Market” and the average fund is pretty significant, and would rationally cause investors to examine their choice of fund manager – that’s prudent. The cost of switching, however, often comes at the price of either making poor choices, or having poor timing, which resulted in the average investor earning only 2.7% per year during this period. That figure is so low, that when Bogle Financial Center first published these findings, we found it almost unbelievable.

A Tale of Missed Opportunity (1984-2002)



Inasmuch as the *S&P 500* is a good proxy for the market, and the *Average Equity Fund* is a similarly effective stand-in for professional money managers, the *Average Mutual Fund Investor* may represent many individual market participants.

For an investor who began with \$1 Million in 1984, the resulting cost from not having fully participated during this 15 year period was nearly \$4.7 Million! Rather than compounding their initial \$1 Million to nearly \$6.2 Million by remaining fully invested in the *S&P 500*, the *Average Mutual Fund Investor* netted less than \$1.5 Million. While many professional and individual investors outperformed both of these measurements, rest assured they are not in the majority, and this lesson should be taken to heart.

So, as you assess your returns from 2003, and evaluate them against your own benchmarks or objectives, we would suggest you keep a few things firmly in mind:

- Asset Allocation (the mix of stocks & bonds) is more critical than manager selection, or relative performance. Make changes to your allocation only as your objectives or lifestyle change, and not in relation to market performance.
- Be at least twice as cautious of increasing equity exposure as you would be in reducing it – losses are tougher to take than missed opportunities.
- Benchmark your performance to reasonable expected returns that are consistent with your allocation. Communicate these objectives to your Advisor(s), and assess relative performance related to these personal goals, and not the more amorphous target of “beating the market”.
- Keep your eye on the horizon – if your goal is to double your money to meet your retirement objectives, or derive a specific level of income from your portfolio, then measure your performance according to that standard.
- Lastly, when you make changes to your allocation, your portfolio, or your team of advisors, be wary of short term performance and trends – time tested approaches to investing may be less exciting, but investors should seek thrills elsewhere.

In more than 65 years of providing investment advice and counsel, *Osborne Partners Capital Management* has worked with hundreds of clients, through many generations. Success in our practice is a function of meeting objectives, whether it's early retirement, charitable goals, increased income, or more long term growth – in each case, they are developed and measured according to each clients circumstances. Please let us know if we can be of any assistance in helping you analyze your current situation, or tailor an approach that specifically targets your **Personal Benchmark**.

Your Most Important Investment

By *Shannon S. Gallo, CFP®*

Over the last year I have watched our clients' families grow and with the new additions, many of our clients have started asking: “What would be the best type of account to open up for my child?” My response: “What would you eventually like the account to do?” Whatever the goal may be, understanding the options available will allow you to answer a few important questions before setting up an account:

- Who do you want to have ownership or control of the account (you or the child)?
- What are the tax consequences transferring assets?
- What assets can be contributed to the account and how can it be invested?
- What are the pros and cons of each type of account?

Custodial Accounts – Custodial accounts are the most common type of accounts established for children: “UGMA” The Uniform Gift to Minors Act and “UTMA” The Uniform Transfers to Minors Act (UTMA). Both types of accounts are very similar but there are a few differences to be aware of.

Both types of accounts are controlled by the Custodian (a parent in most cases), until the child reaches the age of majority. Although the Custodian controls the account, the child is the designated owner of the account. What separates the UGMA from the UTMA is the age at which the child gains control of the account. With a UGMA, the child reaches the age of majority between 18-21, depending on the state (age 21 in CA), while a UTMA allows for longer control of the account, in many states until age 25. We all hope that by age 21 and certainly age 25 the child will be a responsible adult, but we can all think back on our early twenties and in doing so, this may be a cause for concern. As such, the age at which a child receives control of the account is considered one of the disadvantages of UGMA's and UTMA's.

Another disadvantage is the Kiddie Tax. Until a child reaches the age of 14, any unearned income above \$1,500 is taxed at the parent's highest tax rate. In addition, UTMA's and UGMA's count much more heavily than parental assets in determining how much financial aid the child qualifies for college.

UTMA's and UGMA's can be funded with cash, stocks, life insurance, annuities, etc. The account can be invested in a broad range of assets. At the time the child has access to the funds, they can be used for any purpose and are not limited to just education. With the new tax laws reducing

the capital gains rates, if a child is over age 14, low cost stock could be used to fund an account and if the assets were then sold, any capital gains would be taxed at the lower 10% capital gains rate.

Trusts – If an UGMA or UTMA doesn't sound like the way to go, a trust may be the answer. Before we begin, we will go over the basics of a trust. The basic principal involved is an individual (the Grantor) transfers assets to another party (the Trustee) to manage and invest on behalf of the child (the Beneficiary). This concept is extremely important in that many individuals do not realize they should not act as Trustee of their child's account, if they are the one transferring assets to the child. According to the IRS, if the Grantor transfers the assets and also acts as the Trustee, this is not a completed gift and the Grantor is deemed to have "incidence of ownership". If the Grantor dies during the time they are acting as Trustee, the value of those assets will be included in the estate of the Grantor. Since one of the main reasons, other than love, parents transfer assets to their children is to reduce the taxable value of their Estate, acting as Trustee is counter productive. Which leads to two important points, in making any gift, the Grantor should be ready to give up control of the assets and have someone or some organization as Trustee who will act in the best interest of the Trust.

Creating a Trust for a child can be designed in any number of ways. For example, a Trust can be designed so the child receives the money in a lump sum at a specified age, the Trust may pay principal in installments throughout the beneficiary's life or income can be distributed until a specified age. How and when the assets are distributed to the beneficiary is at the discretion of the Grantor when the Trust is created.

Down the road after the child is an adult, Trusts can also protect a child's inheritance. Leaving part or all of a child's inheritance in a Lifetime Trust identifies the inheritance as a child's separate property and prevents it from being divided in a divorce. Furthermore, under the law of most states, Trusts are protected from creditors.

What are the disadvantages? Trusts are initially more expensive to set up, costly to maintain, and very difficult to change but the advantages far outweigh the costs. And like custodial accounts, trusts also jeopardize qualifying for financial aid.

Education Accounts – If leaving a chunk of money to your child is not your main goal but funding their education is, a 529 College Savings Plan may be your best option. 529 plans are designed specifically to help you provide for the ever-rising costs of college.

529 Plans are unique in that the parent is considered the owner of the account with the child designated as the beneficiary. 529 Plans have very generous and flexible funding

options. Monthly contributions can be made to a 529 Plan or funding can be done with a large initial contribution. If a parent decides to make a gift to a 529 Plan for the benefit of their child, the contribution is treated as a gift to the named beneficiary for gift tax and generation-skipping transfer tax purposes. With an individual qualifying for the \$11,000 annual gift tax exclusion, most individuals can make fairly large contributions without incurring any gift tax. If you make a contribution between \$11,000 and \$55,000 for a beneficiary, you can elect to treat the contribution as being made over a five calendar-year period. This allows you to utilize as much as \$55,000 in annual exclusions to shelter a larger contribution. The money (and the growth of the account) is removed from your Estate faster than if you made contributions each year. The best news is that the assets leave your estate but do not leave your control. This is a truly remarkable benefit when you compare it to the "normal" gift and estate tax laws. If you cannot stand the thought of irrevocably giving away your assets, now you can have your cake and eat it too. There is one catch; the account can only be funded with cash, which eliminates gifting low cost stocks. Of course, if you later revoke the account, its value comes back into your estate.

Each state has their own 529 plan in which any individual can establish an account. Contribution limits, investment options and the company administering the plan may make a difference in which 529 Plan you choose. Generally, accounts are invested in a fund based on the child's age which will determine how conservative or aggressive the fund. As the child gets closer to college, the funds can be moved from an aggressive fund to more conservative fund.

In the end, what happens if the beneficiary decides not to attend college, or money is left over or the beneficiary gets a scholarship? If the beneficiary decides not to go to college and you withdraw the funds, Federal law imposes a 10% penalty on earnings for non-qualified distributions. This means that you will get back 100% of your principal and 90% of your earnings. The penalty is not assessed if you terminate the account because the beneficiary has died or is disabled, or if you withdraw funds not needed for college because the beneficiary has received a scholarship. You can change the beneficiary to another qualifying family member at any time in order to keep the account going and avoid (or at least delay) taking non-qualified withdrawals when the original beneficiary doesn't need those funds.

As you can see answering the question "What type of account should I open for my child?" can be complicated. Whether the goal is to pay for college, teach a child the value of money and investing, or allow them to do soul searching in Europe age at 21, there is no right answer, but after thoughtful consideration of the options, making an educated decision should be easier.