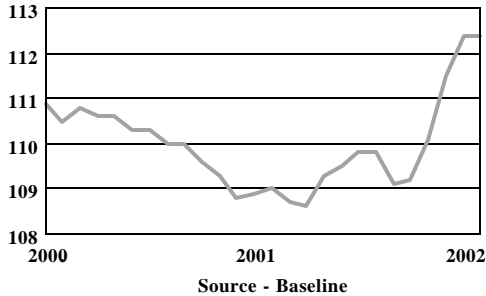


## First Quarter 2002 Highlights

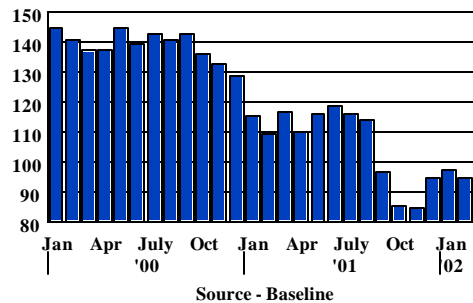
April 2002  
Issue 11

### Index of Leading Indicators



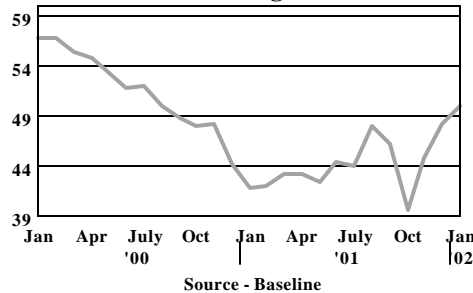
Leading Indicators Are Rising

### Consumer Confidence



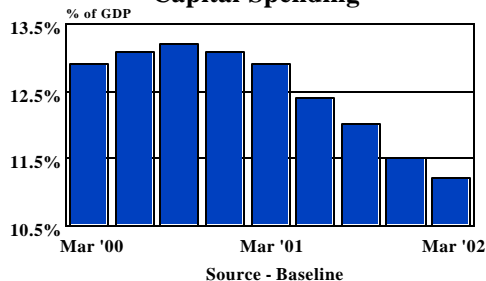
As confidence Returns

### Manufacturing Index



And Manufacturing Is Recovering

### Capital Spending



With Only Capital Spending In the Doldrums



# OSBORNE PARTNERS

## Capital Management

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## America Goes Shopping

By Charles D. Osborne

So what happened to the recession? The National Bureau of Economic Research declared we were in one, and they are the official arbiters of such things. Yet we did not see unemployment rise above 6%, nor did consumer spending slow considerably. In fact, there was only one quarter of negative GDP growth, and a recession usually has two. It appears we powered through this downturn by opening our pocket-books and letting it flow.

The biggest surprise in the

last quarter came from the consumer. Despite rising unemployment and continued uncertain times, people went shopping. As the consumer fueled over 60% of the economic growth, the ripple effect of their spending spread to other sectors and lifted the whole economy. Interest rates remained attractive and this fueled home re-financing. This phenomenon has a dramatic impact on present and future spending due to the lasting affect of improved cash flow from lower interest rates.

Good weather was also a surprise and helped the economy quite a bit. The first quarter always has weather related implications and this was the mildest winter in one hundred years in many parts of

America. Construction hummed and people went out to dine, vacation or just go to the mall in temperate weather. The warm weather alone could well have propelled us out of a funk, but it would not have worked if we did not have the wealth in reserve.

We know that Americans have money. It sounds garish, but it is true. The wealth created in this country is staggering. Our economy is running at over \$10 trillion a year, single family home values have risen \$1.4 trillion to \$11.4 trillion in the last two years and the stock market is now valued at \$13 trillion. Not only do we have the money, but also we are willing to spend it in uncertain times. Unlike Americans, Europeans and the Japanese are the opposite. They tend to save money in the same situation. It may seem foolish, but the consumer's willingness to spend money is a sign of the optimism we have in our country.

Our economy works so well because we have faith in it, and our in political system as well. Extremely damaging acts like September 11<sup>th</sup> and the Enron fraud are aberrations and people realize this. As our economy improves, so will corporate earnings and the stock market will reflect this. After three years of flat to negative returns we are anxiously awaiting that time.

## Built To Order

*By Robert C. Gillooly*

From time to time when we execute a transaction in a client's account they will ask us, "Are you trading that security for your other clients?". The answer is-maybe. What separates Osborne Partners from other investment management firms is our customized portfolio approach. Every one of our clients has a portfolio crafted specially to their individual needs and circumstances, so it is accurate to say that no two portfolios we manage are exactly alike.

Whether we are managing a portfolio for income, growth, aggressive growth, or a combination thereof, our primary mission is to put together a group of securities that matches each investor's risk profile. Many investment management firms claim they are providing investors with custom management, however, most of these firms trade from generic models which buy and sell shares en mass without taking a client's specific needs into consideration. Our firm takes a wholly different approach. We begin with a weekly research meeting, as a team, to discuss specific stock buy and sell recommendations. Once those recommendations are agreed upon, the decision is then turned to the portfolio manager to deem whether each stock is or is not appropriate for every client.

There are numerous factors we analyze and agonize over every decision. For instance:

- If we're selling a stock, will it generate an unacceptable amount of capital gains?
- Is this particular stock too conservative or aggressive for a client's risk tolerance?
- Does a client already own similar issues or perhaps has too much in this area?
- Would this stock be more appropriate for a taxable or tax-free account given its' growth prospects?
- Is the client an employee of the company or a competitor, thus creating an overweight position in the industry?

Every portfolio, however, revolves around a consistent investment philosophy. We buy only high quality growth stocks that have exhibited consistent results over the years; we believe in low portfolio turnover, which cuts down on mistakes and is paramount to a tax efficient portfolio; and we conduct research meetings and manage portfolios as a team leveraging our internal expertise. Thus, when it comes down to managing your portfolio, every decision revolves around you and only you. As our relationship grows, we feel this will help us make better decisions on your behalf over time.

## Residence Trusts

*By Shannon S. Gallo*

In California, residential property values have increased substantially over the years making a family home a large portion of an individual's estate. This can create some obstacles in advanced estate planning as the question arises, "How can you transfer your personal residence to your children or family members without using up your current lifetime exemption amount of \$1,000,000?"

In recent years a special Irrevocable Trust, known as a Qualified Personal Residential Trust (or "QPRT"), has enabled many individuals to pass along their home to their children and family members at a significantly reduced value for tax purposes. A QPRT can hold either an individual's principal residence or his/her second home. In setting up the trust, the principal residence or second home is transferred to the QPRT and the individual continues to use the residence for a fixed number of years as defined in the trust document. During that time the individual continues to pay the mortgage expenses, real estate taxes, insurance, maintenance and repairs while still deducting the mortgage interest and real estate taxes on their individual tax return. When the fixed time period ends, the home is generally distributed to the estate owner's children or family either outright or in trust.

The benefits of a QPRT are substantial as an individual has **the ability to make a large gift at a modest gift/estate tax cost, while still being able to have use of the property rent-free for the fixed time period defined.** The actual value of the discount at the time the QPRT is established is based on age, the IRS interest rate in effect at the time and the term of the trust. After the term of the trust expires, the individual can continue to occupy the residence by paying fair market value rent to the beneficiary, thus continuing to reduce the value of their estate. In addition, if the individual survives the term of the trust, he/she will not be taxed on the appreciation of the home. For example, assume an individual transfers their primary residence to a fifteen year QPRT presently worth \$500,000 and the home appreciates to \$750,000 fifteen years later, the house would then be valued at the discounted rate and no tax would be due on the \$250,000 appreciation in value. On the other hand, if the estate owner were to die with the \$750,000 home in their estate, their home alone would use up a substantial portion of their \$1,000,000 exemption.

Although there are many benefits and substantial tax savings, QPRT's are not designed for everyone. If an individual has a short life expectancy or is terminally ill, this type of trust is not appropriate. A balance between choosing a term long enough to reduce the value of the gift must be considered but not too long to risk that the individual will not survive the term. If the estate owner does not outlive the term of the trust, the residence will be included in their estate. In addition, since at the end of the fixed term the

residence legally passes either outright or in trust to the beneficiaries, the individual should consider a provision in the trust document to have the option to lease the home. If the house is likely to be sold after the death of the parent, it may be preferable to have the asset go through the estate to receive a step up in basis rather than realizing a large capital gain due to the carry over basis applicable to the gift.

A QPRT can be an extremely effective planning strategy to remove a residence's value from an individual's estate at a greatly reduced gift tax cost. Because a QPRT can be established for either a primary or a secondary residence, it may be a particularly attractive option for individuals who's primary residence or vacation home is appreciating in value and will not be sold prior to death.

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