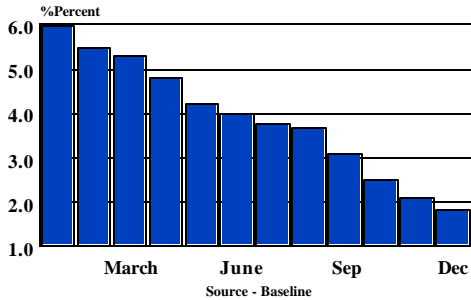


Fourth Quarter 2001 Highlights

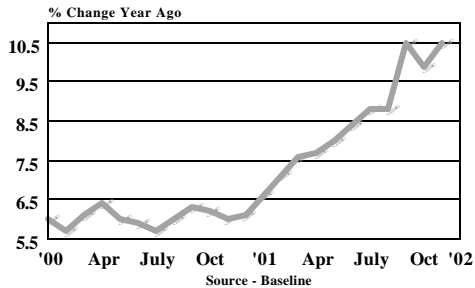
**January 2002
Issue 10**

2001 Federal Funds Rate



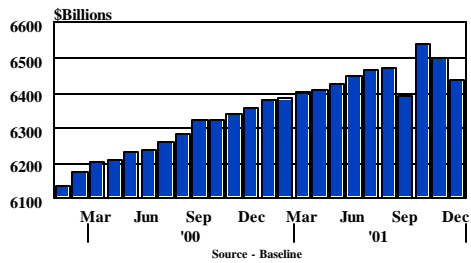
Lower Interest Rates

M2 Money Supply



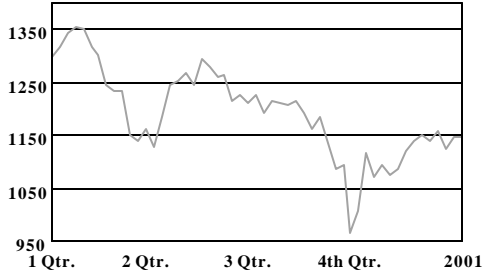
An Increased Money Supply

Consumer Spending



And Moderate Spending

S&P 500 Index



Have Encouraged Investors



OSBORNE PARTNERS
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San Francisco, CA 94104
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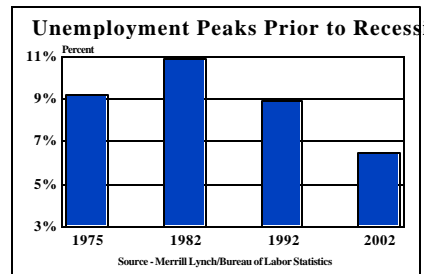
**The Shape of A
Recession**

By Charles D. Osborne

It is official, we are in a recession. The National Bureau of Economic Research, the official organization in charge of figuring these things out, has declared that we are in a period of significant decline in economic activity, i.e. a recession. The common (but unofficial) belief that a recession is two negative quarters of GDP growth will also turn out to be true.

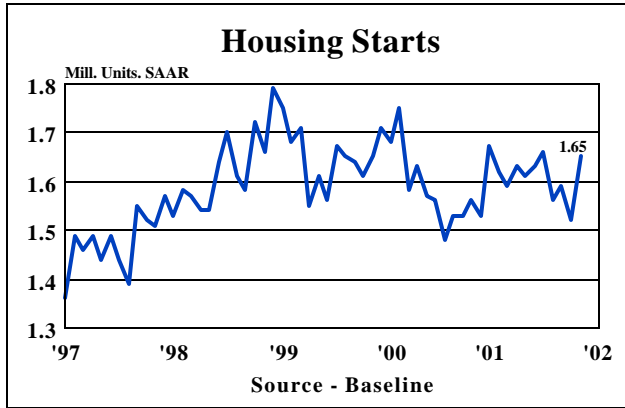
It is a different kind of recession than we have had before, although there are some similarities in all recessions. We always have unemployment going up, inventories

going down and a surprise bankruptcy. Nevertheless, in this recession, unlike others, we will have a stronger housing market, decent consumer spending and a relatively modest unemployment rate. In addition, the usual harbingers of recession, higher inflation and higher interest rates, did not occur. Finally, energy prices have fallen much more sharply than in prior downturns.



It is important to understand the shape of this economic malaise, because it will affect the shape of the recovery. By this we mean not only the macro events that triggered the recession, but also the varying affects on specific

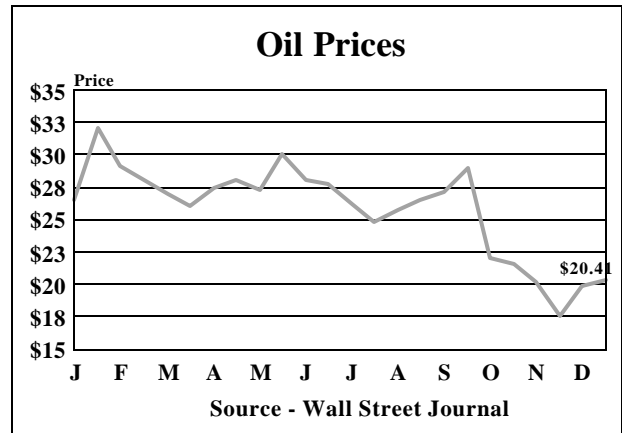
sectors. As stock prices and earnings are highly correlated, investors should know the strength of the general recovery and how each sector has been affected.



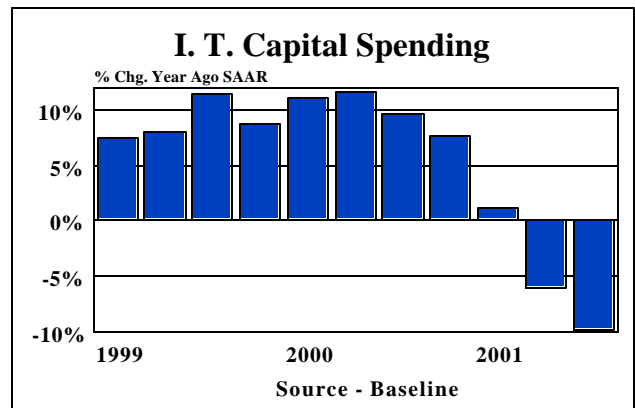
The early anticipation by the Federal Reserve in cutting interest rates has ameliorated the damage in some sectors. The interest rate cuts have helped housing related companies, financial firms and other heavy users of capital, so they have not been hurt badly in this downturn. At the same time, capital spending for information technology and telecommunications was already plummeting before the recession started. Technology was suffering a hangover from the over indulgences of Y2K and the internet boom, and it will be some time before it is back on track. When the September 11th attacks occurred consumer confidence plunged, but recovered relatively soon. Combining low rates, with low gas prices and the tax cut, as well as the modest unemployment rate, consumer spending has held up well.

The sectors hit the hardest will probably have the sharpest recovery and these include telcom, recreation/travel and tech capital spending. The energy sector has been extremely weak compared to prior recessions and should also recover with the economy. It is said that

every recession has a surprise bankruptcy, and the energy sector provided Enron for this one.



The shape of the recession marks the shape of the recovery. The United States and the rest of the world will find their balance. When this happens we will find that those areas hit the hardest, with individual corporate exceptions, will recover the quickest. Conversely, as the consumer is the central character in our economy, and has not been hurt too badly, we expect an orderly but not spectacular return to normalcy. Profit margins will continue to be tight in all areas. So overall earnings will not be as robust in their recovery.



We continue to feel that large U. S. companies will have the best general improvement, and that a

diversified portfolio of these companies will provide excellent long-term returns.

The Importance of After-Tax Portfolio Management

By Justin W. McNichols

Two common complaints about mutual funds are poor performance and the lack of control over capital gains. After two grueling back-to-back stock market years in 2000 and 2001, many investors are encountering the dreaded “double negative”; negative returns and net capital gains. With the Lipper Large Cap mutual fund index return of -20% in 2000, and -23% in 2001, many mutual fund investors will have capital gains to pay, in addition to digesting poor returns.

Osborne Partners concentrates on the maximization of after-tax return. During a year of positive returns, we strive to keep realized capital gains low. In a year of negative returns, we target capital gains to be zero to a net capital loss. To succeed in maximizing after-tax return, we employ two main strategies. First, we offset gains and losses throughout the year, as opposed to making all offsetting moves during the last week of December. Secondly, we occasionally take a loss in a position while subsequently purchasing a fundamentally stronger competitor.

In offsetting realized gains and losses throughout the year, we are not forced to buy or sell a company at the

end of the year, simply to lower capital gains. During our weekly strategy meetings, our investment committee reviews and monitors capital gains, along with potential sell candidates. This on-going process keeps capital gains inline for most of the calendar tax year. The number one goal in portfolio management is to outperform the market, however one does not want to dilute performance with high capital gains. This is why we consistently monitor gains.

Additionally, we occasionally take a loss in a position while subsequently purchasing a competing company, or a company in a similar industry. The firm’s portfolio managers analyze each customized portfolio’s holdings and capital gain situation individually. Subsequently in our strategy meetings, we share possible intra-sector or intra-industry swaps. The goal of these swaps is three-fold. First, we attempt to improve the future return of the portfolio. Next, we keep industry or sector exposure unchanged. And finally, we reduce realized capital gains by taking a loss. A hypothetical example in the telecommunications sector is to sell a losing Motorola position, and buy Nokia. In healthcare, sell Merck at a loss, and buy Pfizer. Or in consumer cyclicals, sell Gap, and purchase Target.

For most of the 1990’s, many repeated the old adage, “in a Bull market, whoever makes the most money wins”. We feel there is a more important adage that many forgot; “in a Bear market, whoever loses the least wins”. Strict, defensive management, coupled with little or no capital gains during poor market periods enables portfolios to start new Bull markets with more assets.

How Does The New Tax Law Affect My Estate Plan?

By Shannon S. Gallo

While no one can predict the outcome of whether or not the estate tax changes will apply after December 31, 2010, there remains many compelling reasons to continue planning. With that in mind, the question should be, "How does one continue their estate planning and what are the major changes from the Tax Relief Act?"

First and foremost, continue your estate planning as it ensures your wishes and goals will be fulfilled. There are always non-taxable reasons for estate planning. Among those reasons are protecting the interests of minors, physical or mental incapacity of family members who cannot care for themselves, as well as allowing the grantor to control their assets during their lifetime or in the event of their disability or incompetence.

With the possibility of the estate tax being repealed, individuals may wonder whether they should continue with their annual gifting program and the answer is yes. Continued gifting will have a positive effect in either case. If the estate tax is not repealed, you will have continued to reduce your estate. On the other hand if the estate tax is repealed, gifts made to children or other individuals can be done for non-tax reasons. *Previously, an individual's annual gift excluded from taxes was \$10,000 per person per year, however, effective January 1, 2002, the annual gift has been indexed for inflation and increased to \$11,000.*

Another major impact of the Tax Relief Act in 2002 was an increase in the Unified Credit Exemption Amount, from

\$675,000 to \$1,000,000. The Unified Credit determines how much you can give away during your lifetime or pass on through your estate tax free. As the intent of the tax bill is to gradually phase out the estate and gift taxes with a complete repeal in 2010, it is not recommended for individuals to make gifts above their Annual Exclusion Amount or above their Unified Credit Amount. The reasoning behind this is if the estate and gift taxes are ultimately repealed, the individual would already have paid the taxes on the additional gifts and the taxes paid would have been unnecessary. As in any case, each situation is unique and in some cases it may make sense to make taxable gifts.

With these changes it will be extremely important to review your estate plan, especially if it includes a Marital Trust, Credit Shelter Trust or Family Trust. As the increases occur over time, periodic reviews will ensure the Credit Shelter or Family Trust will not be inadvertently "over funded." Couples should also review ownership of their assets to take appropriate advantage of the Unified Credit amounts for each spouse.

Finally, new contribution limits for IRAs and Roth IRAs increased to \$3,000. Contribution limits to 401(k)s, 403(b)s and SEPs also increased to \$11,000 and will continue to increase by \$1,000 per year until 2006.

It is vitally important to review the structure of your estate plan to be sure it will address your current needs and incorporate changes that occur over time. With all the uncertainty, planning for the management and disposition of an individual's assets is the most important reason for planning, rather than tax avoidance.