

FOCUS

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The end of an era...

We have some good news, and we have some bad news. First, the bad. After 18+ years of uninterrupted publication, *Focus* will cease publication. Or more correctly, it will cease publication under the Woodside Asset Management banner, which leads us to the good news.

...and the beginning of a new one

As of the end of March, Woodside Asset Management became part of Osborne Partners Capital Management, LLC, a nearly 70-year old registered investment advisor based in San Francisco. And, we will continue to publish *Focus*, but under the Osborne banner:



OSBORNE PARTNERS
Capital Management

Within the next month or two, we will also be moving our offices from Sand Hill Road (where Woodside has been housed since 1988) to downtown Palo Alto. We will send out a formal announcement of the change of

address once we know our exact move date.

Though we part with the Woodside name and with our offices on Sand Hill Road with some sadness, we are very pleased with our new association, and we are looking forward to “repotting” in the vibrant environment of downtown of Palo Alto.

Because many of the functions we currently perform (such as compliance, human resources, portfolio accounting, etc.) will be performed by Osborne staff in the main office in San Francisco, we will be eliminating three positions. Thus, sadly we will be saying farewell to Denise Carlquist, Mary Lettiere and Tom Sedgwick. All three have been exceptionally

loyal and hard-working colleagues for many years, and we will miss working with them. We wish them all the best in whatever new path they follow.

What won't change are our investment philosophy and our dedication to client service. In fact, our colleagues at Osborne have already begun to incorporate some of our investment approach in the portfolios of their wealth management clients as they add new money to their accounts.

***More empirical
proof of
emotionally-
driven decision
making***

Behavioral finance is all the rage now that a Nobel Prize has been awarded in the field. We recently saw striking evidence of how typical investor behavior can be self-defeating, at least financially. A recent study by Dalbar, Inc. (a research firm dedicated to raising the standards of excellence in the financial services industry) reported on the investment results of mutual fund investors over the nineteen year period 1985-2003. The S&P 500 produced an annualized return of just under 13% over that period. The average investor in U.S. equity mutual funds: 3.5%. Yes, that's right, only 3.5%. For investors in bonds funds, the news is no better: the Lehman aggregate bond index returned about 8%, while investors in bond funds earned a little less than 3%.

How can this be? After all, the period spanned a portion of one of the greatest bull markets in history. The answer is simple: in spite of the adage to buy low and sell high, it is hard for most people to adhere to it. In a bull market, their optimism grows, and they buy more when they should be taking profits. In a bear market, their pessimism grows, causing them to sell when they should be wading back in. The flows in and out of equity mutual funds bear this out. Inflows peak at market tops, and outflows peak at market bottoms.

What is the solution for the average investor? Rebalancing. By that we mean the regular adjustment of the

portfolio back to some target asset allocation. This ensures that as asset classes go up in value, they will be trimmed back and the proceeds reallocated to those parts of the portfolio that have lagged or declined. In other words, it forces the investor to do what he should have been doing all along: sell high and buy low, just the opposite of what most fund investors tend to do.

***Tax facts that
make us fume!***

With April 15th just around the corner (as of this writing), we thought we'd share with you some facts about your taxes that we learned at a recent economic conference at Stanford, at which one of the speakers was a member of the President's tax reform panel.

- The panel estimated that tax compliance in the United States costs individuals and businesses \$140 billion annually.
- Since 1986, there have been more than 15,000 changes to the tax code.
- 60% of individuals use paid preparers. (Note: this does not include do-it-yourselfers who use TurboTax and the like.)
- Taxpayers in the highest 20% of taxable incomes pay 85% of all personal taxes.
- Due to credits such as the earned income credit, taxpayers in the lowest 40% of taxable incomes actually have a small negative tax, i.e., they receive money rather than having to pay money.

We have commented in the past about the problems with a highly skewed distribution of tax liability. In California, for example, when the market began to drop in 2000, state tax revenues plunged because they were so dependent on the incomes of the highest earning taxpayers, which dropped significantly. With a broader tax base, tax

revenues are less sensitive to the fortunes of the well-to-do. Moreover, more people have “skin in the game,” so to speak, and thus pay more attention to how their taxes are spent. We think this a good thing.

Unfortunately, the political realities of the day suggest that any meaningful tax reform won't be forthcoming any time soon. The Republicans are disorganized, and the Democrats don't want to do anything to give the President any kind of victory. We maintain, as we have for years, that the solution is to make it a felony for any member of Congress to use any kind of assistance, paid or otherwise, in preparing his or her tax return. Perhaps after hours and hours with a pencil and a calculator, they'll begin to see the light. Of course, Congress would have to pass this legislation. Fat chance!

***Tax cuts
continue to work
their magic...***

Last July, we wrote about the impact that President Bush's tax cuts were having on the economy. Specifically, revenues were up significantly, exactly the opposite of what the Joint Committee on Taxation had predicted. Guess what? They continue to grow dramatically, reflecting strong corporate profits (and a strong economy) and rising personal incomes. So much for the claims that the economy is in trouble or that the American public is suffering economically.

As reported by *The Wall Street Journal* (3/23/06), tax revenue for the first five months of the fiscal '06 year were up by \$81 billion over the same period last year, a growth rate of 10.3%. This is on top of the astounding growth of 15% for fiscal year '05. We would argue that these numbers make a strong if not iron-clad case for extending the tax cuts permanently. Of course, the growing budget deficit will probably induce Congress to raise taxes instead of reduce spending, which is likely to reverse the trend in revenues and thus exacerbate the problem. Where is Ronald Reagan when we need him? ❏

...but profligate spending is more than offsetting those gains

In the same editorial, the Journal points out that government spending has grown at a 6.6% annual pace since 2001. And this is before the Medicare drug benefit kicked in. Had spending grown only at the 3.1% average rate that prevailed between 1993 and 2000 during the Clinton administration, we would be enjoying a surplus of almost \$150 billion instead of the large and growing deficit we face today.

Even the government knows things are bad and getting worse

Along the same lines, the General Accounting Office has some really bad news for us. Art Cashin of UBS Financial Services dredged up a report on a recent audit of the Treasury's Bureau of Public Debt. To quote the GAO:

“Total federal debt outstanding has dramatically increased over the past 25 years from \$908 billion as of Sept. 30, 1980 to \$7.918 trillion as of Sept. 30, 2005. Large budget deficits emerged during the 1980's due to tax policy decisions and increased outlays for defense and domestic programs... Through fiscal year 1997, annual federal deficits continued to be large and debt continued to grow at a rapid pace... As a result, total federal debt increased more than five fold between 1980 and 1997... [Remember that the so-called “surplus” that appeared in the later years of the Clinton administration were the result of accounting treatments and did not in fact really exist.—*ed.*]

“As discussed earlier, federal debt managed by the bureau totaled about \$7.9 trillion at the end of the fiscal year, or more than \$26,000 for every man, woman, and child in this country today. But that number excludes many items, including the gap between future promised and funded Social Security and Medicare benefits, veterans' health care, and a range of other commitments and contingencies that the federal government has pledged to support. If these items are factored in, the present value of the total burden is about \$46 trillion. Stated differently, the total burden for

every American is more than \$150,000—and every day that burden becomes larger. Our long-term budget simulations show that without action by 2040, the federal government may have to either cut federal spending by 60 percent or raise taxes to about 2.5 times today’s level to pay for the mounting cost of the federal government’s long-term commitments. Either option would be devastating to the economy and the future standard of living for Americans. “

Clearly, we’re in trouble in spite of the strong economy. Unless and until the politicians wake up and start thinking and talking about the real issues we face instead of how best to denigrate the opposition, we, and our children, face an increasingly bleak future.

**Random
gleanings**

[After all that gloom and doom, you probably need something to cheer you up a bit.—*ed.*]

I was in the express lane at the store quietly fuming. Completely ignoring the sign, the woman ahead of me had slipped into the checkout line, pushing a cart piled high with groceries. Imagine my delight when the cashier beckoned the woman to come forward, looked into the cart and asked sweetly, “So which six items would you like to buy?” Wouldn’t it be great if that happened more often?



Because they had no reservations at a busy restaurant, my elderly neighbor and his wife were told there would be a 45-minute wait for a table. “Young man, we’re both 90 years old,” the husband said. “We may not have 45 minutes.” They were seated immediately.



All eyes were on the radiant bride as her father escorted her down the aisle. They reached the altar and the waiting groom; the bride kissed her father and placed something in his hand. The guests in the front pews responded with

ripples of laughter. Even the priest smiled broadly. As her father gave her away in marriage, the bride gave him back his credit card.



Three friends from the local congregation were asked, “When you’re in your casket, and friends and congregation members are mourning over you, what would you like them to say?”

Artie said: “I would like them to say I was a wonderful husband, a fine spiritual leader, and a great family man.”

Eugene commented: “I would like them to say I was a wonderful teacher and servant of God who made a huge difference in people’s lives.”

Don said: “I’d like them to say, ‘Look, he’s moving!’”



Smith climbs to the top of Mt. Sinai to get close enough to talk to God. Looking up, he asks the Lord, “God, what does a million years mean to you?”

The Lord replies, “A minute.”

Smith asks, “And what does a million dollars mean to you?”

The Lord replies, “A penny.”

Smith asks, “Can I have a penny?”

The Lord replies, “In a minute.”



John was on his deathbed and gasped pitifully. “Give me one last request, dear,” he said.


“Of course, John,” his wife said softly.

“Six months after I die,” he said, “I want you to marry Bob.”

“But I thought you hated Bob,” she said.

With his last breath John said, “I do!” ❏

WOODSIDE ASSET MANAGEMENT, INC.

Woodside Asset Management, Inc. is an investment management and personal financial counseling firm. Our investment philosophy is based on a time-tested strategy of diversification across six principal asset classes: cash, bonds, domestic and foreign stocks, natural resources, and real estate. The firm is registered with the Securities and Exchange Commission. All services are provided on a fee-only basis. Questions, comments and inquiries, whether about *FOCUS* or about the firm, are invited. Also, please visit our web site at www.woodsideasset.com for further information. 

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The Bank has 11 offices throughout California and operates regional offices in Phoenix, Arizona; Boulder, Colorado; West Palm Beach, Florida; Atlanta, Georgia; Chicago, Illinois; Boston, Massachusetts; Minneapolis, Minnesota; New York, New York; Durham, North Carolina; Portland, Oregon; Philadelphia, Pennsylvania; Austin, Texas; Dallas, Texas; Northern Virginia; and Seattle, Washington. More information on the Bank can be found at www.svb.com

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