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The stock market rallied strongly following the Presidential election, turning a lackluster year for stocks into a respectable one. For the full year, the S&P 500 returned 10.9%, and the NASDAQ Composite gained 9.2%. Smaller stocks did even better, as reflected in the 18.4% rise in the Russell 2000 Index. Foreign stocks, however, were the year's standout performers, thanks in large part to a falling U.S. dollar. In 2004 the most widely used benchmark of foreign stocks, the Morgan Stanley EAFE Index, returned 20.4%. As for bonds, it was a modest year, as the Lehman Aggregate Bond Index posted a 4.3% return.

Our portfolios performed quite well last year. Among our domestic stock funds, five of our six managers posted returns higher than that of the S&P 500 Index. Also all three of our diversified foreign stock funds outperformed the S&P 500 last year, while our recent investment in a Pacific/Asia stock fund is already showing a nice profit. Meanwhile, our two "inflation hedge" investments added further to our performance. The Pimco Commodity Real Return Strategy fund, which tracks a commodity index and also owns Treasury-Inflation Protected Securities (TIPS), returned over 16% last year. In July we added a gold fund to appropriate portfolios, and that fund has already appreciated more than 15%. With regard to bonds, our use of low-cost municipal bond funds for taxable accounts and low-cost, high-quality corporate bond funds for non-taxable accounts served us well. Furthermore, our bias towards shorter maturities kept us protected from rising interest rates without sacrificing significant income.

Two years ago at this time, we wrote that "stocks are attractive long-term investments at current levels." We believed that stocks were undervalued, and we recognized widespread investor pessimism after three consecutive losing years for the market. Subsequently, our portfolios were well positioned to profit from the rally in stocks over the past two years. Today stocks are much less attractive from a valuation standpoint, and investment sentiment is once again becoming speculative. We modestly reduced our exposure to stocks in most portfolios last year and expect to do more of the same this year. Within our stock portfolios we will emphasize large-cap funds that hold high-quality dividend paying stocks. These stocks represent the most attractive part of the market and will serve us well in difficult times. We will also continue to allocate a significant portion of our portfolio to foreign stock funds. In our bond portfolios we will continue to emphasize quality and safety. We believe that our philosophy of broad diversification, healthy skepticism, and a focus on the long-term will continue to serve us well in the future, just as it has in both good and bad markets in the past.

Sincerely,

David B. Ackerman, CFA, CFP
Partner

DBA/sb