April, 2005

The 1st quarter of 2005 is over already! It never ceases to amaze me how quickly the months pass! Another week or so and we are past April 15th, which in addition to being the tax filing deadline is also "Tax Freedom Day". It is the day where you have earned enough to pay all your taxes for the year. Isn't it nice to be working for ourselves for the remaining eight months!

Please find enclosed your quarterly reports and the performance report for our Risk Adjusted Portfolios. In order to keep this quarter's letter from getting too long, the market commentary and our Portfolio information is in the article enclosed. Highlights of the article:

- The major market indexes were down while our portfolios, on average, were not!
- The economy and interest rates seem to be behaving more 'normally'.
- The Income Plus portfolio is now called the Capital Preservation Portfolio.
- Details on the objectives and management of the new Income Portfolio.

Keeping up with Paul's educational pursuits hasn't been easy. We told you last quarter about his having passed the first of three CFA exams. Before gearing up for the second CFA exam Paul has acquired two professional designations from the College for Financial Planning in Denver, The Chartered Mutual Fund Counselor (CMFC) and the more advanced Accredited Asset Management Specialist (AAMS). He is a tremendous resource for us and rises to every challenge that comes his way.

My family and I just returned from another trip to Florida to see my children's great grandma and their grandparents. As a bonus, my kids enjoyed the great beach weather we had while there. I had a great time driving the new Itasca Horizon motor home (what a difference a big diesel engine makes!). We had to put the old Bounder "to sleep" early this year. After our Christmas trip, I couldn't keep up with the repairs!

We stopped at Road Atlanta on the way back to Chicago last weekend to watch some of our racing buddies. It was great to see everyone, even though the weather didn't cooperate – it actually snowed a little Saturday morning. We look forward to attending more races this season and meeting with all of you over the course of the year.

From all of us at RFG, happy spring!

## Markets

Investment markets have gotten a volatile start in 2005, lots of ups and downs and no clear direction. [*]The S&P 500 ended the quarter down -2.59% (-2.15% after dividends) and the DJIA down -2.59% (-2.06% after dividends). The NASDAQ Composite however was down -8.10%! We are pleased to report that on average our Risk Adjusted Portfolios have ended the 1st quarter UP (after fees and expenses)! Although our portfolios are up (except for Market Equivalent and Market Plus) just marginally, we'll take that when the major market indexes were down.

Real Estate and oil prices have done nothing but go up. Real estate has been up for more than 15 years while oil has roughly doubled in the last year. We don't know what is next, but nothing goes one way forever. Short term interest rates have risen with the Fed's recent, repeated quarter point increases, (expect more). The Fed has indicated that it is looking to adopt a neutral stance on interest rates, neither stimulating nor slowing the economy. The current Federal Funds rate is 2.5% which is still approximately 1% less than the Consumer Price Index (CPI) for 2004. I would expect neutral to be declared in the range of the CPI. Additionally, the rest of the yield curve has started to behave in a more normal fashion by increasing slightly as the Fed raises rates. This quarter, the Treasury yield curve has assumed a more normal shape (between 2% and 3% higher at the long end than at the short end) than it has had in quite a while. This is a good thing since, normally, markets like normal.

## Portfolios

We have changed the name of the **Income Plus Portfolio** to the **Capital Preservation Portfolio.** It is still at approximately 20% risk of the S&P 500 or approximately 20% in equities. Our objective for this portfolio is to produce a return after expenses, in excess of inflation, (thus preserving purchasing power) with less volatility than our conservative portfolio. The name now matches the portfolio's objective.

After nearly a year of watching a hypothetical portfolio we have also launched our new **Income Portfolio**. This portfolio is designed to do just that, generate income. Securities included in this portfolio typically generate a regular dividend or interest payment (not reinvested), thereby providing a fairly consistent yield. Because managing a portfolio for income is a very different process than is managing one for growth, I'll describe the objectives and the process in more detail in the following paragraph.

Virtually every financial database available and all public performance reporting of securities is based upon total return. Total return combines the growth of the value of the security with the interest and dividends generated. This technique is at best not helpful, and at worst disguises critical elements in the performance characteristics of securities or portfolios to be evaluated for income purposes. Because of this, the Income Portfolio is not designed with a risk level or equity level as a target, as are our Risk Adjusted portfolios. The primary goal is to produce income while over the long term appreciate in value at a rate faster than inflation. Securities selection and monitoring are centered on these dual objectives. Meeting these objectives is no mean feat, and the portfolio's ability to achieve these objectives is in no way guaranteed. Consider this about the inflation objective. If inflation is 3.1% (the long term average) for 20 years of retirement, the price of an item you are paying $1.00 for today is going to increase to $1.84. So in addition to providing a competitive current income stream, the portfolio must also grow in value and be able to increase its income stream by 84%. After 30 years, because the effects of inflation are felt on a compounded basis, that $1.00 item will now cost $2.50. The portfolio and its income will need to have grown by 250%!

The current composition of the Income Portfolio makes it approximately as volatile as our Moderate Portfolio, and that is assuming that the dividends and interest are reinvested. When dividends are not re-invested in a portfolio, volatility goes up. Quarter to quarter total returns are virtually meaningless in this context. We expect the Income Portfolio to be a valuable addition to the arsenal of financial tools we bring to bear on your behalf.

* Market data as reported by the Wall Street Journal, April 1st, 2005.