



January 2004

RE: 2004 Outlook & Other Issues

Dear Valued Client,

I am happy to report that the longest "bear market" since World War II came to an end last year with most stocks, corporate bonds and real estate investments up significantly. For example, S&P 500 and NASDAQ were up 26% and 50%, and the Goldman Sachs Corporate Bond Index continued its four-year up-trend by advancing 5.5%. Additionally, our average *unrestricted* client **outperformed the overall market by 3%**.

In our July, 2002 client letter, we forecasted that aggressive economic stimulus (i.e. tax reductions, low interest rates and the increasing growth of the nation's money supply) would give the stock market the fuel needed to make up most of the ground lost during that year. Although we are well on the way to fulfilling that objective, there are several factors we must remember.

Stock Outlook: This is not a replay of the 1990's!

History has repeatedly shown that after a large, multi-year stock market decline (i.e. the Great Depression, World War II and the 1970's recession), the stock market moves "sideways" for several years (see 1970's chart of the Dow Jones Industrial Average).

We are expecting the economy to grow at a moderate rate over the next two to four years with slight increases in interest rates during that time. *The S&P 500 should reflect this by trading in a range between 1250 and 900.*

On the positive side, this is what Wall Street calls a "stock picker's market". Our strategy is to focus on companies that are financially performing well in this environment, take profits on these stocks at significant price points identified by our research, and possibly use hedging strategies during major market declines. In other words, the key to success in this type of market is to rigidly follow a time-tested discipline.

Bond Outlook: The Corporate Bond "Bull" Market continues!

Since 2000, we have been encouraging all of our clients to increase their investment allocation in bond and equity income holdings to at least 33%. Although we feel the investment climate will continue to be good for income investors, due to consistently low interest rates caused by moderate economic growth and low inflation, there are several key issues that need to be considered:

- 1. Corporate Bonds:** One of the few positive surprises over the last four years has been the "Bull Market" in corporate bonds (even with the 2002 corporate accounting crisis). Although it requires patience, we are still able to find 3 - 5 year bonds paying up to 7% and 6 - 10 year bonds yielding up to 8.5%. In addition, we have structured hedging strategies in order to protect the value of bond holdings in margin accounts if interest rates rise unexpectedly.
- 2. Equity Income:** Over the last year we have increased our research and investment management capability in equity investments that generate annual yields of 6% - 8% from dividend income (i.e. reits, preferred stocks and master limited partnerships). In fact, we have developed our own preferred stock index to better track the market for these kind of investments (see chart of the W.I. Preferred Stock Index).
- 3. Municipal Bonds:** We are very concerned about the high valuation of most municipal bonds, and how the financial problems plaguing state and local governments nationwide could cause municipal bond prices to drop 10% from today's levels. We are recommending that clients avoid additional investment in this area, sell all existing municipal bond mutual funds, sell bonds with maturities exceeding 2014 and seriously consider the use of hedging strategies to protect the remaining holdings in accounts with margin capabilities.
- 4. Other Income Investments:** We are still selectively investing in private real estate trust deeds on properties in the San Francisco Bay Area. These investments are currently yielding between 7-10% over five years.

Other Issues: *Please review thoroughly the information contained in this letter. It is important that we mutually agree on a future course of action that reflects today's opportunities and risks.*

Client Restricted Investments: One of the advantages of working with Winans International is the ability to combine client directed investments with investments selected by us into one portfolio. Please keep in mind that any investments listed under "Client Holdings" on your Portfolio Overview report are considered restricted, and thus we have no authority to sell these holdings without client direction. In addition, these investments have not met our selection requirements and thus are not treated the same way as investments that we invest in. If you have any restricted investments, please let us know what your objectives are for these holdings. In general, we find these investments inferior to the holdings we select, and we recommend that you allow us to remove them from the portfolio. Also, you can call the brokerage house directly on trading these investments if we are not available to help you.

Investor Class Action Lawsuits Against Corporations: Due to 2002's corporate accounting crisis triggered by the bankruptcy of Enron, shareholder lawsuits have been filed against a few of the companies that we had invested in such as: Tyco International and Elan PLC. We have notified the brokerage firms holding your accounts, as well as the law firms involved, that we want our clients to be included as plaintiffs in these cases. Hopefully, there will be investor compensation for the disgraceful conduct of many companies and/or their officers. If you receive any documents regarding these lawsuits, please forward the information to us.

Improving Client Communication: As a general policy, we try to respond to all client requests during weekdays within 24 hours. As our business has grown, so has the volume of phone calls, voicemail, e-mail and faxes. In order to facilitate this growth, we have tried to better organize our effort in the following ways:

1) Phone Calls: During a normal day, I have set aside from 11:00-12:00 and from 1:30 – 4:00 to speak directly with clients. In order to make our conversation more efficient and effective, please schedule a time and tell Gloria what needs to be discussed. Please keep in mind that Karen, Vivek and Gloria are available much of the time and can assist you with most requests.

2) Voice Mail: We check voicemail in the mornings and early afternoons. If you have a matter that needs immediate attention, please call back and talk to a staff member on weekdays from 8:00 to 5:00(PST).

Please do not leave time sensitive investment instructions on voice mail!

3) Emails & Faxes: We check for emails and faxes in the morning and our deleted email files once a week. Unfortunately, due to our virus protection software, many "non-spam" emails are sent to the deleted file.

If you are sending us important, time-sensitive material by email or fax, please call us to confirm that it was received.

As a final note, nothing brings more joy to an "old" investment analyst than having once criticized research being proven correct. Back in 1998, we conducted research for The Wall Street Journal on how most investors would be better off avoiding mutual funds, and directly investing stocks and bonds, due to the excessive fees charged by many mutual funds to their investors. Needless to say, Wall Street considered this "heresy", and I was labeled a "rebel". Words cannot describe the vindication I feel now that the truth is being told about the massive breach in fiduciary and ethical standards committed by many of those mutual funds that criticized my research (see article). Finally, additional research can be found on our website www.winansintl.com.

I hope all is well with you, and I look forward to seeing you during our next meeting.

Sincerely,

**Kenneth G. Winans
Founder & President**