



APRIL 11, 2005

In order to better acquaint you with Wealth Advisor Group LLC, we are sending you our quarterly client newsletter which accompanies our clients' quarterly performance reports. We hope this gives you some insight into our firm. If you have any questions about our services, please call.

## First Quarter 2005 Report

### Hiding In The Closet

In 2004, the American Funds mutual fund family collected over \$84 billion in new assets, primarily distributed into their three largest funds – *Growth Fund of America A*, the *Investment Company of America A*, and the *Washington Mutual A*. These popular funds were sold primarily by brokers and bankers, and most clients paid a load to buy them.

There is nothing wrong with anything written above, but when you shine the light a bit closer, some disturbing stuff starts coming into view. And the concern just doesn't stop with these American Funds, but spreads to many of the biggest domestic large cap mutual funds in the industry. What are we talking about? According to independent mutual fund research company *Morningstar*, many of the largest mutual funds have a high R-squared factor. In English, this means that they have a high statistical relationship with the S&P 500. For example, a fund with an R-squared of 90 (100 is the highest possible) means that fund is 90% correlated with the S&P 500. The industry considers anything above that number a "closet" index fund.

So what's the big deal with that? In 2004, Morningstar found that over 27% of all large cap funds have greater than a 95 R-squared. Add to this the fact that, according to Lipper, the average internal expense charge of large cap funds is 1.47%, and we see what is hiding in that dark, scary closet. The fact is that mutual fund buyers are paying very high internal fees, and often a big load to boot, in order to purchase something that has little chance of performing much better than an S&P 500 index fund. And because of the high expenses and potential loads, an investor has very little chance of long term performance any where near the returns that the S&P 500 offers. Recognize any of the funds below?

Name	Category	2004 R-squared
Amer Funds Growth Fund of Amer A	Large growth	93.25
Amer Funds Washington Mutual A	Large value	92.85
Amer Funds Investment Co of Amer A	Large value	95.37
Fidelity Magellan	Large blend	98.83
Dodge and Cox Stock	Large value	86.94
Vanguard Windsor II	Large value	87.75
Fidelity Growth and Income	Large blend	95.29
Davis New York Venture A	Large blend	91.07
Vanguard PRIMECAP	Large blend	92.54

*Morningstar*

Note that regardless of the stated category of the fund -- growth, value or blend, it still can be a closet index fund. And remember, this is just a short list showing some of the largest funds in existence. There are many hundreds more funds with very similar statistics.

How or why is this happening? Are the fund managers doing all this on purpose, or is something else taking place. Basically, it's a little bit of both. Remember, the funds above represent hundreds of billions of dollars in assets that are earning internal fees. It is important to the fund companies that their shareholders stay in those funds. By mimicking an index fund, fund managers can be assured that performance won't be really horrible; and by doing that, they assure that most investors will stay satisfied enough not to sell and move elsewhere. That means the internal expense spigot stays open and the fees keep on flowing.

Another reason for this phenomenon is a structural one. When fund assets build up to huge amounts, there are only so many

stocks that can absorb the money involved in these huge buying and selling transactions. The easiest stocks to buy and sell are the biggest ones out there, which just happen to be the S&P 500 stocks. Imagine that.

Wealth Advisor Group has been aware of this closet indexing situation for a long time. Last year, we were given the ability to offer our clients Dimensional Fund Advisor (DFA) Funds for many equity asset classes. These very low cost, institutional assets class funds have outperformed many of the Vanguard index fund alternatives, and we have started using them in both taxable and tax deferred accounts. (You may have noticed some of them in your account. Please contact us if you would like to learn more about them.) We constantly search for ways to improve the net cost of investing and its corresponding positive effect on your performance. Every additional dollar we can bring to our clients' bottom lines helps them, and frankly, it helps us as well, because our clients' and our interests are exactly the same. If you know of a family member, friend or colleague whose financial closet may need some Spring cleaning, please refer them to us, and we promise to transform theirs into a neat, clean, highly efficient one. *InvestmentNews 2/21/05; Fortune 2/21/05*

### Our New Look

You have probably noticed that we've changed our logo. We felt it was important to clearly demonstrate two things. First, we wanted to underline our relationship with Dixon Hughes PLLC and its importance to Wealth Advisor Group and our clients. Few advisory firms in the nation have the benefit of the human, technical and financial strengths that come with our affiliation with the largest regional CPA firm in the Southeast.

Second, that three ringed figure on our binders, brochures and letterhead is not a strange Pennsylvania Dutch hex sign or mixed up ying/yang symbol, but a figure representing the three fundamental values Wealth Advisor Group brings to our client relationships.

### Charlotte & Abe

No, that isn't the name of a new Thursday night prime time sitcom. Rather, we are excited to announce that Wealth Advisor Group is opening an office in the South Park area of Charlotte. Abe Early will head up that office. Abe has spent several years of his investment career in Atlanta, and now returns to his home state, where both he and his wife Suzanne will be close to their families in High Point and Charlotte. We knew Abe was really smart for two reasons; first, he is a Wake Forest grad and has earned his CFP designation, and second, he immediately accepted our offer to join Wealth Advisor Group. He continues the tradition of all our advisors by putting his clients' welfare above all else. We are delighted to have Abe on board and ask that if you have any family, friends or colleagues in the Charlotte area, please refer them to our new South Park office.

### First Quarter 2005 Asset-Class Performance

	1 st Qtr '05		1 st Qtr '05
S & P 500	-2.16%	<i>Int'l Large Cap</i>	-0.40%
<i>Large Cap Value</i>	0.19%	<i>Int'l Large Cap Value</i>	0.30%
<i>Medium Cap</i>	-0.45%	<i>Int'l Small Cap</i>	5.02%
<i>Small Cap</i>	-3.79%	<i>Int'l Small Cap Value</i>	6.65%
<i>Small Cap Value</i>	-2.90%	<i>Int'l Emerging Mkts</i>	1.43%
<i>Micro Cap</i>	-6.43%	<i>Int'l Emerging Mkts Value</i>	2.80%
<i>Real Estate</i>	-7.34%	<i>Int'l Emerg. Mkts Small Cap</i>	1.67%
<i>Intermediate Income</i>	-1.28%	<i>Pacific</i>	-1.81%
<i>Long Term Income</i>	0.15%	<i>European</i>	0.38%

Source: The Vanguard Group and DFA Funds

Most asset classes limped along during the first quarter until a weak final three week period put a decidedly lower tilt on their returns. Interestingly, international stocks fared a bit better than domestic. Small beat large in international equity asset classes, but large beat small in the U.S. In both places, value seemed to do a bit better than growth. Real Estate was the big loser at over a 7% loss, which shouldn't surprise us after a five year bull market run. Small Cap internationals were the upside winner at 5% and 6%. A portfolio without international holdings would clearly struggle this past quarter. Income was also nothing to cheer about. Intermediate bonds lost over 1% and long term barely broke even.

The domestic asset class pullback was not surprising. In addition to Real Estate mentioned above, Small Cap stocks are coming off back-to-back years of dramatic (almost 60%) total returns. It is only natural for some type of retrenchment, and this trend may continue over the intermediate timeframe. International asset classes took advantage of a weak dollar, and will continue to act as a dollar hedge in your portfolio. The scientific diversification of your portfolio through the use of Modern Portfolio Theory will not guarantee that every quarterly report will be a rosy one. It will, however, remove most of the diversifiable risk from your portfolio, thereby dampening the more extreme moves that a few specific asset classes will always

experience.

As always, we have enclosed your Quarterly Performance report with this letter. We have included a notebook to hold your reports, as many clients have requested this preference. If this is your first report and we have not managed your portfolio for a full three months, you will only receive a partial report, with a full one to start next quarter.

Please contact us with any questions you may have about your portfolio. Get ready for the change of sports' seasons, and enjoy your springtime.



Our client centered portfolio management – something we call **The PROsperity Model (sm)**, is designed by combining:

- Our investment **Philosophy**, based in Modern Portfolio Theory,
- Our **Resources**, seen in human terms by our highly experienced, professional advisors; our affiliation with Dixon Hughes; and finally our unique ability to offer our clients institutional investment vehicles unavailable to most brokers, bankers or individual investors,
- Our **Objectivity**, which is anchored in our fee-only compensation structure, assuring no potential conflicts of interest of any kind.
- Our clients stand at the center of these principles, benefiting by the **Integration** of all three. We believe that a superior investment experience and performance can only be found when not one or two, but all three values occur simultaneously.

Sincerely,

Frank W. Hoyle, Jr.  
President

Frederick F. Kramer IV, J.D.  
VP/Chief Investment Officer

Suzanne R. Holbert CPA/PFS  
Personal Financial Specialist

Catherine S. Anderson  
Chief Compliance Officer

Paul J. Harteg, CFP, AIFA  
Financial Advisor

Abe D. Early III, CFP  
Financial Advisor