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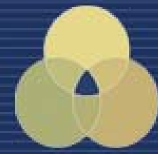

JULY 11, 2005

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.

Second Quarter 2005 Report

Gamble: gam' bel (verb); to bet on an uncertain outcome

If you ask people whether they gamble or not, they usually reply directly, with a simple "yes" or "no". Most equate gambling with going to the casinos or attending a weekly poker game. Few consider themselves a gambler just because they bet during March Madness, the Super Bowl or a friendly golf game.

Gambling often deals with timing. Winning and losing streaks are common. Some people think gambling and the stock market are basically the same thing. Even the verbiage can often be similar. When you hear the expression "Cut your losses short and let your winners ride", it is hard to know whether someone is talking about the craps table or the latest technology stock.

Let's take a quick, one question test. No, this is not an example of the new SAT testing format. And, yes, it is a trick question.

Which is the riskiest bet?

a. **a slot machine**
b. **bingo night**
c. **the lottery**
d. **the stock market**
e. **all of the above**
f. **none of the above**

Choose your answer before you continue.

The correct answer is ….f. none of the above. There is no risk in a, b or c. Why? Because the "house" determines what the "gamblers" will win.

a. Casinos determine what the payout ratio is on slot machines. Someone might win the big jackpot tonight, but rest assured that the total winnings and losses have already been calculated and that over any meaningful period of time the owner of the machines will make money.
b. Bingo "parlors" also experience no risk. That's why so many churches use bingo as a fundraiser. They simply choose the prizes or calculate how much of the cash receipts will be paid out for the night…and they keep the rest.
c. Lotteries work the same way. The state determines what percentages of the receipts will be paid out to the winner, and the rest of the money goes for administration expenses and some meaningful public purpose, such as education or benefits for senior citizens.

Now you may be questioning why we are talking about the "owners" of gambling and not the gamblers themselves. That was the trick part of the question! We asked which is the riskier bet, but we didn't say riskier to whom. Why would someone choose to be a gambler if they could in fact be the "owner" of the gambling enterprise, with no risk?

And now let's discuss d. the stock market. We mentioned earlier that many people equate "playing" the stock market to gambling. No doubt, if you have ever bought individual stocks, the buying and selling process you used may indeed be similar to

gambling, especially if your holding periods are short term in nature. But what happens if we become the "owners" of the stock market, and not the "gamblers" trying to bet on any particular stock? And what happens if you are a long term owner?

Owning equity asset classes does just that. If your "timing" is long enough, it actually turns the ownership of equities into a low or no risk proposition. Unconvinced? Look at the chart below. We have chosen the worst performing equity asset class over the last 70 years – Large Cap US stocks, as represented by the S&P 500 Index. One column shows a ten year holding period, starting with the most recently ended year – 2004. A new ten year holding period is shown every five years. These rolling 10 year periods break 70 years (1935-2004) into 13 periods. The second column gives the average annual return for each year during that ten year period.

10 year periods	Avg. Annual Return	10 Year Periods	Avg. Annual Return
1995-2004	12.2%	1960-1969	9.8%
1990-1999	17.9%	1955-1964	12.4%
1985-1994	16.0%	1950-1959	20.2%
1980-1989	16.1%	1945-1954	13.7%
1975-1984	15.7%	1940-1949	8.1%
1970-1979	4.6%	1935-1944	8.2%
1965-1974	4.8%		

DFA, Inc.

No, your eyes are not deceiving you. Every single 10 year period shown had positive annualized returns, with most time periods showing very generous numbers. This occurred despite all the horrible, scary and miserable events that have taken place during the past 70 years. So why not just forget an advisor, buy an S&P 500 index fund and be done with it? Because you can do so much better than that, both in terms of risk and return. Look at the long term study shown below:

Asset-Class	***50 yr. Annualized Return (1955-2004)***	***Growth of $1 (1955-2004)***
S&P 500 Index	10.9%	$180
Large Cap Value	12.9%	$428
Small Cap	13.1%	$468
Small Cap Value	16.3%	$1,916

DFA, Inc.

You should know from our past quarterly letters that Value and Small asset classes give the best opportunity for increased returns. Modern Portfolio Theory (MPT) gives you a way to blend those superior returns in a way that can help control the risk of the portfolio, yet still take advantage of generous returns. And don't forget Real Estate and the various International asset classes as well. If you are impressed with the consistently positive performance shown in the study on the previous page, don't you think your long term returns using MPT will be even more rewarding? You can bet on it.

Second Quarter 2005 Asset-Class Performance

	2nd Qtr '05	'05 YTD		2nd Qtr '05	'05 YTD
S & P 500	1.32%	-0.87%	*Int'l Large Cap*	-1.23%	-1.62%
Large Cap Value	2.75%	2.94%	*Int'l Large Cap Value*	-1.40%	-1.10%
Medium Cap	4.43%	3.96%	*Int'l Small Cap*	-1.63%	3.31%
Small Cap	4.84%	0.86%	*Int'l Small Cap Value*	-1.14%	5.43%
Small Cap Value	3.02%	0.03%	*Int'l Emerging Mkts*	3.76%	5.25%
Micro Cap	3.93%	-2.75%	*Int'l Emerging Mkts Value*	1.05%	3.87%
Real Estate	14.65%	6.24%	*Int'l Emerg. Mkts Small Cap*	0.69%	2.37%
Intermediate Income	4.08%	2.74%	*Pacific*	-1.63%	-3.41%
Long Term Income	7.14%	7.30%	*European*	-1.11%	-0.73%

Source: The Vanguard Group and DFA Funds

In many ways, second quarter returns were exactly the opposite of the first quarter's. Domestic equity asset classes showed Small out performing Large. Real Estate, which was the big loser last quarter, was the big winner this time around. International Equity asset classes had modest losses, except for Emerging Markets classes. Modern Portfolio Theory's inclusion of diversified asset classes has once again dramatically helped the performance of portfolios in all risk levels.

Even with the Fed ratcheting up the federal funds rate, intermediate and long term interest rates dipped, which led to generous returns on bonds. This continues to baffle the experts, as well as us. With higher growth, higher energy prices, and a Federal Reserve aggressively raising short term rates, longer term bonds and mortgage rates have not gone up as expected. Our attempts at minimizing portfolio risk associated with rising interest rates by using short term bonds/funds and hybrid funds (which don't have the normal interest rate risk of bonds) have, so far, proved unnecessary and in some cases a drag on

potential income returns. We have to believe that you can only push on a rubber band so far before it snaps back. Stay tuned.

The modestly positive second quarter helped to offset the moderately negative first quarter. All in all, we have had six months of choppiness, and frankly, more may be on the horizon. It is basically a battle of increasing short term rates (bad guys) vs. a mostly healthy, growing economy (good guys). To get a meaningful up move in the market, we will most likely have to stop trying to paddle up stream against the current of higher rates. So watch Alan Greenspan for a signal to the end of increasing rates.

TD Waterhouse + Ameritrade = TD Ameritrade = Non Event

By now, you should have received information about the merger involving your custodian. Our talks with management have resulted in the above equation. Ameritrade currently has no meaningful institutional/advisor division, so they will have little influence on that side of the business (which incidentally has been consistently profitable for TD Waterhouse). You will not have to sign any papers. Each account will continue to be insured for $150 million. Transaction fees will not go up; in fact, over time, economies of scale may push them down even more. But in the end, it should basically be a non event. We will keep you up to date with any new information we receive.

As always, your individual performance report is included with this letter. New client portfolios not managed for a full three months may not have all sections of the report included this time, but will starting next quarter. Please call us with any questions you may have.

In the meantime, stay cool, and enjoy your summer.

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,

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