
Letter From The Portfolio Manager

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All We Can Do



Eric M. Kobren

By the end of February, we will have spoken with approximately a hundred portfolio managers so far this year. While our primary emphasis in speaking with a manager is to learn about their people and the investment process they employ, we also hear quite a bit about their market outlook. We have heard some very smart and experienced people, who are usually right, explain in a very reasonable way why the stock market will go up this year. We have also heard some very smart and experienced people, who are usually right, explain in a very reasonable way why the stock market will go down this year. And we have observed this same dichotomy of views on the economy (stronger and weaker), the dollar (rising and falling) and interest rates (higher and lower).

While we have our own opinions on the markets, which we think should be credible given our years of experience and the evidence of our track record, we also acknowledge that, like any advisor, not all of our decisions will be correct. All we can do is work hard, stay true to our philosophy and process, and execute well. If our process is sound and if we are continually striving to make it more effective (which we are), then the results should continue to be there over time.

We build diversified portfolios. We believe that for long-term growth, it's generally better to be an owner (stocks) than a lender (bonds). We believe that costs — not just management fees, but also transaction and tax costs — are critical to monitor and control.

In what we think is a lower than average return environment for conventional stocks and bonds in the years ahead, we look to add value through the use of unconventional asset classes and market exposures and through the identification and use of active managers. And, as always, we will gradually adjust our asset allocation according to shifts in relative valuations.

Perhaps the most important responsibility that we have is to make sure that we understand your financial situation thoroughly so that the portfolio we construct for you has the appropriate level of risk given your own objectives and risk tolerance. Then, given that risk level, our task is to maximize your total return over time. For taxable clients, we obviously care more about the after-tax return than the pre-tax return.

Cautiously Optimistic

So, all that said, what is our market outlook? Although it appears that individual investors and Wall Street are more bullish than usual, we don't quite share the same level of enthusiasm for the stock market. We acknowledge the positive factors that could propel the market higher, but we also notice some factors which aren't quite as friendly. For a quick monthly review of our market outlook, please refer to our [Five-Factor Model](#) on our website: kobreninsightmanagement.com.

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The positive factors include economic growth remaining resilient and above-trend, as well as an interest-rate environment where rates remain low by historic standards. The negatives include above-average valuations that are trending lower (falling P/Es), interest rate relationships that aren't friendly (inverted yield curve, tight credit spreads), and the aforementioned "bullish" sentiment readings.

Add it all up, and we think a cautiously optimistic stance makes the most sense. We often use the phrase "cautiously optimistic," and it was interesting to come across a mention of it during one of our evening reads recently (John Maudlin's "Just One Thing"):

"Albert Wang in an article in the 2001 Academy of Sciences Journal of Financial Intermediation shows us that a cautious optimism is the appropriate approach. Wang uses evolutionary game theory to study the population dynamics of a securities market. In his model, the growth rate of wealth accumulation drives the evolutionary process ... He finds that neither underconfident investors nor bearish sentiment can survive in the market. Massively overconfident or bullish investors are also incapable of long-run survival. However, investors who are only moderately overconfident can actually come to dominate the market! In the world of our ancestors, overconfidence would get you killed. Lack of confidence would mean you sat around and starved. Cautious optimism was the right approach! And it still is."

Bond Guy

If you have the time, we would encourage you to read this month's [Research Perspective](#) on our website. It is an interview with our (proudly) self-proclaimed "bond guy," Chris Keith. Not only does Chris structure and manage portfolios of individual bonds for our clients interested in capital preservation and yield generation, but Chris also handles the research on our fixed income mutual funds. It is obvious to those of us who work with Chris each day, that he is very good at what he does, but it is gratifying to hear from so many of the outside investment firms we deal with that they think he is one of the best, if not *the* best, fixed income fund analysts. And unlike the stereotype of experienced bond market professionals being curmudgeons, Chris always has a quick smile.

Thank you for your confidence.

Sincerely,



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President
Portfolio Manager



Rusty Vanneman, CFA
Director of Research
Co-Portfolio Manager

P.S. If you have any questions on this article, comments on how we can improve our website, service or any other matter, please feel free to call, email or stop by the office.