



## Second Quarter 2003 Analysis

The market is currently in a confirmed rally. We mentioned in our 1<sup>st</sup> quarter report that the market appeared to be reversing direction and we were anticipating above average earnings for the 1<sup>st</sup> quarter. Now, looking back at the 2<sup>nd</sup> quarter, we see that the market hit bottom on March 12<sup>th</sup> and started an upward trend that appears to remain strong. The earnings reports were even better than we anticipated and the hot stocks that we were tracking began to break-out and hit new highs. We enthusiastically reentered the market.

The market's performance for the year as of June 30<sup>th</sup> was as follows:

DOW:	up 7.7%	- most popular index
NASDAQ:	up 21.5%	
S&P 500:	up 10.8%	- most popular benchmark
Russell 2000:	up 17.0%	
Trustar	up 10.2%	

Though it may appear that some of the indexes, especially the NASDAQ, performances were impressive, one has to consider prior performance in order to accurately determine the true performance. Because several indexes performed so miserably last year, they were "overdue" for a significant positive pop. The next question is, was the positive pop enough to compensate for their prior poor performance? Let's say you started last year with \$100. If you had a 40% loss last year, then you lost \$40 and ended up with \$60. In order to recapture your lost \$40 and return to your original \$100, you will need to earn a 67% return on your current \$60. Simply earning 40% on your funds this year will not recapture your 40% lost last year. Below is a table that shows last year's performance and the needed performance for the current year in order to recapture last year's losses.

Actual Performance comparison				
Index	Last year's performance	This year's needed performance to recapture lost principal	Current Year performance	Actual gains / (Continued shortfall)
DOW	-16.8%	20.2%	7.7%	-12.5%
NASDAQ	-31.5%	46.0%	21.5%	-24.5%
S&P 500	-23.4%	30.5%	10.8%	-19.7%
Russell 2000	-21.6%	27.6%	17.0%	-10.6%
<b>TRUSTAR</b>	-5.5%	5.8%	10.2%	<b>4.4%</b>

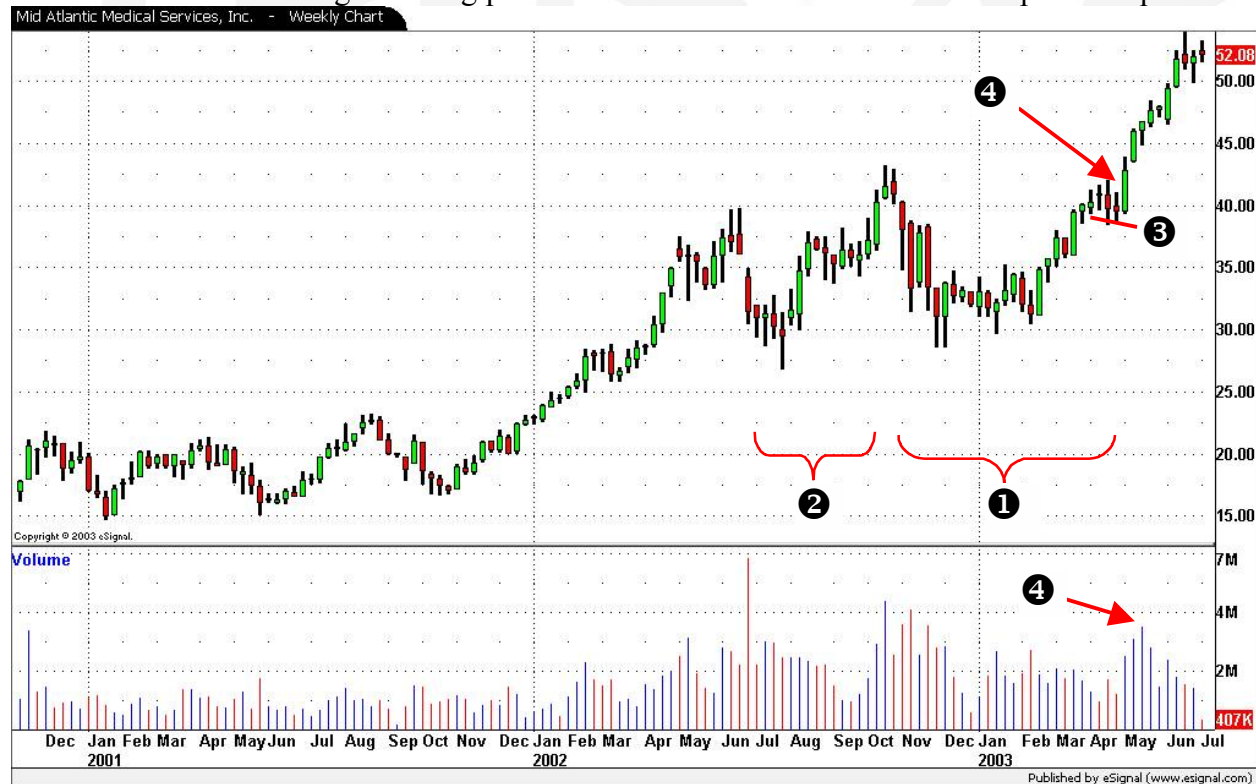
As you can see, touting current performance does not reflect true performance. Our commitment to preserving clients' principal and always focusing on positive returns has kept us well ahead of the pack.



## Our Holdings & 2<sup>nd</sup> Quarter Activity

**Coventry Health Care, Inc. (CVH):** HMOs remained strong through much of the 2000-2002 bear market, climbing higher as techs crashed all around them. The sector started losing steam last summer as one of the last bastions of strength to buckle under the market's final lurch downward. Nearly a year later, several HMOs have reemerged, forming solid bases and setting up for another run. Many institutions were accumulating shares in this sector and breakouts seemed imminent. We bought in at \$33.98 on 4/14/03 several weeks before Coventry's earnings announcement. When Coventry released their earnings, their quarterly profit had increased a whopping 74 percent and sailed past Wall Street's expectations. Although the stock began rising rapidly, we were not sure how strong the market's rally was at this point and had seen other breakouts fail. We decided to be conservative and lock in our profits. We sold on 4/29/03 at \$38.05 realizing a 12% gain.

**Mid Atlantic Medical Services, Inc. (MME):** Seeing the continued strength in CVH, we turned our sight on the next potential HMO breakout. Maryland-based Mid Atlantic had formed a six-month base ❶ following its prior four-month consolidation ❷. Volume came in heavy in the early stages of its base. Volume then quieted down as Mid Atlantic found a bottom to its base, an auspicious sign. The stock gained ground as it carved the right side of its base. It rose to within 3% of its high, then formed a handle, sloping gently downward ❸, the way many of history's greatest stock winners have done before explosive breakouts. On April 30<sup>th</sup> Mid Atlantic broke out on 2 ½ times normal trade volume and we bought in at \$42.50 ❹. The following week, Mid Atlantic released its earnings showing profits had increased 87%. This was on top of last quarter's





112% increase. The strength of Mid Atlantic's financial statements and their continued price action have led us to continue to hold them in our portfolios. As of June 30<sup>th</sup> the stock price was \$52.30 and our unrealized gain is 23.1%.

**Centene Corporation (CNTE):** As we continued to troll the Health care sector, we discovered Centene. Their sales and earnings growth were impressive, and mutual funds were increasing their position in the stock. Initially we were reluctant to add them to our portfolio due to their relatively thin trading volume. In the past, this thin volume had allowed hedge funds to manipulate the stock price. However, their performance and strong sector caused us to buy them at \$35.30 as they attempted to breakout on May 16<sup>th</sup>. What we initially feared came to pass as the breakout failed and the price began to drop. At the end of the day, we were down 8% at which point we usually cut our losses and close out the losing position. However, we noticed that the short interest had substantially increased, signifying potential manipulation. During the following week, the stock price barely moved and volume was very low. At this point we felt very bullish and knew that the short interest was in a very precarious position. On May 28<sup>th</sup> the company announced a 3 for 2 stock split and the stock rose all the way to \$39. The stock split will become effective July 12<sup>th</sup> and we will continue to hold the position as long as it stays in a growth pattern. As of June 30<sup>th</sup> the stock price was \$38.53 and our unrealized gain is 9.2%

**Thoratec Corporation (THOR):** This manufacturer of circulatory products for patients with congestive heart failure exhibited the same characteristics as Centene Corporation mentioned above. We bought them on June 5<sup>th</sup> at \$15.16 as they attempted a breakout. Although this breakout failed, its pattern still suggests that the stock is consolidating and that another breakout attempt is still looming. Although we are down 3.2%, we will continue to hold them until they either breakout or their consolidation falls apart. Their stock price closed at \$14.68 on June 30<sup>th</sup>.

**AdvancePCS (ADVP):** AdvancePCS provides pharmacy benefit management services to over 75 million benefit plan members making it the nation's largest independent provider of health improvement services. Although we weren't overly impressed with their fundamentals, they were coming out of a consolidation pattern that extended back into the summer of last year. The stock broke out on June 5<sup>th</sup> and we bought in at \$35.64. Over the next several weeks, it rose as high as \$40.85 but it failed to exhibit the same strength that caused us to hold onto other winners (e.g. Centene, Coventry, and Mid Atlantic). When it started to correct we hesitated to sell our positions because the rest of the sector was still performing well. However, when it fell below \$37.00 on heavy trade, we exited our position at \$36.31. Our realized gain was 1.9%

**Conerstone Realty Income Trust, Inc. (TCR) & Peets Coffee and Tea, Inc. (PEET):** We continue to hold both of these stocks. TCR has been consistent with its dividend of 7% and has been a hedge to our equity holdings. Peet had shown potential but does not seem to be able to gain a foothold on its breakouts. We continue to monitor Peet for the best exit point.

### Market Analysis and current forecast

After staging a follow-through on March 17<sup>th</sup> and rallying for three months, the market probably is due for a correction, but we are not going to sell in anticipation of it. Despite what you might



have read elsewhere, the market is full of younger new companies that are boasting impressive growth. We are tracking them in search of more opportunities. Even though the market has performed superbly, the “crowd” remains deeply distrustful. That’s actually good for stocks. We don’t want the market getting overheated with too much optimism so early in the advance. Most individuals only look at the market indexes’ point gains or losses without taking into consideration the volume associated with the point movement. For example, If the DOW is down 200 points, is that bad? Well, without knowing the volume, you don’t really know. Volume indicates whether large investors are taking money out of the market or adding to their positions. Thus, if the market dropped 200 points but the volume was low, we would not attach much significance to the point drop. There has only been one clear day of intense selling in the past 17 sessions for the NASDAQ and one clear day of selling for the S&P500 in the past eight sessions. This leads me to conclude that the markets are only taking a breather, not turning bearish.

We will continue to seek out superior investment opportunities and hedge our holdings. All of our efforts have been, and will continue to be, focused on finding those leaders and delivering results to you. We are ahead of the market, yielding positive results, and will continue to strive to increase the value of your portfolios.

### Other Business

We appreciate all of your referrals to us. Many investors have been burned during the past several years and are reluctant to take their funds out of the bank and begin investing them again. As you know, there are profits to be made in the market and we hope that you will tell your associates about the performance you have experienced in your own portfolios.

The quarterly advisor fees will be charged to your accounts next week.

If you have any questions or comments about this analysis, please do not hesitate to call me. We appreciate your patronage.

Sincerely,



Jonathan Davey, CPA MBA  
Registered Investment Advisor