



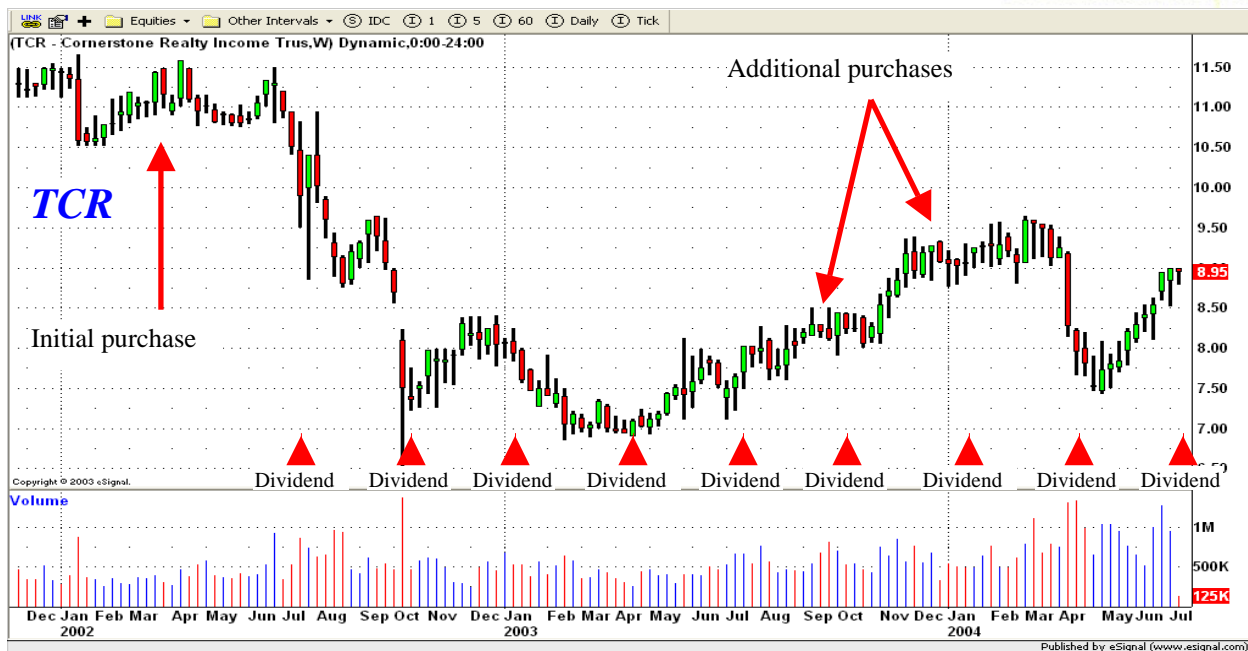
Second Quarter 2004 Analysis

The market volume significantly slowed down in the second quarter as the indexes moved quietly sideways. The volume on several days was the lowest in over a year. Although the economy continued to strengthen and corporate earnings were robust, investors stayed away from the market and took a “wait-and-see” attitude. The uncertainty created by geo-political turmoil, the anticipation of an interest rate increase, and record high gasoline prices were several driving factors behind the market’s ambivalence. While investors appear to flee at the slightest hint of bad news, they seem reluctant to embrace any good news. As we methodically troll through the reams of corporate reports, we see noteworthy improvements in corporate earnings and governance and remain confident that eventually these corporate improvements will push the stock prices higher and present new opportunities. Additionally, many secondary and contrarian indicators (e.g. Short Interest Ratio) are pointing to a market upturn.

Our Holdings & 2nd Quarter Activity

This quarter was a first for us – we did not make any trades. There have been other quarters where we had light activity but never did we have a quarter that saw us neither buy or sell. The equities market offered very few opportunities, and the REIT market was getting hit pretty hard due to interest rate fears. What amazed us the most was the stability in the bond market. Even though the bond market went down on the first talks of an interest rate hike, we anticipated a more pronounced impact from the actual interest rate hike and kept our bond clients sitting in cash waiting for devaluation. It now appears that the fallout early in the second quarter factored in the future rate hike enough to avoid a secondary collapse.

We have been holding **Conerstone Realty (TCR)** for several years now and have added to our position several times. When we first purchased TCR back in March of 2002, the historic low interest rates were beginning to impact the apartment sector. We saw the stock slide from \$11 down to under \$7. However, since we felt confident that TCR would continue paying its quarterly dividend of \$.20 (\$.80 annually) we decided to hold our positions. Due to the high, consistent dividend, every client who holds TCR is now in a positive position. Even those who bought way back at \$11 have had the dividend income offset the price decline. Even with the recent interest rate hike, TCR still delivers a very good dividend yield – approximately 10%.



Ameritrade (AMTD) and **Nortel (NT)** retreated during the quarter. We watched Ameritrade drift down, rather than sell, simply because their bottom line has seen phenomenal growth. Their earnings-per-share tripled in 2003 and is expected to double again through 2004. In April, during their first quarter earnings conference call, they stated that they expected growth to be slower in the second quarter, which has been tradition. We decided to hold our position due to their expected growth for the rest of the year. Ameritrade is so convinced that their stock is undervalued that they are buying back their own stock.

Our position in Nortel was affected most by investor paranoia. Like us, you may have read several articles this past quarter drawing similarities between Nortel and Enron. This simply isn't true for several notable reasons. First, Enron's entire financial structure was a façade. Their revenues were based on derivatives, their liabilities were hidden through off-shore entities, and their cash position was weak. Enron didn't implode because of their accounting fiasco. Their stock had already dropped 50% before any malfeasance was discovered. At the start of 2001, Enron's stock was at \$80. Investors did not get wind of anything suspicious until August of 2001 when the CEO, Jeffrey Skilling, abruptly resigned and the stock was at \$43. Conversely, Nortel has confirmed that their revenues and cash position are legitimate. To me, those two items are the most crucial elements as I weigh Nortel's future. My management experience in the accounting department of a high profile, public company educated me in the types of shenanigans that Nortel's previous management was playing. While unscrupulous and fraudulent, there has been no long-term impact to Nortel operationally. Nortel is continuing to win contracts and position themselves for growth. Although Nortel's previous management manipulated earnings, their revenue stream remained sound. Additionally, I'm very pleased to see the reaction of Nortel's directors to past imprudence. Secondly, the economy was slowing down at the time of Enron's demise. This further exacerbated the situation and led to their bankruptcy. On the other hand, the economy is improving now and providing support for Nortel



to grow. Therefore, while their drop is most unfortunate, we expect the stock to fully recover and continue to perform.

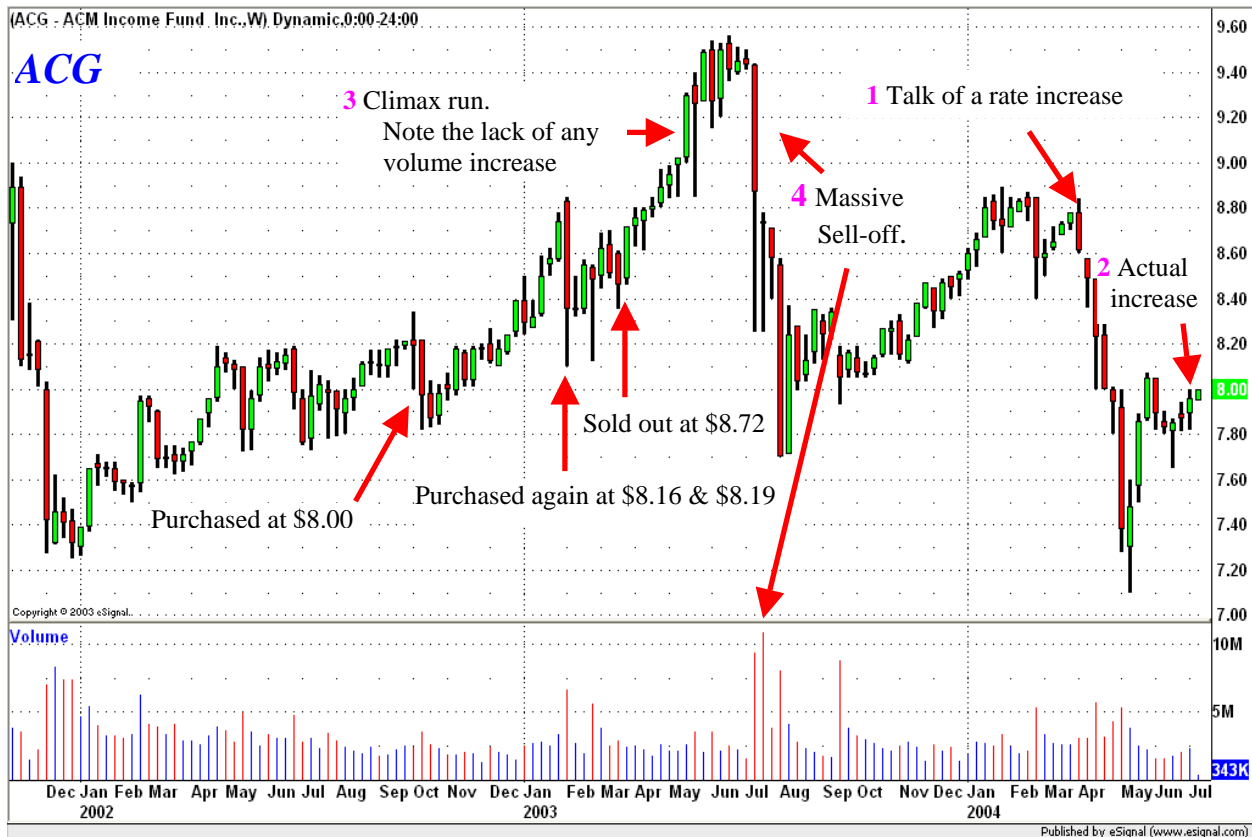
Thoratec (THOR) and **Seriological (SERO)** are both providers of medical products. We've been waiting a long time for THOR to breakout. As the only FDA approved provider of artificial heart devices, they should be one of the hot stocks on the street. Unfortunately, their management team does not appear competent enough to marginally predict quarterly results. Therefore they have lost credibility among many analysts and are susceptible to extreme price volatility. We were looking forward to their second quarter results when they made a surprise announcement that they would miss their earnings estimate by a nickel. In our opinion, most investors overreacted and pushed the stock way down. We remain bullish on them due to Medicare's significant reimbursement increase for their product starting in October of 2004, and as the only heart assist alternative for patients waiting for a heart transplant which normally takes over a year.

We bought SERO as it was breaking out of a common pattern in March. The stock advanced over the next several weeks until the overall market influence restrained it's trend. We noticed that it had a tendency to retreat to its 200 day moving average line and then sharply bounce up (1). We did not react to SERO's slide due to the light volume it was experiencing during this pull back and it bounced up again as we anticipated in early June. Concerning their potential growth, in June the U.S. Patent Office issued a patent on SERO's proprietary purification process, which inactivates infectious prions. Prions are defective proteins that cause "mad cow" disease.





Our favorite bond fund is the **ACM Income Fund (ACG)**. The following chart shows the effect of the threat of an interest rate hike in March (1) and the lack of any additional fallout when the Federal Reserve actually raised interest rates ¼ point (2). We owned this closed end fund from late 2002 to early 2003 – the tail end of the bear market. When the bull market began in late March of 2003, we sold the bond fund and returned to the equities market. ACG continued to grow and had a textbook “climax run” (3) which is characterized by a rapid price climb without any corresponding volume increase. These types of movements almost always are followed by a massive sell-off.(4). Our timing wasn’t perfect, but we locked in our profits and exited before the storm hit. We now see that ACG seems to be leveling off and are contemplating a major purchase in that fund. They pay a monthly dividend of \$.0675 (i.e. \$.81 annually) that translates into a 10% yield. Additionally, this closed end fund offers more liquidity and efficiency than directly holding bonds at this time.



Although there hasn’t been much noticeable activity this past quarter, we continued to diligently search out new opportunities. On average, we filter through hundreds of stocks per day and select the top 40 stocks based on our criteria. We then track these 40 companies on a daily basis. However, this mix of 40 companies is constantly changing as we discard the laggards and start to track new rising stars.



Other Business

We appreciate all of your referrals to us. However, in order to encourage even more referrals to us, we will wave your next quarterly fee if you refer a new client to us.

The quarterly advisor fees have been charged to your accounts this week. If you have any questions about this analysis, please do not hesitate to call me. Thank you for your continued patronage.

Sincerely,

A handwritten signature in blue ink, appearing to read "Jonathan Davey", is written over a horizontal line.

Jonathan Davey, CPA MBA
Registered Investment Advisor