



## Fourth Quarter 2003 Analysis

2003 will be remembered as a year of recovery – the year the worst bear market in our generation finally came to an end. Back in March when the rally began, we tentatively began to move back into equities. Everyone's main question was the sustainability of the rally. After all, there had been four bear market rallies since 2000, all of which proved to be short lived. We put aside our emotions and relied strictly on historical analysis which indicated that the beginning of every bull market is when the largest gains are realized. Most of our activity took place in the second and third quarters. Fourth quarter values suffered from long-awaited profit taking, and our acquisition rate notably slowed. However, as we look at the first quarter of 2004, we see opportunities in several sectors and anticipate a very active year of trading.

The 2003 economy was influenced by several significant factors:

- the lowest interest rates in 50 years
- record mortgage refinancings
- a summer tax cut
- corporate belt-tightening.

These factors helped spur 3<sup>rd</sup> quarter GDP growth to a 20 year high of 8.3% – 19% higher than the previous year. This translates into an optimistic outlook for 2004. The recovery has been confirmed, business confidence is high, the cash flow of companies has substantially improved, equity prices appear attractive, and the Federal Reserve seems content to keep interest rates low.

### Our Holdings & 4th Quarter Activity

It has been said that investing is more of an art than science. Fundamental research is the science and technical analysis is the art. The beauty of adding technical analysis to our standard fundamental research is that it provides a risk management tool through the use of stop orders and the like that can often cushion a downside blow. Instead of waiting for news and reacting, we are looking at technical ingredients like the moving average and trend lines. Stocks form patterns, our charts show these patterns, and it's called technical analysis. Stocks values will follow money flows. We believe that the market, by its very nature, is technical. The value of our portfolio is not determined by what the company does; it's determined by where the stock is selling. Technical analysis is the use of the price and volume pattern of the stock itself, not the company yardsticks to forecast the stock price. In the end, it's not the company, but the stock that determines how well you are doing financially.

The annual performance of our clients' accounts ranged from a high of 18% to a low of -8%. The average of all accounts was about 3%. This wide range was due primarily to the level of involvement of each account during the initial market rally. As you can see in our trading activity below, the largest gains were scored in the spring. Our only losses were realized during the late summer and autumn correction. During this time, several new accounts were opened and significant positions were placed in those few stocks that realized losses. Overall we are pleased with our performance. Of our 17 trades listed below, we were correct on 70% of them. Of those stocks that we sold at a loss, most of them reversed their declines. This confirmed that our stock



selections were accurate, but we should have allowed more flexibility in their trading range due to the unusual state of the market. We were still cognizant of the market's previous sharp reversals and decided to be extremely conservative in cutting losses.

AMTD, LAVA, DGIN, GDT, IHP: When it became apparent that the autumn correction was going to stifle emerging breakouts, we locked in our gains and realized our losses on Ameritrade, Magma Design, Digital Insight, Guidant, and IHOP. We see continued opportunity in Ameritrade and just repurchased them yesterday.

NCEN, FMT, DRTE: New Century Financial and Fremont General, both real estate financing companies, and Dendrite International, a pharmaceutically oriented software company, were purchased in late October when the market appeared to rally again and they moved up sharply on heavy volume. However, we sold fairly quickly when the market started to correct in November and their breakouts faltered. Although we were two for three on these purchases, the actual dollar gain-to-loss ratio realized was over 4.5 to 1 – meaning that for every \$1 lost on Dendrite was offset by \$4.50 in gains on New Century Financial and Fremont General.

### ***2003 Investment Activity***

Company Name	Purchase Date	Purchase Price	Sale Date	Sale Price	Gain/Loss Percentage	Notes
IRT REIT	01/30/2002	\$11.15	02/10/03	\$12.01	17.6%	Dividend Adjusted
IRT REIT	06/12/2002	\$11.95	02/10/03	\$12.01	4.6%	Dividend Adjusted
Peet's Coffee & Tea Inc.	05/17/2002	\$17.10	08/04/03	\$19.65	14.9%	
ACM Income Fund Inc.	10/30/2002	\$8.00	03/31/03	\$8.72	13.3%	Dividend Adjusted
ACM Income Fund Inc.	02/06/2003	\$8.17	03/31/03	\$8.72	7.6%	Dividend Adjusted
Coventry Health Care Inc.	04/14/2003	\$33.98	04/29/03	\$38.05	12.0%	
Mid Atlantic Medical Services	04/30/2003	\$42.50	07/18/03	\$52.78	24.2%	
Centene Corporation	05/16/2003	\$23.53	07/12/03	\$24.73	5.1%	
AdvancePCS	06/05/2003	\$35.64	06/23/03	\$36.31	1.9%	
Ameritrade Holding Corp.	07/23/2003	\$9.65	10/03/03	\$13.02	34.9%	
Magma Design Automation Inc.	08/07/2003	\$21.22	10/02/03	\$18.05	-14.9%	
Digital Insight Corp.	08/18/2003	\$22.64	09/29/03	\$19.36	-14.5%	
Guidant Corporation	08/27/2003	\$50.35	09/29/03	\$46.50	-7.6%	
IHOP Corp.	08/27/2003	\$35.95	09/29/03	\$31.92	-11.2%	
New Century Financial	10/23/2003	\$34.70	11/07/03	\$37.10	6.9%	
Dendrite International Inc.	11/07/2003	\$16.70	11/17/03	\$15.50	-7.2%	
Fremont General Corp.	10/27/2003	\$16.01	11/17/03	\$16.40	2.4%	

### ***Current Holdings:***

THOR: We allowed Thoratec Corporation a wider trading range. We decided to hold onto Thoratec eventhough it fell below our standard 8% cutoff. Thoratec's 4<sup>th</sup> quarter decline was unusual because of consistent, methodical, low volume sell-offs. We knew that several scandal ridden, mutual funds held very large positions in Thoratec. Based on huge investor redemptions of these mutual funds, we felt that those mutual funds were divesting their holdings, but anticipated other mutual funds to step in and support the stock price. While our assumption was correct, this support did not materialize until the beginning of 2004. Though Thoratec's slide affected virtually every account during the 4<sup>th</sup> quarter, its decline has since reversed and has recovered a remarkable 13% in just the first 8 days of January. Considering Thoratec's strong



fundamentals and that it's the sole provider of patented artificial hearts, we feel that it should return a very nice gain this year.

TCR: We made an additional purchase of Cornerstone Realty Corporation, our longest held security, this past quarter. This was our second purchase of Cornerstone this year. Cornerstone started recovering along with the overall market in March. Although the current price is 18% below our initial purchase price last year, its consistent dividends have resulted in an adjusted loss of only 3%. The first quarter dividend in April 2004 will result in a dividend-adjusted gain on our initial purchase. Our dividend-adjusted gain from our purchase in September 2003 is 12%, and our most recent purchase in December is at a dividend-adjusted breakeven.

BLL, GPRO: Ball Corporation, a container provider, appeared to be positioned for a breakout. It never came and we decided to close out the position a few days ago, with a 3% gain in order to free up capital to take advantage of opportunities on the horizon. Gen-probe, a biomedical firm, caught our interest based on their new products and heavy volume price increases. They have been the most volatile stock in our portfolio. We have been as far down as -6.8% and planning to close out the position only to have it rocket up to as high as 21%. It's currently up 6%. We think that it has the fundamentals and technicals to go much higher.

### Other Business

If Trustar prepares your taxes, you can ignore the rest of this section on taxes. It is very important you inform your CPA or tax preparer that some of your 1099R dividends do not qualify for the new corporate dividend tax rates.

The dividends received from Alliance Income Fund (ACG) are fully taxable and should be reported as interest income. They were not taxed at the corporate level and therefore are fully taxable at the individual level. The tax treatment on dividends of Cornerstone Realty Trust (TCR) are as follows:

- 5.0% taxed as Ordinary Income.
- 2.4% taxed as Unrecaptured Section 1250 Gain.
- 92.6% not taxed – Return of Capital (this amount decreases your basis in TCR, which will increase your capital gains and be taxed when the stock is eventually sold. It is imperative that you keep track of this number).

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. We appreciate your patronage.

Sincerely,

Jonathan Davey, CPA MBA  
Registered Investment Advisor