

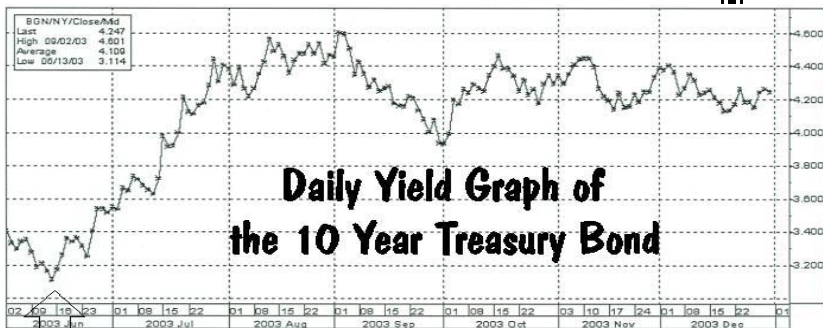


2ND QUARTER 2004

Have you felt as though your bond portfolio has been on a roller coaster ride lately? That's called volatility. Ever since the April 2nd surprising unemployment figure, bond vigilantes pushed bond prices down and yields up in anticipation of not one, not two, not three, but at least four future interest rate increases by the Federal Reserve.

So, here we are at mid-year with one 25 basis point increase in interest rates by the Federal Reserve. But bond yields are down and prices are up since the bloody month of April. The reason? Bond market investors became much too bearish and they over sold the market.

The "red hot" economy has simmered down according to current economic releases. Plus, it appears that the Fed will keep its promise to raise interest rates at a "measured" pace. We have included a yield graph of the ten-year US Treasury bond from June 2003 thru June 2004. On June 13, 2003 the bear market in bonds began; it's easy to see how the ten-year Treasury bond volatility has been on a wild one-year ride.



June 13, 2003 lowest yield in 45 years; 3.11%

As our last quarterly *Investment Outlook* identified: Your portfolio is postured for higher rates. Many of your corporate and municipal bonds are callable between now and their maturity dates.

Please review your quarterly report titled, *Portfolio Appraisal with Yield to Worst*. The "Yield to Worst" column is very important for us to review.

Take this example:

Northrop Grumman
9.375% due October 15, 2024
priced at 106.27, yielding 2.63%.

You intuitively know the 2.63% yield couldn't possibly be the yield to maturity. It is the "Yield to the Worst Call" date of October 15, 2004. And you can see, if for some foolish reason, Northrop Grumman did not call the bond in October, each year that passes, your yield increases handsomely.

Take a look at just how the yield increases:

Call Date	Call Price	Yield
10/15/04	104.36	2.612
10/15/05	103.93	7.149
10/15/06	103.49	7.747
10/15/07	103.05	7.992
10/15/08	102.62	8.131
10/15/09	102.18	8.222
10/15/10	101.75	8.289
10/15/11	101.31	8.340
10/15/12	100.87	8.382
10/15/13	100.44	8.417
10/15/14	100.00	8.448

To state the obvious, these bonds were purchased as a money market substitute with the almost certainty, they will be called in October. You are not stuck in a low yielding long-term bond.

Look at this municipal bond example: California State Public Works Board 5.375% due March 1, 2012 priced at 107.312 for a 2% “Yield to Worst”.

As you can see from the chart, the worst call is March 1, 2006. If the bond lasts to maturity, the actual yield is 4.242%.

Call Date	Call Price	Yield
3/1/06	102	2.000
3/1/07	101	2.836
3/1/08	100	3.222
3/1/09	100	3.643
3/1/10	100	3.914
3/1/11	100	4.103
3/1/12	100	4.242

For non-callable bonds, the Yield to Worst is the same as the “Yield to Maturity”.

Another column on your report to focus on is labeled, *Pct. Assets*. The bonds in your portfolio are listed in maturity date order. Add up the Pct. Assets or Percentage of Assets maturing next year, 2006, and 2007. You will see we are rolling over or calling a percent of your portfolio almost every year.

All of this verbiage boils down to this: As interest rates move, your callable bonds will either be called or you will receive a higher yield. A portion of your portfolio matures almost every year to roll over and hopefully replace with higher yielding paper. My personal portfolios are designed exactly like yours; staggered maturities, with some callable and some non-callable bonds.

If your net equity increases or decreases month to month and you hold your positions until maturity, you will receive your yearly interest and full face value at maturity. The scenario is very different for stock market investors. Poor souls. All this year the market has gone sideways, they’ve earned little to no dividend income and stocks, unlike bonds, have no maturity date.

We agree with the current thoughts of the Chief Economist of Goldman Sacks. A 6%-7% total return in stocks is about all we expect over the next few years. Warren Buffet has the same opinion. If we are all correct, your bond portfolio may have some bumps in the road, but no potholes and no waiting for a rally to bail you out like the stock investors are hoping for.

If you would like further explanation of our thoughts or comments, please call any time.

Wishing you a wonderful summer,

Marilyn Cohen