

True North

Compass Financial Consulting, LLC

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Providing Financial Direction

SUMMER 2003

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Year To Date

Review

- DJIA... +7.7%
- S&P 500... +10.7%
- Russell 2000... +17.0%
- MSCI EAFE... +7.6%
- 10 Yr Treasury... +4.6%

TRIVIAL PURSUIT

Where is the corporate headquarters of Forward Air?

The first person to give us the correct answer via our email at kraus@financialdirection.com will be awarded a \$50 gift certificate to Lowes (we figured very few of you could use a gift certificate for Forward Air's services unless it was to ship your recently graduated child's stuff off to him before he got the idea to head back home). We will only respond to the winner, whose name along with the correct answer will be published in the next newsletter.

THE DEATH OF EQUITIES: Why the age of equities may be over.

Excerpts from a recent Business Week article.

"At least 7 million shareholders apply."

have defected from the stock market. If the institutions, who control the bulk of the nation's wealth, now withdrew billions from both the stock and bond

markets, the implications for the U.S. economy could not be

worse. Until now, the flight of institutional money from the financial markets has been merely a trickle. But it could turn into a torrent. On Wall Street, the flight from stocks has forced firms to push alternative investments hard- thereby drawing still more money from the stock market. Further, this 'death of equit[ies]' can no longer be seen as something a stock market rally- however strong- will check. To bring equities back to life now, accounting policies would have to be made more realistic and tax laws rewritten. But these steps may not be enough."

" Even if the economic climate could be made right again for equity investment, it would take another massive campaign to bring people back into the market. For better or for worse, then, the US economy probably has to regard the death of equities as a near permanent condition- reversible some day, but not soon. Says Alan B. Coleman, dean of SMU's business school, 'We have entered a new financial age. The old rules no longer

"Today, the old attitude of buying solid stocks as a cornerstone for one's life savings and retirement has simply disappeared.

The stock market is just not where the action is at."

Okay, my guess, is that right now more than one of you has your phone in hand

ready to call and request we sell your stocks so you can put the money under your mattress. I would completely agree that the article purveys a fairly depressing outlook on the market. But before you make the call, you may want to know one thing—the "recent" article I am quoting from was written and published in Business Weeks August 13, 1979 issue. That is right, 1979. That day the Dow Jones Index closed at 875.26. Today, it stands close to 9,000 equating to a 928% total return over the past 24 years or 10.2% annually. This one article almost single-handedly shot off the flare that told smart investors it was time to jump on the "bull." You could consider it the shot heard through the markets. Of course, what it initially did was scare and panic a lot of investors who were not deeply rooted in their belief of the long-term nature of the markets. I liken it to the same sentiment that has surfaced over the past couple of years.

Do we believe we are on the cusp of another great bull market like we saw through the '80s and

'90s? No, but I also do not believe we are at the opposite extreme where it becomes necessary to issue the stock market a death certificate. Remember, back in the '70s we were dealing with a host of issues that were just as scary and potentially devastating as the issues we face today. Investors were faced with runaway inflation, terrorism (don't forget we had 52 hostages being held in Iran in 1980), the Cold War, numerous accounting scandals, a rush to gold, and Charlie's Angels. Today, we have potential deflation (see page two), terrorism and its resulting war, accounting scandals, a rush to gold, and, you guessed it, Charlie's Angels. I have even seen the re-emergence of the dreaded bell-bottoms. But in contrast to any death sentence, we all know the market "came back to life" in this last quarter even while the economy still struggles to find its footing.

We still expect continued volatility and temporary setbacks along our investing futures, but remember, we are in this for the long haul. As the Business Week article reaffirms, "Be careful what you read." Remember, the majority of financial articles and television shows are meant to drive you to either fear or greed, both of which prove beneficial to their advertisers but deadly to your long-term financial success.



Market Update—2nd Quarter 2003

What is deflation? I am sure many of you have been hearing about the threat of deflation on CNBC or any of the other shows that are supposed to be stricken from your daily viewing schedule. So, we wanted to give you a brief primer on deflation and the possible impact it could have. Deflation is when prices for goods and services begin falling as opposed to inflation where prices are increasing. Whether or not deflation is bad depends on the reasons for the declining prices. Deflation that results from workers becoming more efficient can be a good thing whereas deflation caused by lack of consumer demand or structural problems in the economy, as is the case in Japan, is a bad thing. Unlike Japan, the US has good demand and most importantly allows inefficient companies to fail. Japan has kept the supply of goods and services artificially high by allowing poorly run companies to stay in business. Keeping the supply of goods and services greater than their demand continues to support a deflationary environment in Japan.

Deflation has its biggest impact on debtors. While prices and/or wages are falling, a debtors obligation remains fixed. This causes the debt to be much more “costly” and could lead to much higher default rates on loans. The good news is that with interest rates at such incredibly low levels, debt servicing for both companies and individuals does not appear to be excessively burdensome.

Most historians reflect on two U.S. deflationary periods. One was during the great depression. No doubt about it, that time period was financially lousy from all angles. However, many of the economic “safety measures” in place today (e.g., the Federal Reserve and its ability to adjust short-term interest rates, money supply, etc.) were not functioning back in those days. With these safety measures and our country’s true “super power” status, many find it difficult to be able to rationalize how such a doomsday deflationary scenario would reappear.

Another example of a deflationary period in the U.S. economy was from 1870-1900. Here, deflation was a result of the U.S. transforming itself from an agrarian economy to an industrial economy. One could see how that time period might share some similarities with our current business environment where we have automation and technology to spur growth. We are shifting from an industrial economy to a technological one. It is interesting to note that the late 1800’s was considered a period of strong economic growth and rising stock prices. What is key is that in a deflationary period even small gains in stock prices can be rewarding because the real return is high.

Let us remind you again that those who face the most difficulty in any potential deflationary period are those with a high debt load. If you live below your means, you will have less concerns if such an environment ever presents itself.

Thoughts around shareholder lawsuits

Since we manage a portfolio of individual stocks, we occasionally receive a packet from some faceless attorney group seeking to establish a class action lawsuit against a company we may have owned or currently own in our portfolios. What investors need to be concerned with, however, is the “shoot first, ask questions later” style many of these attorneys and their lawsuits employ. What we mean, is that many times, a lawsuit is pursued simply because a stock price dropped. What happens is that these law firms watch for daily price drops in any stock, and if the decline meets their definition of “big enough,” they begin their lawsuit process. Their goal is to hopefully capitalize on investor frustration regarding the price drop which in turn will generate the attorney’s billings and fees. Unfortunately, the fees they collect are really at the expense of all investors as a company’s management must incur the expense and distraction of addressing these fly by night lawsuits. Many times you will see a company settle because they understand the cost of fighting even a baseless claim will be more than just settling out of court and moving on. In this scenario, the attorney pockets their fees and investors realize a judgment equating to a few pennies a share. I am sorry but I cannot think of any more blatant example of “guerrilla” tactics to generate fees.

Those of you holding Michaels stock have a perfect example of this style of lawsuit. A few months ago its price dropped over 10% in one day. Over the next week, there must have been a dozen lawsuit notices. Today, however, Michael’s price is not only back to where it began but it’s higher. The suit was baseless and driven only by the price drop. Lawsuits do have their place in corporate America when investors are faced with blatant wrongdoings. But the only place for these baseless, price drop type lawsuits is the bottom of an investor’s trash can.



Trivial Pursuit from Spring 2003

Question for April, 2003

Well, here is a question that should scare all you parents with children in college. A survey was recently done by MonsterTrak.com to determine the percentage of graduating seniors who plan to live with their parents after college. What is that percentage? The first response within 5% of the exact percentage from the MonsterTrak survey will win.



Answer for April, 2003.

The correct answer was 63% and was provided by Malcolm Widmann. The Widmanns win the \$50 Michaels gift certificate and for those of you with college age kids, that study should make you afraid, very afraid.

How does the old saying go? "One man's junk is another man's treasure." Well, this fund holds junk that we believe over time will be treasure. While Payden has tried to glamorize the fund by naming it the High-Income fund, if you look into the portfolio you will see that what it actually holds are more affectionately known as "junk" bonds.

As a basic primer on the bond market, let me explain how credit risk affects the interest which entities must pay investors in order to hold their bonds. The US Government is considered the safest credit risk in the world—meaning that if you lend them your money, you are virtually guaranteed to get back the full amount plus whatever interest they agreed to pay. The opposite extreme would be third world countries, start ups or companies experiencing severe financial troubles, think WorldCom. Throw in several of your family members and that is the definition of "bad credit risk." So the question must be begged, "If your

MUTUAL FUND SPOTLIGHT

Payden High Income Fund

YTD Return: 10.55%

5 year annualized return (6/26/03): 3.99%

"You can always find treasure in a pile of junk."

—Grandfather Perry

less-than-reliable Uncle Larry was going to pay you the same interest rate as the US government, who would you lend your money to?" Of course, the US Govern-

ment. Thus, government bonds set the floor for interest rates. There is no way anyone would lend money to a non-US government entity for an interest rate equal to or less than what they could get from the US Government. So, if your Uncle Larry or the country of Argentina wants to borrow money, they have to offer a higher interest rate. The greater the chance you might not see your money again, the higher interest rate you are going to demand for your money. Got it?

This is where the Payden High Income fund comes into play. They invest in what

is considered low quality "Uncle Larry" type bonds, which is something you definitely should not try at home. There are a few agencies that rate entities based on their perceived credit risk. The ratings can range from a "AAA" to the dreaded "Not Rated." These ratings help determine what a company will have to pay in interest for the ability to borrow. The Payden Fund hangs out in the middle tier of credit quality, the "B's", which means they will avoid any major surprises but may lag in a wild "up market."

Overall, they achieve what we strive for—consistency. Over the past few years, several junk bond managers have lost significant amounts of money placing bets on Enron or WorldCom. Payden, however, has bragging rights in that they have yet to have a bond go bust on them, which is quite a feat in the "high income" environment and is the reason we like the management of this fund. My grandfather, who once owned an antique store, used to say, "You can always find treasure in a pile of junk." We expect Payden to do the same.

In the era of complex companies, where it sometimes takes hours to comb through their financials, it sure is nice to have a company that has one of the simplest financial statements around. Forward Air ("FWRD") has some cash, a few receivables, some property, a few payables and, finally, equity. This is a company that understands the market it is serving and serves it well.

FWRD offers its customers scheduled ground transportation of cargo as a cost effective, reliable alternative to air transportation.

They transport cargo that generally must be delivered at a specific time but is less time-sensitive than traditional airfreight. A typical shipment consists of a pallet load of freight, such as computers, telecommunications equipment, machine parts, and trade show exhibit materials, each with an average shipment weighing

INVESTMENT PROFILE

Forward Air

Current Price: \$25.17

2003 YTD Return: +29.78%

"...picture Forward Air as a mini-UPS but with a need for significantly less capital..."

700 pounds. It serves its customers by locating terminals (75 terminal locations

across the US) at or near airports and receives shipments at its terminals, then transports them by truck to its central sorting facility or to one of its eight regional hubs, where they are unloaded and sorted. After sorting, the shipments are reloaded and delivered to the terminals nearest their destination. You can picture FWRD as a mini-UPS, but with a need for significantly less capital since it purchases all

of its transportation needs from outside trucking companies. Thus, what you are getting is a logistics company that helps businesses move their items from one location to another in the most cost effective and efficient means possible.

Forward Air came to our attention in the latter part of last year as a result of its inclusion in the Forbes "200 Best Small Companies in America." As we dug deeper into the company, we saw a lot of things that we liked. The company has no debt, \$60 million in cash, is buying back up to 10% of its stock, which increases earnings to the remaining shareholders, and met all of our target metrics. Its 30% rise in price this year once again shows the benefit of the markets volatility, allowing us to buy great companies at temporary and sometimes insanely low prices.

Our recommended "to-do" list for the summer.

➤ Spend a week this summer taking a siesta away from the media. In other words, deprive yourself of reading, watching television, surfing the internet or listening to the radio. You might actually find that it won't harm you and actually gives you freedom from worry. You may find yourself with more energy to work on relationships or time to think and become more focused.

➤ Focus on our abundance. We challenge each of you over a 30-day period to start a list and add one item each day that you are grateful for to the list. This will change your focus from what you have lost in the market or at your job to what you have in abundance. Reviewing this list on a regular basis will help you focus on how truly you are blessed.

➤ Recommit to tracking your spending plan on Quicken. One of our clients recently gave us a great idea. He suggested that we develop a Quicken template that would mirror our planning output and the 5 uses of cash. By providing this template, a client who wanted to begin the process of monitoring their spending and savings plan would be able to jump right in and use categories/reports geared toward their financial plan. If you are interested in this tem-

plate, please let us know and we will get it out to you right away. Thanks for the great idea. We always encourage and appreciate ideas or tips about things we can do to make your financial lives easier or better.

➤ Make your dinner time a bit more peaceful by registering on the national "do not call" list. It is easy and can be done at www.donotcall.gov.

➤ Review your wills. Over the past few months, I have shared with several clients the wording of our wills. They sufficiently cover all bases should something happen to Sue and I before our children finish college. Our objectives were to ensure that the responsibilities of raising our children would not be a financial burden for the

Things to think about while you are at the beach.

guardians, and that whatever was left over would not be a hindrance to our children reaching their full potential. Please note that each of you are the best ones capable of determining what is right for each of your families. There is no right or wrong answer, and your answer can change over time as you see your children mature. Many of you expressed an interest in duplicating the wording of our wills. Here are some of the key components of our current wills:

Of course, we can give you the exact wording used in our wills and assist you with any changes you may want to make. In most cases, it would only require a quick codicil to your current document. Also, maybe the above wording spurs some other intentions you had not thought of before. We would be happy to discuss and/or coordinate this wording as well.

• A lump sum distribution to the guardian for a house add on or upgrade.

• A flat sum each year to the guardians to help with living expenses. The amount is adjusted each year based on the increase in inflation.

• Sufficient funds to pay for private grade school for both our children and the guardian's children. We wanted private school to be an option for our children and would not want there to be an issue if our children were going to private school, but the guardians could not afford to send their children to private school.

• When the youngest child turns 25, whatever money is remaining would be split 2/3 to charity and 1/3 to the kids.



Of course, we can give you the exact wording used in our wills and assist you with any changes you may want to make. In most cases, it would only require a quick codicil to your current document. Also, maybe the above wording spurs some other intentions you had not thought of before. We would be happy to discuss and/or coordinate this wording as well.



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