



Out Of the Blue

Fourth Quarter (and Year) Review

by Walter S. Frank, Chief Investment Officer

It was so unexpected. The fourth quarter rally of last year, we mean. Up until then the market had been struggling to keep its head above water. Then, out of the blue with the election still months off, the pickup that began in August turned into a full-fledged rally that refused to quit. When the year was over the Vanguard 500's total return magically turned out to be 10.7% (9.2% of which came in the fourth quarter).

When we say out of the blue, we don't mean to imply that there were no reasons for the market to rise. There obviously were (in hindsight). What we do mean is that there was no one event, no obvious trigger setting off a market rally. In fact, we were so puzzled by this almost spontaneous combustion of a rally, that we headlined an article in October, "The Rally From Nowhere."

Not only were we (and everyone else) surprised by the rally, we were also surprised by its staying power. As with everything else in the market, where performance is the measure of all things, a trend tends to be reinforced by the bandwagon effect (if it's moving, hop on), and that was certainly the case last quarter.

Looking back, we are still a little surprised by the rally. But then we were a little surprised earlier in the year by the inability of the market to gain any footing. Perhaps it was oil prices. Or perhaps it was the blah economic news, but the market simply could not overcome a persistent skepticism much of last year, even though the profit news was as good as it gets. Finally, when we least expected it, everything clicked.

The portfolios

The model portfolios, naturally, benefited from the rally. We are pleased to report that six of the seven growth portfolios outperformed the Vanguard 500 Index Fund for the quarter. (Moreover the same six also outperformed the Vanguard fund for the year, and the seventh tied it.) (See Table 1.)

Market Trends

	Trailing 12-Mo Trend	Forward 6-Mo Estimate
Economy	Higher	Higher
Interest Rates	Flat	Higher
Dollar	Lower	Lower
Inflation	Lower	Higher
Dow	Flat	Higher
NASDAQ	Flat	Higher
Europe	Higher	Flat/Higher
Japan (Nikkei)	Higher	Higher
Hong Kong (Hang Seng)	Higher	Higher

Table 1
2004 Portfolio Performance

Portfolio	4th Quarter	Yr.	3 Yr.
<i>MONEYLETTER</i>			
Venturesome	11.7%	13.4%	54.6%
Moderate	12.3	16.3	59.6
Conservative	6.8	11.4	28.8
Fidelity			
Venturesome	10.3	12.1	33.3
Moderate	10.0	13.3	36.6
Conservative	6.4	10.6	18.3
Vanguard			
Venturesome	9.3	11.8	27.1
Moderate	8.8	12.3	27.5
Conservative	6.0	10.7	15.1
<i>MONEYLETTER</i> Select	12.1	12.2	N/A
Vanguard 500 Index Fund	9.2	10.7	10.8

The top-performing among our portfolios were the *MONEYLETTER* all-family portfolios. This was due to the fact that those portfolios can roam over our entire fund universe, as opposed to the fund family portfolios that are restricted, obviously, to the fund offerings of the family concerned. Last year was not a vintage year for either the Fidelity or the Vanguard fund families. Their portfolio results, while nothing to sneeze at, reflect that fact.

Another result from last year which was contrary to expectations was that the Moderate portfolios outperformed the Venturesome for the year. This was not true for the fourth quarter, except for the *MONEYLETTER* portfolios. An explanation for the yearly difference comes immediately to mind, and that is that the Venturesome portfolios carried a larger cash position, awaiting reinvestment, after the sale of our Asian and international positions last May.

While the differing cash positions explain the yearly results, they do not explain why the *MONEYLETTER* Moderate slightly outperformed the Venturesome in the fourth quarter. The explanation for that comes from the individual fund holdings, not the allocations. The Moderate portfolio contains Baron Partners, the Venturesome portfolio does not... Baron Partners was up a mere 18.6% last quarter. That is enough to juice any portfolio's performance.

As for the year, we simply want to point out that we had double-digit returns all through the portfolio list. Notice, particularly, the 16.3% return of the *MONEYLETTER* Moderate portfolio, and the 13.4% return of the *MONEYLETTER*

(continued on page 2)

(continued from page 1)

Venturesome portfolio. Notice also the returns of the Conservative portfolios. Those portfolios, by construction, are not growth portfolios. Yet the combination of stock and bond funds managed to produce returns on a par with that of the Vanguard 500. Some of the return was due to good fortune. Who would have predicted that as the Fed moved to raise short-term rates, bond prices would hold steady or even rise.

Most of the time in discussing performance, we tend to concentrate on the short-run, the quarter or the year. That is the nature of an advisory newsletter. Every now and then it is worth taking a longer look. As Table 1 shows, the asset allocation growth portfolios outperformed the Vanguard 500 Index Fund by a considerable amount over the three years beginning in 2002. In fairness, we must point out that these were not great years for the S&P 500. Large caps, which dominate the index, have been out of favor all that time, while small caps and overseas markets have been in favor. Still, the difference in performance is not simply a matter of market trends.

One final word about portfolio performance. Keep in mind that when a fund closes we remove it from the model portfolios and replace it with an open fund. In almost all cases funds that close are top performers. They are closing because they are performers and threaten to grow too large for comfort. Our practice means that last year we removed a fair number of top performers, such as RS Partners and FBR Small Cap, from our portfolios.

Funds and allocation

We made two allocation changes over the course of the quarter. First, we re-established an international allocation in September for the Venturesome and Moderate portfolios. International funds came on strongly as the year progressed, and as the panic over China's decision to restrain growth subsided. We established the new 10% allocation by reducing our cash position. Second, we doubled the international allocation in mid-November by shifting some funds from domestic to international uses. We ended the year then with the portfolios less concentrated domestically than they have been.

As for the individual funds in our portfolios during the quarter, the top performers list contains a surprise. The aforementioned Baron Partners is right up there, as you would expect, but there is one fund that won by a nose, and that is Fidelity Europe. (See Table 2.)

In fact, you will see that there are two international funds among the four funds in our portfolios that gained 17% or more last quarter. The only pattern that we can detect among the top-performing funds is that the international funds were aided by the weakness of the dollar, particularly against the euro. As for the domestic funds in the group, they are both mid-cap value funds. And last year was the year for smaller, that is small- or mid-cap, value. Of course, there are a great number of funds in those categories, and they did not all perform on a par with the top performers. In the end, it was just good stock-picking that won out.

Looking at the year as a whole, one feature of the year that stands out for us is that it was a difficult year to maneuver. We had oil, we had China, we had a deteriorating Iraq, and we had an economy that did not follow the script. We also had market that was no longer cheap after the blazing run in 2003. All this created a cautious attitude that held the market in check until the breakout rally.

We do not expect this year to be any easier on the nerves. Many of the issues facing the market last year still exist. A new complication is that we start the year off with the Federal Reserve sounding a bit more concerned that it is not moving fast enough. 2005 does not promise a to be piece of cake either. \$

Table 2
Portfolio Fund Performance
Selected Funds-4th Quarter

Fidelity Europe	19.1%
Baron Partners	18.6
Fidelity International Small Cap	17.4
RS Value (formerly Contrarian)	17.4
Dodge & Cox International Stock	16.1
Vanguard Europe	15.9
Fidelity Leveraged Companies	15.8
Artisan International Value	15.4

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Looking For January

The snows have come. The bitter cold is here. The football playoffs are in high gear. But where, oh, where is the January Effect? The new market year is simply not supposed to begin as this one did. This is supposed to be the month when all those small caps that were beaten down by tax selling last month come back to life as bargain hunters snap them up.

Ah, you point out, there was no tax selling, and the year-end rally carried right on through New Year's Eve. That is absolutely right, and provides the explanation of why the New Year has started off in such wretched fashion. The profit-taking we should have seen in December arrived one month late, and it drove the market down in the first two weeks of this year.

So far as we could see nothing else could account for the persistent selling we have seen so far. The economic numbers that have been released so far this month have been fine, in many cases better than expected. The profit reports have been dotted with disappointments, but have also had their share of pleasant surprises (think Apple).

Moreover, market valuations have improved slightly as profit estimates have held steady while stock prices have moved down 2% for the S&P 500, and as much as 5% for the small caps (Russell 2000).

Whenever selling persists, the first question that is raised is whether this is the beginning of something serious. (By "serious" we mean a severe correction or a bear phase.) Our answer to that is no. We do not believe that we are seeing anything more than delayed profit-taking.

A strong quarter

The economy ended last year surprisingly strong. We say surprisingly, because as we moved into December the concern about Christmas sales was widespread. As it turned out, retail sales were solid in December. Auto sales were particularly strong. Even if we exclude auto and gas sales (which move up and down with gas prices), adjusted retail sales were up a solid 0.6% last month. The Christmas season turns out to have been fine.

Industrial production last month also turned out to be stronger than expected. High tech production in particular stood out, growing at a very healthy 1.7%. And for the year, high tech production grew at more than 20%.

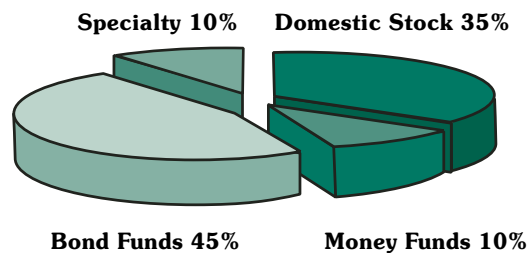
All in all, the expectation now is that the economy grew at better than 4.0% last quarter. Looking at the employment numbers for the quarter, we would expect to see another good productivity number.

The market

The implication of the growth number for the quarter is that we should see encouraging profit reports as they are released over the rest of this month. This is exactly what the market needs after the profit-taking we have seen. The economy has momentum going for it now. The momentum will slow some as we move into this year, but growth will still be market friendly. \$

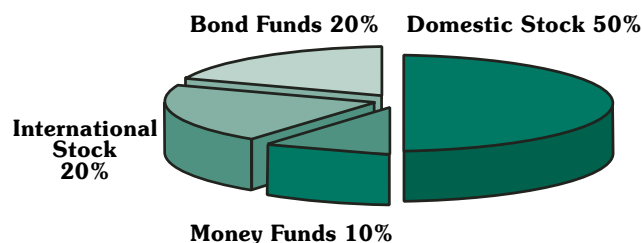
CONSERVATIVE

Seeks steady long-term growth of capital with limited short-term volatility



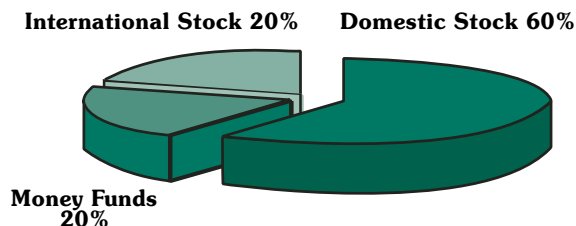
MODERATE

Seeks greater long-term growth than the Conservative Portfolio by taking prudent risks



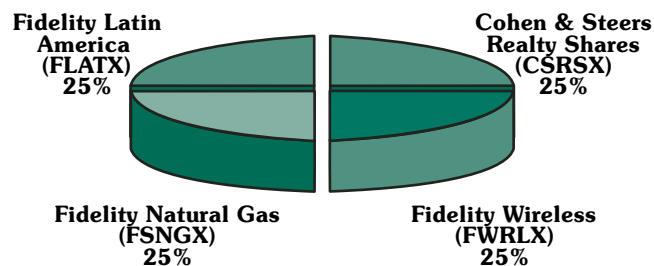
VENTURESOME

Seeks maximum long-term growth by accepting greater short-term volatility



SELECT

Seeks maximum long-term growth by assertively upgrading fund positions



Domestic Stock Funds

RANK	01/14 2005	1 Mo Ago	6 Mo Ago	Ticker Symbol	FUND NAME	Fund Type	Conservative	Moderate	Venturesome	TOTAL RETURN			PRICE PER SHARE	RISK		NTF/wtf
										1 mo.	6 mo.	12 mo.		Std. Dev.	Beta	
1	1	13	BPTRX	Baron Partners	MCGro	*	B	B	B	0.4%	25.7%	38.0%	\$16.75	28.6	1.26	FSW
2	2	5	RSCOX	RS Value (Contrarian)	MC	B	B	B	B	1.9	21.5	25.9	21.73	18.6	0.60	FSW
3	3	3	RSPFX	RS Partners (closed)	SC	B	B	B	B	-0.2	20.1	26.3	33.91	20.9	0.69	FSW
4	8	24	MUHLX	Muhlenkamp Fund	MCVal	B	B	B	B	1.4	19.5	22.0	78.05	27.9	1.24	FSW
5	5	7	FBRVX	FBR Small Cap (closed, 1%r<90d)	SCGro	B	B	B	B	2.3	17.9	24.4	40.97	23.4	0.82	FSW
6	9	106	BGRFX	Baron Growth (closed)	SCGro	B	B	B	B	0.2	19.1	21.9	44.24	18.4	0.72	FSW
7	11	55	BARAX	Baron Asset	MCGro	B	B	B	B	1.2	17.9	23.0	51.67	21.2	0.94	FSW
8	7	136	MXIX	Marsico 21st Century (2%r<30d)	LC	B	B	B	B	-0.8	18.7	15.4	11.61	21.1	0.95	fsw
9	10	64	LLSCX	Longleaf Partners Smallcap (closed)	SCVal	B	B	B	B	-1.1	17.1	17.8	29.18	19.2	0.80	fw
10	32	108	NPRTX	Neuberger Berman Partners	LCVal	(B)	(B)	(B)	(B)	0.8	15.8	16.9	25.01	20.7	1.10	f
11	-	-	MOPIX	MainStay Small Cap Opportunity (closed)	SCVal	B	B	B	B	0.4	15.3	17.3	17.80	17.5	0.63	FSW
12	6	9	FLVCX	Fidelity Leveraged Co (\$10,000, 1.5%r<90d)	MC	*	B	B	B	-1.6	16.1	16.1	22.17	36.3	1.39	Fw
13	15	69	JSVAX	Janus Contrarian	MC	B	B	B	B	-1.7	17.4	13.2	12.66	22.3	1.10	SW
14	27	4	TAVFX	Third Avenue Value (1%r<60d)	SC	B	B	B	B	0.6	12.7	21.2	50.98	17.2	0.79	FSW
15	77	132	BSCFX	Baron Small Cap	SCGro	(B)	(B)	(B)	(B)	1.3	14.1	16.1	21.77	21.5	0.79	FSW
16	22	37	FLPSX	Fidelity L P Stock (closed, 1.5%r<90d)	SCVal	B	B	B	B	0.3	14.1	16.1	39.29	18.0	0.75	Fsw
17	24	1	ARTGX	Artisan Mid Cap Value	MCVal	B	B	B	B	-1.0	12.4	21.7	16.49	19.8	0.87	FSW
18	29	107	JAVLX	Janus Twenty (closed)	LCGro	B	B	B	B	-1.4	13.7	18.4	43.38	17.3	0.93	FSW
19	31	73	MPEGX	MSI Mid Cap Growth	MCGro	*	B	B	B	-1.0	14.2	16.0	20.47	22.2	1.17	fsw
20	34	97	WGROX	Wasatch Core Growth (closed, 2%r<60d)	SCGro	B	B	B	B	-0.6	14.0	15.7	42.06	28.5	1.10	FSW
21	66	10	CGMFX	CGM Focus	SCVal	*	H	H	H	2.2	13.3	13.4	29.07	37.9	1.03	fsw
22	21	18	CRMMX	CRM Mid Cap Value Inv	MCVal	B	B	B	B	-1.2	12.7	18.8	24.94	18.9	0.78	FSW
23	19	76	VIMSX	Vanguard Mid-Cap Index	MC	B	B	B	B	-1.2	14.5	14.0	15.16	20.1	0.97	fsw
24	13	62	WBSNX	WmBlair S-C Growth N (closed, 1%r<60d)	SCGro	B	B	B	B	-1.6	14.4	14.0	24.57	30.1	1.12	FSW
25	28	150	SMDCX	Strong Advisor Midcap Growth	MCGro	H	H	H	H	-0.4	14.1	12.5	13.57	26.2	1.35	FSW
26	26	87	WMCVX	Wasatch Small Cap Value (closed, 2%r<60d)	SCVal	(B)	(B)	(B)	(B)	-0.2	14.0	12.5	5.34	26.6	0.96	FSW
27	33	53	BUFSX	Buffalo Small Cap (closed)	SCGro	*	(B)	(B)	(B)	-3.2	13.3	17.6	26.36	31.2	1.25	SW
28	110	85	CAMOX	Cambiar Opportunity	LC	H	H	H	H	0.9	12.8	12.3	16.52	18.4	0.94	FSW
29	25	239	BRAIX	Bridgeway Aggressive Investors 2	MCGro	*	H	H	H	-0.3	14.5	8.2	13.80	-	-	fsw
30	14	14	PRSVX	T. Rowe Price S-C Value (closed, 1%r<1yr)	SCVal	B	B	B	B	-2.4	12.5	16.3	34.29	18.0	0.69	fsw
31	47	59	DODGX	Dodge & Cox Stock (closed)	LCVal	(B)	(B)	(B)	(B)	-0.4	12.4	13.1	127.40	17.6	0.85	sw
32	23	78	VSEGX	Vanguard Strategic Equity	MCGro	(H)	(H)	(H)	(H)	-2.1	13.6	12.4	20.66	17.8	0.83	fsw
33	17	-	WEHIX	Weitz Hickory	SC	*	B	B	B	0.2	11.0	15.0	32.11	29.1	1.38	fsw
34	37	25	FDVLX	Fidelity Value	MCVal	H	H	H	H	-1.2	11.5	15.2	69.53	19.0	0.89	Fsw
35	54	165	MGRIX	Marsico Growth & Income (2%r<30d)	G&I	H	H	H	H	-1.0	13.2	10.1	17.29	15.2	0.75	FSW
36	55	224	JAVTX	Janus Venture (closed)	SCGro	*	H	H	H	-1.9	14.0	9.0	55.87	29.0	1.25	FSW
37	60	212	MFOCX	Marsico Focus (2%r<30d)	LCGro	H	H	H	H	-1.1	13.8	7.9	16.26	15.3	0.74	FSW
38	86	27	VWNFX	Vanguard Windsor II	LCVal	H	H	H	H	-0.1	10.5	14.6	30.24	16.2	0.82	fsw
39	50	19	TRMFX	T. Rowe Price Mid Cap Value	MCVal	H	H	H	H	-1.1	11.1	14.3	22.27	19.8	0.90	fsw
40	64	39	MQIFX	Mutual Qualified (1%) CIZ	MCVal	H	H	H	H	0.2	10.8	12.9	19.09	13.3	0.61	sw
41	44	93	JAENX	Janus Enterprise	MCGro	H	H	H	H	-1.9	11.5	14.2	36.44	21.4	1.09	FSW
42	12	26	VISVX	Vanguard Small-Cap Value Index	SCVal	(H)	(H)	(H)	(H)	-2.9	11.9	14.6	13.33	22.4	0.90	fsw
43	61	35	MPVLX	MSI Value Portfolio	LCVal	H	H	H	H	-0.8	11.3	12.8	17.46	20.6	1.05	fsw
44	41	51	MPSCX	MSI Small Cap Value (closed)	SCVal	H	H	H	H	-1.0	11.6	12.2	21.90	20.7	0.98	fsw
45	45	-	BPAVX	Boston Prtrs All Cap Value	MCVal	H	H	H	H	0.1	9.5	15.7	14.12	-	-	F
46	57	12	TGDVX	TCW Galileo Diversified Value N	LCVal	H	H	H	H	-1.5	11.0	14.1	13.02	19.8	1.03	FW
47	68	66	FFIGX	Fidelity Focused Stock (.75%r<30d)	LC	*	H	H	H	-0.2	11.0	11.8	9.94	17.2	1.00	Fw
48	76	188	USAUX	USAA Aggressive Growth	MCGro	*	H	H	H	-0.9	12.5	9.2	28.63	21.5	1.00	w
49	79	6	SMCDX	Strong Mid Cap Disciplined	MCVal	H	H	H	H	0.5	8.5	17.0	21.95	23.1	0.99	FSW
50	63	198	PBSVX	PBHG Small Cap Value	SC	H	H	H	H	-1.6	13.5	7.2	21.51	23.8	1.11	FSW
51	38	68	BPMCX	Boston Partners Mid Cap Value	MCVal	H	H	H	H	-1.5	10.9	13.6	12.52	20.1	0.93	FSW
52	20	-	LSCRX	Loomis Sayles Small Cap Value Ret	SC	H	H	H	H	-1.9	11.2	12.7	24.82	17.2	0.80	FSW
53	43	131	VEXMX	Vanguard Extended Market Index	MC	H	H	H	H	-1.7	11.9	10.2	30.15	21.5	1.02	fsw
54	51	15	TASCX	Third Avenue Small-Cap Value (1%r<1yr)	SCVal	H	H	H	H	-0.4	10.1	12.5	22.04	19.9	0.85	FSW
55	82	135	FDSCX	Fidelity Small Cap Ind. (1.5%r<90d)	SC	H	H	H	H	-0.1	11.0	9.8	19.31	16.7	0.58	Fsw
56	49	185	USCGX	USAA Capital Growth	MCGro	*	H	H	H	-1.5	13.5	5.6	7.23	23.9	1.13	fsW
57	16	2	BERWX	Berwyn Fund (1%r<180d)	SCVal	(H)	(H)	(H)	(H)	-2.3	10.5	13.6	27.82	22.3	0.77	fsw
58	102	217	USAAX	USAA Growth	LCGro	H	H	H	H	-1.6	12.3	8.1	13.56	20.9	1.14	-
59	78	163	NBNGX	SIF Mid Cap Growth (2%r<30d)	MCGro	*	H	H	H	-1.7	11.2	10.8	10.82	23.5	1.23	FSW
60	114	74	HAVLX	Harbor Value	LCVal	H	H	H	H	0.3	9.9	10.6	16.15	18.1	0.94	Fsw
61	88	109	VCVLX	Vanguard Capital Value	LCVal	H	H	H	H	-0.9	11.2	8.9	11.34	-	-	fsw
62	71	121	NMANX	Neuberger Berman Manhattan	MCGro	*	H	H	H	-1.0	10.6	10.5	6.76	23.4	1.15	f
63	94	38	VIVAX	Vanguard Value Index	LCVal	H	H	H	H	-1.0	10.2	11.3	20.88	18.6	1.03	fsw
64	90	241	FIGGX	INVESCO Small Company Growth	SCGro	*	H	H	H	-0.7	13.1	3.5	12.10	24.2	1.15	FSW
65	81	161	PRNHX	T. Rowe Price New Horizons	SCGro	*	H	H	H	-1.6	11.4	9.0	28.34	28.3	1.30	fsw
66	93	75	VALSX	Value Line Special Situations	MCGro	S	S	S	S	-1.0	9.8	12.2	23.55	15.4	0.71	FSW
67	120	152	BUFMX	Buffalo Mid Cap	MCGro	S	S	S	S	-1.0	10.6	10.0	12.60	-	-	FSW
68	127	92	FEXPX	Fidelity Export & Multinat'l (.75%r<30d)	LC	H	S	S	S	-0.5	10.5	9.4	19.37	20.3	1.07	Fsw

Bold funds are currently held in MONEYLETTER model portfolios.
Advice: B=Buy, H=Hold, S=Sell, (B), (H), (S)= advice new this issue,
 *=not for this portfolio.

Std. Dev.: Standard Deviation based on trailing 3-yr. returns.

Beta: fund's correlation to the market (S&P 500 = 1.0). A fund with a beta greater than 1.0 is more volatile than the S&P 500.
NTF/wtf: NO TRANSACTION FEE/with transaction fee (F/f) for Fidelity, (S/s) for Schwab and (W/w) for TD Waterhouse.

Domestic Stock Funds

RANK	01/14 2005	1 Mo Ago	6 Mo Ago	Ticker Symbol	FUND NAME	Fund Type	Conservative	Moderate	Venturesome	TOTAL RETURN			PRICE PER SHARE	RISK		NTF/wff
										1 mo.	6 mo.	12 mo.		Std. Dev.	Beta	
69	108	100	GABAX	Gabelli Asset	MC	H	H	H	-0.6	10.2	10.2	40.24	17.8	0.91	FSW	
70	113	31	LSGIX	Loomis Sayles Value	LCVal	H	H	H	-0.7	9.6	11.9	16.85	16.4	0.89	fsW	
71	137	206	FIDYX	INVESCO Dynamics	MCGro	S	S	S	-0.4	11.6	6.3	16.22	28.2	1.48	FSW	
72	56	45	PENNX	Royce Penn Mutual (1%r<180d)	SCVal	Ⓢ	Ⓢ	Ⓢ	-1.6	10.1	11.7	9.78	20.4	0.80	Fsw	
73	58	232	VLIFF	Value Line Fund	LCGro	S	S	S	-1.6	12.2	6.5	13.51	13.1	0.73	FSW	
74	65	56	RYTRX	Royce Total Return (1%r<180d)	SCVal	S	S	S	-1.3	9.8	12.0	11.91	15.7	0.66	FsW	
75	89	21	TGIGX	TCW Galileo Dividend Focused N	MCVal	H	H	H	-1.7	9.8	12.3	11.17	13.8	0.57	FW	
76	254	194	FIIIX	INVESCO Core Equity	LC	H	H	H	3.1	10.2	3.9	10.53	15.3	0.89	FSW	
77	30	60	VHCOX	Vanguard Cap Opp (closed,\$25,000,1%r<5yr)	MCGro	*	S	S	-3.7	11.4	11.0	29.52	25.3	1.28	fsW	
78	101	43	PRFDX	T. Rowe Price Equity-Income	LCVal	H	H	H	-0.5	9.6	10.6	26.04	16.3	0.83	fsw	
79	42	34	ARGFX	Ariel Fund	SCVal	Ⓢ	Ⓢ	Ⓢ	-2.3	8.6	15.8	51.43	15.6	0.53	FSW	
80	67	83	TUDRX	WPG Tudor	SC	*	H	H	-0.4	9.3	11.1	16.88	27.0	1.22	FsW	
81	141	210	LMVTX	Legg Mason Value	LCVal	H	H	H	0.3	10.6	6.7	63.91	23.3	1.19	-	
82	95	81	MPMVX	MSI Mid Cap Value	MCVal	S	S	S	-1.3	10.5	9.2	22.76	23.1	1.18	fsw	
83	35	94	NAESX	Vanguard SmallCap Index	SC	S	S	S	-3.0	11.4	9.6	25.59	23.2	1.01	fsw	
84	117	57	FCNTX	Fidelity Contrafund	LC	S	S	S	-0.2	8.8	11.6	55.63	11.4	0.54	Fsw	
85	69	222	RSSGX	RS Smaller Company Growth	SCGro	*	S	S	-1.6	12.3	5.1	21.64	28.5	1.23	FSW	
86	18	127	SMTVX	Strong Multi-Cap Value	MCVal	Ⓢ	Ⓢ	Ⓢ	-1.0	11.1	7.1	61.69	22.4	1.01	FSW	
87	73	103	RPMGX	T. Rowe Price Mid Cap Growth	MCGro	S	S	S	-2.6	10.5	10.9	48.07	22.1	1.11	fsw	
88	92	8	RYPRX	Royce Premier (1%r<180d)	SC	S	S	S	-1.8	8.3	15.1	14.56	19.4	0.84	FsW	
89	142	125	FDEQX	Fidelity Disciplined Equity	LC	S	S	S	-0.6	10.0	8.8	24.96	14.3	0.81	Fsw	
90	115	33	BEGRX	Mutual Beacon (1%) CIZ	MCVal	S	S	S	0.0	8.7	11.2	15.60	12.5	0.57	sw	
91	116	187	KAUFX	Federated Kaufmann Fund (0.2%)	MCGro	S	S	S	-1.0	10.4	8.1	5.20	19.5	0.86	FSW	
92	131	227	WAAEX	Wasatch Small Cap Grth (closed,2%r<60d)	SCGro	S	S	S	-1.3	11.4	6.1	38.09	27.1	1.17	FSW	
93	62	89	OTCFX	T. Rowe Price Small Cap Stock Fund	SC	S	S	S	-2.9	10.8	10.1	30.40	19.2	0.84	fsw	
94	100	237	TMGFX	Turner Mid Cap Growth	MCGro	*	S	S	-1.8	12.4	4.1	23.66	29.3	1.45	FSW	
95	107	195	ARTMX	Artisan Midcap (closed)	MCGro	S	S	S	-1.1	10.6	7.4	28.80	23.1	1.17	FSW	
96	106	88	SAOPX	Salomon Brothers Opportunity	MCVal	S	S	S	-1.1	9.8	9.1	46.26	13.0	0.67	sw	
97	85	52	VPMCX	Vanguard PRIMECAP (closed,\$25,000&1%r<5yr)	LC	S	S	S	-1.9	9.5	10.9	60.40	21.7	1.13	fsw	
98	125	42	WVALX	Weitz Value Fund	MCVal	H	H	H	0.6	8.1	10.6	36.96	16.7	0.82	SW	
109	118	50	VUVLX	Vanguard U.S. Value	LCVal	H	S	S	-1.0	9.5	8.2	13.44	17.3	0.87	fsw	
184	52	-	FSLSX	Fidelity Value Strategies	SC	*	H	H	-4.2	10.2	1.1	35.36	29.4	1.41	F	

Dow Jones
NASDAQ
S&P 500

-1.1%
-3.3
-1.6

3.4%
9.0
6.6

0.2%
-1.1
4.8

indexes do not
include dividends

International Stock Funds

1	1	6	FLATX	Fidelity Latin Amer. (1.5%r<90d)	LatinA	*	H	H	3.4%	35.7%	28.4%	\$20.54	29.8	-	Fs
2	2	10	PRLAX	T. Rowe Price Latin America (2%r<1yr)	LatinA	*	H	H	3.1	34.5	25.7	15.48	29.7	-	fsw
3	18	-	TREMX	T. Rowe Price Emg Europe&Med.	Europe	*	Ⓢ	Ⓢ	10.5	26.2	29.3	16.51	29.2	-	fw
4	3	18	SLAFX	Scudder Latin America	LatinA	*	H	H	2.8	33.1	21.3	31.13	27.3	-	FSW
5	6	64	FEMKX	Fidelity Emerging Mkts (1.5%r<90d)	Int'l	*	B	B	5.7	28.0	15.1	12.74	-	-	Fsw
6	4	43	VEIEX	Vanguard Emerging Mkts Stk Index (.5%r)	Int'l	*	B	B	2.9	26.7	16.8	14.26	22.6	-	fsw
7	12	34	FIEXX	Fidelity Europe (1%r<30d)	Europe	*	B	B	2.8	22.9	22.3	33.65	22.5	-	Fsw
8	5	37	DREGX	Driehaus Emerging Mkts Gr (2%r<60d)	Int'l	*	B	B	4.0	24.6	15.4	22.47	24.9	-	FSW
9	7	33	DRFMX	Dreyfus Emerging Market (1%r)	Int'l	*	B	B	2.2	22.9	17.2	19.00	21.6	-	FSW
10	11	7	VINEX	Vanguard Intl Explorer (\$25,000,2%r<60d)	Int'l	*	B	B	4.4	18.4	24.5	16.13	16.3	-	fsw
11	19	8	FISMX	Fidelity Intl Small Cap (2%r<90d)	Int'l	*	H	H	5.4	17.8	24.3	23.24	-	-	Fw
12	14	62	PRASX	T. Rowe Price New Asia	Pacific	*	B	B	4.0	24.2	9.5	9.86	19.7	-	fsw
13	9	4	DODFX	Dodge & Cox Intl Stock	Int'l	*	B	B	2.1	18.7	25.5	30.09	23.4	-	fsw
14	13	-	NBISX	Neuberger Berman Intl (2%r<180d)	Int'l	*	B	B	4.1	17.6	25.1	18.16	16.3	-	fsw
15	20	28	ARTJX	Artisan Intl Small Cap (closed,2%r<90d)	Int'l	*	Ⓢ	Ⓢ	4.8	19.2	19.6	17.32	-	-	SW
16	8	55	MAPTX	Matthews Pacific Tiger (2%r<90d)	Pacific	*	B	B	3.1	23.1	12.3	15.36	23.6	-	FSW
17	10	69	JVEIX	Janus Intl Equity (1%r<90d)	Int'l	*	B	B	2.6	19.0	22.1	18.03	13.9	-	FSW
18	16	2	OAKEX	Oakmark Intl Small Cap (closed,2%r<90d)	Int'l	*	H	H	4.3	17.1	22.8	20.05	20.4	-	FSW
19	17	68	FSEAX	Fidelity SE Asia (1.5%r<90d)	Pacific	*	H	H	4.7	23.0	6.1	16.29	21.1	-	Fsw
20	-	-	PISRX	Forward Intl. Small Cos.	Int'l	*	H	H	5.0	17.8	18.0	12.78	-	-	FSW
21	-	-	QFVOX	Quant Foreign Value (1%r)	Int'l	*	H	H	3.1	16.0	20.7	15.24	19.9	-	FSW
22	21	50	SGSCX	Scudder Global Discovery (closed)	Int'l	*	H	H	1.7	18.5	16.2	34.08	20.1	-	FSW
23	28	-	MPACX	Matthews Asia-Pacific (2%r<90d)	Pacific	*	H	H	4.6	16.7	15.4	12.27	-	-	FSW
24	15	5	ARTIX	Artisan Intl Value (2%r<90d)	Int'l	*	H	H	2.0	14.7	24.3	20.64	-	-	FSW
25	23	21	BJBIX	Julius Baer Intl Equity A (2%r<90d)	Int'l	*	H	H	3.2	17.0	16.4	30.98	12.5	-	FS
26	32	12	AIOIX	Amer.Cent.Intl Opportunity (2%r<180d)	Int'l	*	H	H	6.9	13.3	19.4	9.65	20.4	-	S
27	22	13	MACSX	Matthews Asia G & I (closed,2%r<90d)	Pacific	*	H	H	2.0	16.2	16.9	15.60	11.4	-	FSW
28	25	61	SCOPX	Scudder Pacific Opportunity (2%r<1yr)	Pacific	*	H	H	3.0	19.2	7.2	12.98	19.0	-	FSW
29	30	11	PRIDX	T. Rowe Price Intl Disc. (2%r<1yr)	Int'l	*	H	H	4.1	12.6	17.8	32.25	16.0	-	fsw
30	65	38	FPBFX	Fidelity Pacific Basin (1.5%r<90d)	Pacific	*	S	S	7.2	12.4	10.6	19.74	14.7	-	Fsw
31	26	41	JAOSX	Janus Overseas (closed,2%r<90d)	Int'l	*	H	H	1.3	16.2	8.9	23.55	16.5	-	FSW
32	33	36	WBIGX	Wm. Blair Intl Growth N (closed,1%r<60d)	Int'l	*	S	S	2.3	14.1	12.4	21.56	14.6	-	FSW
33	31	30	VTRIX	Vanguard International Value (2%r<60d)	Int'l	*	H	H	1.5	14.0	12.9	30.25	16.8	-	fsw
34	47	53	SCOBX	Scudder Global	Global	*	S	S	1.5	14.8	9.9	26.08	12.7	-	FSW
36	27	27	VEURX	Vanguard European Stock Index (2%r<60d)	Europe	*	H	H	-0.3	13.9	13.8	25.23	17.4	-	fsw

Bond Funds (next issue on page 6: Specialty Funds)
 01/14/2005

Ticker Symbol	FUND NAME	Fund Type	Conservative	Moderate	Venturesome	TOTAL RETURN			PRICE PER SHARE	Std. Dev.	Yield	NTF/wft
						1 mo.	6 mo.	12 mo.				
FFRHX	Fidelity Floating Rate High Inc (1%r<60d)	BnkLoan	B	*	*	0.0%	1.4%	1.8%	\$9.97	-	3.14%	Fw
BUFHX	Buffalo High-Yield (2%r<180d)	HighYld	*	*	*	-0.5	4.7	6.4	11.47	4.40	3.73	FSW
CMHYX	Columbia High Yield	HighYld	*	*	*	-0.7	3.2	0.8	8.77	4.46	6.30	fSW
FAGIX	Fidelity Capital & Income (1%r<90d)	HighYld	*	*	*	-0.5	8.7	5.2	8.40	13.66	6.59	Fsw
SPHIX	Fidelity High Income (1%r<90d)	HighYld	*	*	*	-0.6	5.3	3.7	9.02	8.05	7.48	Fsw
JAHYX	Janus High Yield (2%r<90d)	HighYld	*	*	*	-0.7	4.7	3.1	9.85	4.30	6.14	FSW
NTHSX	Northeast Investors Trust	HighYld	*	*	*	0.4	7.0	11.8	7.83	5.72	7.12	fw
PHYDX	PIMCO High Yield	HighYld	*	*	*	-0.5	5.7	3.1	9.90	8.71	6.42	SW
STHYX	Strong High Yield Bond (1%r<180d)	HighYld	*	*	*	-0.4	5.1	3.7	7.90	8.47	6.77	FSW
PRHYX	T. Rowe Price High Yld (closed,1%r<1yr)	HighYld	*	*	*	-0.4	5.6	3.1	7.16	5.83	7.56	sw
TGHNX	TCW Galileo High Yield Bond	HighYld	*	*	*	-0.1	6.6	6.6	7.35	7.42	7.69	SW
VAGIX	Value Line Aggressive Inc (1%r<120d)	HighYld	*	*	*	-0.4	4.1	4.1	5.15	7.43	6.12	FSW
VWEHX	Vanguard High Yield Corporate (1%r<1yr)	HighYld	*	B	*	0.0	6.0	6.5	6.40	5.93	7.14	sw
BGBX	American Century Intl Bond	Int'l	*	*	*	-0.5	10.6	9.1	14.50	10.96	3.99	fSW
FNMX	Fidelity New Markets Income (1%r<90d)	Int'l	*	*	*	-0.4	11.0	4.0	14.17	12.57	6.01	Fsw
PYGF	Payden Global Fixed Income	Int'l	*	*	*	0.2	4.0	2.9	10.02	3.72	4.35	fsw
SSTGX	Scudder Global Bond S-T (closed)	Int'l	*	*	*	0.5	7.0	4.6	10.43	5.75	4.97	FSW
RPBX	T. Rowe Price Int'l Bond	Int'l	*	*	*	0.4	9.6	6.5	10.54	9.79	2.26	fsw
BGNMXX	American Century Ginnie Mae	IntTerm	*	*	*	-0.1	1.7	0.5	10.46	2.75	4.61	fSW
ACITX	American Century Inflation Adj	IntTerm	B	*	*	0.2	5.4	6.3	11.27	7.68	4.23	fSW
CPTNX	American Government Bond	IntTerm	H	*	*	-0.1	2.1	0.6	10.64	4.35	2.57	f
BBHIX	BBH Inflation Indexed Sec	IntTerm	B	*	*	0.0	5.2	6.8	11.16	7.88	3.85	FSW
SRINX	Columbia Income CIZ	IntTerm	H	*	*	-0.4	3.3	0.5	10.09	4.92	5.53	FSW
SRBFX	Columbia Intermediate Bond CIZ	IntTerm	H	*	*	-0.3	2.8	0.2	9.10	4.21	4.89	FSW
DODIX	Dodge & Cox Income	IntTerm	H	*	*	0.0	3.3	2.5	12.83	3.57	4.21	fsw
DRBDX	Dreyfus A Bonds Plus	IntTerm	*	*	*	0.5	4.4	1.1	13.86	5.05	4.24	FSW
DRGMX	Dreyfus GNMA	IntTerm	*	*	*	0.0	2.7	2.4	14.69	3.23	4.43	FSW
DSINX	Dreyfus Strategic Income	IntTerm	*	*	*	-0.1	3.4	-0.4	14.74	4.80	4.07	FSW
FGMNX	Fidelity GNMA	IntTerm	*	*	*	-0.1	2.1	1.4	11.10	2.47	4.12	Fsw
FINPX	Fidelity Inflation-Protected Bond	IntTerm	B	*	*	-0.1	5.1	5.7	11.35	-	1.32	Fw
FBNDX	Fidelity Investment Grade	IntTerm	H	*	*	0.0	3.8	3.4	7.53	4.46	3.32	Fsw
FBDFX	Fremont Bond	IntTerm	H	*	*	-0.3	3.5	2.6	10.43	4.72	2.14	fsw
MWTRX	MetroWest Total Return	IntTerm	*	*	*	-0.2	2.9	0.8	9.80	5.88	6.04	SW
PRRDX	PIMCO Real Return	IntTerm	H	*	*	-0.4	4.3	4.4	11.43	7.96	3.35	SW
PITDX	PIMCO Total Return	IntTerm	H	*	*	-0.4	3.1	2.0	10.66	4.59	2.01	SW
PTMDX	PIMCO Total Return Mortgage	IntTerm	H	*	*	0.0	2.6	2.1	10.72	3.12	2.58	SW
SCSBX	Scudder Income (closed)	IntTerm	H	*	*	0.2	3.9	3.5	13.02	4.39	4.35	FSW
STVSX	Strong Govt Securities	IntTerm	H	*	*	-0.3	2.0	0.1	10.74	4.78	3.54	FSW
PRGMX	T. Rowe Price GNMA	IntTerm	*	*	*	-0.1	1.9	0.6	9.67	2.93	4.48	fsw
PRCIX	T. Rowe Price New Income	IntTerm	*	*	*	-0.1	3.1	1.4	9.12	4.24	3.71	fsw
TGMNX	TCW Galileo Total Return Bond	IntTerm	H	*	*	0.4	3.9	4.1	9.96	3.30	4.18	SW
USAIX	USAA Income	IntTerm	H	*	*	0.1	4.0	3.5	12.44	4.83	4.40	w
VALBX	Value Line U.S. Govt Sec	IntTerm	H	*	*	0.0	2.4	1.5	11.73	4.48	3.63	FSW
VFIIX	Vanguard GNMA	IntTerm	B	*	*	0.4	3.7	2.9	10.46	3.49	4.62	fsw
VIPSX	Vanguard Inflation Protected Sec	IntTerm	B	*	*	0.0	5.2	6.6	12.52	7.75	4.47	sw
VFITX	Vanguard Intermediate Treas.	IntTerm	H	*	*	-0.6	2.5	-0.3	11.25	6.14	4.47	fsw
VBMFX	Vanguard Total Bond Market Index	IntTerm	H	*	*	0.0	3.9	3.4	10.27	4.41	4.33	fsw
MNTRX	WellsFargo Montgomery Total Ret (closed)	IntTerm	H	*	*	-0.4	2.5	1.8	12.37	4.59	3.48	fSW
WTIBX	Westcore Plus Bond (2%r<90d)	IntTerm	*	*	*	-0.2	4.2	4.7	10.84	4.13	5.35	FSW
WPGVX	WPG Core Bond	IntTerm	H	*	*	-0.2	3.0	1.9	10.81	4.65	2.86	Fsw
DRGBX	Dreyfus 100 Treasury L-T	LngTerm	*	*	*	0.7	6.2	0.4	16.18	8.39	4.44	FW
FGOVX	Fidelity Government Income	LngTerm	*	*	*	-0.3	2.2	0.5	10.23	5.51	2.99	Fsw
KIFIX	FifthThird Bond	LngTerm	*	*	*	-0.1	3.3	2.2	10.16	4.87	3.23	w
MGFIX	Managers Bond	LngTerm	*	*	*	0.3	4.9	3.2	24.58	6.62	4.18	FSW
STCBX	Strong Corporate Bond	LngTerm	*	*	*	-0.2	4.5	1.1	10.68	6.94	4.66	FSW
PRPIX	T. Rowe Price Corporate Inc	LngTerm	*	*	*	-0.3	4.6	2.1	9.88	6.05	4.93	fsw
PRULX	T. Rowe Price U.S. Treas. L-T	LngTerm	*	*	*	0.1	5.1	2.0	11.94	9.34	4.32	fsw
VWESX	Vanguard Long-Term Corporate	LngTerm	*	*	*	0.3	8.4	4.2	9.62	10.53	5.46	fsw
VUSTX	Vanguard L-T Treasury	LngTerm	*	*	*	0.1	6.7	2.9	11.61	10.98	4.95	fsw
FSICX	Fidelity Strategic Income	Multi	B	B	*	0.2	8.5	6.9	10.70	5.47	5.08	Fw
LSBDX	Loomis Sayles Bond Instl	Multi	B	B	*	0.3	10.0	7.8	13.71	8.45	6.87	FSW
LSBRX	Loomis Sayles Bond Retail	Multi	B	B	*	0.3	9.8	7.5	13.69	8.43	6.69	FW
RPSIX	T. Rowe Price Spectrum Income	Multi	*	*	*	-0.2	5.2	3.5	12.02	4.37	4.04	fsw
MGIDX	Managers Int. Duration Govt	ShfTerm	*	*	*	0.1	3.1	3.4	10.65	2.85	2.32	FSW
MGSDX	Managers Short Duration Govt	ShfTerm	B	*	*	0.3	1.7	2.4	9.68	0.71	2.74	FSW
MWLDX	MetroWest Low Duration	ShfTerm	B	*	*	-0.2	1.7	0.6	9.40	3.06	3.97	SW
BTINX	American Century Target 2010	ZeroCpn	*	*	*	-0.4	3.2	1.8	86.89	9.56	-	fSW
BTFIX	American Century Target 2015	ZeroCpn	*	*	*	0.2	7.8	6.4	73.51	14.68	-	fSW
BITTX	American Century Target 2020	ZeroCpn	*	*	*	1.1	12.1	10.4	54.58	18.28	-	fSW
BITRX	American Century Target 2025	ZeroCpn	*	*	*	2.9	17.1	15.3	46.98	21.40	-	fSW

Quant Foreign Value Fund (Part 2)

Interview with Bernard R. Horn Jr., manager of The Quant Foreign Value Fund. See part 1 of the interview in the January 7, 2005 issue.

ML: The Quant Funds' web site states that the fund is invested using both quantitative and fundamental techniques. What role does quantitative analysis play in your investment process?

Horn: There are two parts to the quantitative portion of the investment process. The first is a global valuation model that dates to the 1980s, when there were no databases of foreign company information. We developed a country model and an industry model that ranked countries and industries from the most undervalued to the most overvalued. In parallel, we run a set of company screens.

ML: What parameters do you use in constructing the portfolio?

Horn: One of the most important things to take away from this interview is the reason people should invest in international funds is to mix that investment in with their other investments in a way that will lower the risk of their overall portfolio. So when it comes to diversification by country, industry, and number of securities, we take that very seriously. We generally have at least 15 different industries and 15 different countries in the portfolio. We also usually equally weight our individual stock holdings at the time of purchase. So if there are 40 to 50 stocks, each will account for 2.0%-2.5% of the portfolio. Of course, that will get out of balance for a while as some stocks outperform and others underperform. But as a company approaches 5%, we'll either sell it entirely because it no longer meets our criteria, or cut it back and reinvest in other attractive opportunities.

Sometimes there are industry sectors where we find a lot of companies that are particularly undervalued, so we might be overweight in those sectors relative to the benchmark. In some cases, say for instance, if we think that domestic US companies are the best values in the world, we might not have any exposure to a particular sector.

ML: Do you actually compare the valuations against American counterparts?

Horn: Absolutely. That's why we have more confidence that an international company is, in fact, the best value in the world. It's a bit unusual in the sense that most international funds are run by teams that cover just international companies. We think its another part of our value add that we're constantly looking at American companies and comparing how good they are against international firms. We get a rich amount of information from that comparison, which we think helps our investment process immensely.

ML: Where are you finding good values now?

Horn: British homebuilders are particularly undervalued, and we have a bit heavier weighting there. We've also just added a number of telecommunications operators, including Portugal Telecom and SK Telecom (Korea). These are

100% U.S. TREASURY FUNDS

	7-Day	30-Day	1-Year
Vanguard Treasury MMF	1.85%	1.77%	1.00%
Fidelity Spartan US Treas MMF	1.68	1.66	0.92
Gabelli US Treasury MMF	1.68	1.63	0.95
Amer Century Capital Presv Fund/Inv	1.60	1.54	0.82
CMA Treasury Fund RIC	1.46	1.44	0.63
T. Rowe Price US Treasury MF	1.46	1.46	0.74
HSBC Investor US Treas MM/CI D	1.45	1.40	0.70
JPMorgan 100% US Treas MMF/Morgan	1.45	1.42	0.68
RMK Select Treas MMF/CI A	1.41	1.44	0.63
US Treasury MF of America/CI A	1.36	1.41	0.60

GENERAL PURPOSE TAXABLE FUNDS

	7-Day	30-Day	1-Year
PayPal Money Market Fund	2.30%	2.25%	1.36%
Scudder MM Series Premium/CI S	2.16	2.13	1.19
Scudder MM Series Premium/AARP	2.15	2.11	1.21
Scudder MM Series Prime Reserve/AARP	2.04	2.01	1.09
Vanguard Prime MMF/Retail	2.01	1.95	1.10
TIAA-CREF Money Market Fund	1.99	1.93	1.12
GE Money Market Fund	1.95	1.89	1.06
MFS Money Market Fund	1.92	1.90	1.00
Morgan Stanley Active Assets MT	1.91	1.84	0.98
Marshall MMF/Investor Class	1.90	1.88	1.02

TAX-FREE GENERAL PURPOSE FUNDS

	7-Day	30-Day	1-Year
Vanguard Tax-Exempt MMF	1.56%	1.66%	1.13%
Strong Tax-Free Money Fund	1.37	1.52	1.06
Dreyfus BASIC Muni MMF	1.32	1.38	0.84
Amer Century T-F MMF/Inv Class	1.28	1.34	0.87
Fidelity Municipal MMF	1.27	1.38	0.85
USAA Tax Exempt MMF	1.26	1.36	0.86
Fidelity Tax Free Money Market	1.24	1.34	0.82
Scudder Tax-Exempt Money Fund	1.24	1.33	0.85
Dreyfus Municipal MMF	1.23	1.26	0.71
Scudder T-E Cash Managed Shares/TEP	1.23	1.34	0.86
T. Rowe Price Summit Muni MMF	1.23	1.32	0.82

TAX-FREE STATE-SPECIFIC FUNDS

	7-Day	30-Day	1-Year
Vanguard OH Tax-Exempt MMF	1.54%	1.64%	1.11%
Vanguard NY Tax-Exempt MMF	1.52	1.62	1.08
Vanguard CA Tax-Exempt MMF	1.51	1.63	1.10
Vanguard PA Tax-Exempt MMF	1.50	1.63	1.10
Vanguard NJ Tax-Exempt MMF	1.47	1.60	1.08
Fidelity PA Municipal MMF	1.21	1.31	0.81
Fidelity OH Municipal MMF	1.20	1.30	0.76
Dreyfus FL Municipal MMF	1.19	1.21	0.69
Fidelity FL Municipal MMF	1.19	1.26	0.80
Fidelity CT Municipal MMF	1.18	1.29	0.77

Taxable equivalent yield = yield / (1—total effective tax bracket). Funds are ranked by 7-day yields; 7-day and 30-day yields are compound yields as of 1/11/05. Third column refers to 1-year total return. Criteria for inclusion include: top-yielding unrestricted retail funds only, with minimum initial investment <\$25,000 and assets >\$100 million.

Source: Money Fund Report (800) 343-5413

dominant companies in smaller markets. We've been increasing our exposure to Japan very slowly and recently added a little broadband access company, E-Access. We've started to see quite a lot of Japanese small caps show up in our screens. This will probably be an area where we will take a much closer look in the next month or two.

ML: Thank you very much. \$

Forward International Small Companies

In the *MONEYLETTER* issue of November 8, 2004, we profiled another Forward fund, the Forward Hoover Small Cap Equity. In that case, Hoover Investment Management was the subadvisor for the fund. In the case of Forward International Small Companies, Forward Funds has again teamed with an experienced subadvisor—in this case, it's Pictet International Management. Pictet is an affiliate of Geneva-based Pictet and Cie, a private bank with \$103 billion in client assets and more than 1,900 employees worldwide. The two firms teamed up in December 2003: Pictet contributed the strength of its experienced international portfolio managers, while Forward contributed the sales and marketing skills. Hence, the former Pictet International Small Companies fund became the Forward International Small Companies fund. The retail fund dates to March 5, 2002, but an institutional class is older, dating to April 30, 1998.

While this retail fund is relatively small at \$9.7 million in assets, as is the institutional fund at \$41 million, the Pictet team manages more than \$1 billion in global small cap assets. They anticipate that their assets under management can grow to \$2.5 or \$3.0 billion before liquidity and other issues arise. Thus, one characteristic of the fund—that it is one of the still-open funds in Morningstar's small/mid-cap growth category—should remain valid for some time.

The retail fund's total returns since its 2002 inception have been strong, with gains of 61.6% in 2003 and 25.5% in 2004, both in excess of the category average. These returns placed the fund in the top quartile in 2003 and within the top 45% in 2004. And from its inception through 2004 year end, its average annual return was 23.2%.

The approach

The managers use a very disciplined approach, encompassing qualitative research, quantitative analysis, and primary research, along with macroeconomic considerations. The team starts by looking at a universe of 8,000 international small-cap companies with market capitalizations of less than \$2 billion. They use a series of screens to identify those that are profitable and have strong business models, whittling down the initial universe to about 1,000. Next, they examine the finances of each prospective investment, and characterize firms into four categories: emerging growth, established growth, defensive growth, and cyclical growth. Note that while the fund is characterized as a growth fund, the managers do take into account valuations, looking for "growth at a reasonable price." Finally, they rank each firm based on how effectively

it uses its profits to generate additional growth. The combination of different types of growth stocks and sensitivity to valuation helps to control the fund's risk.

Next comes a look at the companies and how they operate, up close and personal. The sector a firm operates in is scrutinized, to determine competitive characteristics. Each firm is ranked on its strength of organization and management. The team then holds individual meetings with managements of prospective candidates to further identify new products, business goals, and competitive advantages.

They finally construct a portfolio of about 100 of the best names they find. As a final check, they make sure they have minimized their exposure to sectors or countries with negative outlooks. To further mitigate risk, the fund will not have more than 20% of assets in emerging markets, and individual positions are capped at 5% of assets.

A look at regional exposure tells a bit more about the managers' strategy. The fund has 16% of assets in "Pacific ex-Japan"—they recently commented that the fund's largest

Top Five Countries & Holdings (% of Assets)

United Kingdom	13.9	Leica Geosystems	1.6
Japan	11.0	Biomerieux	1.5
Germany	9.4	Puma	1.4
France	7.5	CIR Spa	1.3
Australia	7.0	Regus Group	1.3

As of December 31, 2004

overweight is to Hong Kong and China. While that exposure was a detraction to results early in 2004, investor confidence in the region returned later in the year. The fund also has about 58% of assets in Europe excluding the U.K. They have been favoring core countries such as Germany and Switzerland. And while the U.K. is the largest single country weighing, the fund is actually underweight the U.K. relative to its benchmark—the HSBC World Ex U.S. Smaller Companies. They have also been reducing the exposure to Japan, as economic statistics softened and the market did not support the fund's "emerging growth" investments there. The team has been emphasizing "defensive growth" stocks, which are in mature sectors, but undergoing a change that will lead to earnings acceleration. Because these firms are undergoing company-specific change, they are less influenced by external events. \$

Forward International Small Companies (PISRX)
 Forward Funds, 433 California Street, 11th Floor
 San Francisco, CA 94104; (800) 999-6808
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