



## VIEW FROM VISTA

April 8, 2004

Dear Valued Client,

Enclosed is your Quarterly Report from Vista Capital Partners for the first quarter of 2004. Following a year of tremendous gains for virtually every asset class, the first quarter was fairly lackluster (which was fine with us). Stocks weathered concerns over high valuations, high oil prices and terrorism to finish the quarter mixed. Mutual funds focusing on small cap stocks were up nearly 6.0%, outpacing large company stock funds, and real estate funds continued their hot streak, up a category-best 11.91% in the first quarter. International stocks again managed to outpace their U.S. peers, with the average overseas-stock fund up 4.45% vs. the average diversified U.S. stock fund's increase of 2.98%. Bond investors held on to their gains of the last several years, with the 10-year U.S. Treasury Note providing a total return of 4.69% through March 31<sup>st</sup>. Consider:

- Fueled by investors' desperate search for income, funds investing in real estate, primarily via real estate investment trusts (REITs), are now up an average of 17.52% annualized over the past five years, making it the top performing stock fund category during that time. *Time to dramatically reduce our expectations for future real estate returns.*
- At \$36 a barrel, oil prices are more than 50% above their 10-year average and sending inflationary shivers through the economy. *However, higher oil prices have been slow to influence inflation/interest rates due to the increasing importance of technology and services in the U.S. economy. Oil's share of the country's gross domestic product (GDP) has declined 47% in the last 20 years.*
- Over the 12 months ended June 30, 2003, foreigners bought \$231.5 billion in U.S. Treasury securities, or nearly two-thirds of all the borrowing the Treasury did. Foreigners now hold more than \$1.3 trillion, or 36%, of U.S. Treasury debt. *International demand for U.S. Treasuries, viewed as a safe haven in the past, has helped to keep interest rates low, but watch out if they decide to start selling.*
- Total household net worth in the U.S. hit a record \$44.4 trillion at the end of 2003, driven by rising house and stock prices. *While this has helped sustain consumer spending, it increases the potential for damage due to a stock market pullback and/or a sharp fall in home prices. A recent economist estimated that a 20% drop in the stock market alone would reduce projected economic growth from 4.5% to 3.2%*
- Medicare's trustees said the program is on track to go bankrupt in 15 years – seven years sooner than previously projected. *We remain concerned about the burgeoning obligations of the U.S. government in regards to healthcare and Social Security, and the impact this will have on future tax rates.*
- Corporate profits in the fourth quarter rose at the fastest rate in nearly 20 years, up 29% from a year earlier and the biggest jump since 1984. *The primary reason behind the stock market's strength and a testament to the power of productivity gains.*
- In a sign that hiring is finally catching up with recent economic growth, U.S. employers added more workers in March than in any month since April 2000. Upon hearing the news, bonds took their worst one-day hit in almost eight years. *This may have been the interest rate shift everyone has been expecting.*

Investment Focus

You've probably heard of the old adage in real estate – that it's all about location, location, location. Well, when it comes to investments, Vista would argue that it's all about expenses, expenses, expenses. Our investment philosophy and on-going strategy place the utmost importance on minimizing investment expenses. Below are just some of the ways in which a focus on low costs and expenses manifests itself in our investment philosophy:

- In the context of a diversified, asset allocated portfolio, we utilize index funds for the most efficient parts of the market. In less efficient parts of the market, where we believe managers have a better chance of outperforming their index, we still include some index funds to minimize the risk of underperformance and maximize after-tax returns. Index funds have rock-bottom expense ratios and do the best job of keeping trading costs down.
- Individual stocks and bonds are used when the portfolio is large enough to provide adequate diversification, eliminating a layer of expense.
- We avoid loaded funds and any other form of a commission and insist that the only revenue Vista brings in is the fee our clients pay us. This avoids any conflict of interest, which, in turn, will ensure we always have the best interests of our clients in mind.
- When researching and selecting actively managed mutual funds, a well-below-average expense ratio is one of our first screens. Research shows this dramatically improves the odds of outperformance and, we believe, is one of the key reasons behind Vista's success in selecting actively managed funds.
- Low turnover (a low amount of trading) is important, both within the portfolio and the mutual funds in which we invest.

This last point brings us to something that has long been one of the mutual fund industry's dirty little secrets – the extraordinarily high and hidden cost of trading. When a mutual fund buys or sells a stock, it has to pay a broker to complete the transaction. This cost is not included in the funds expense ratio and gets passed along to investors with minimal disclosure. Don Phillips, managing director of Morningstar Inc., a mutual fund research firm, recently estimated that stock funds spend 0.30% of fund assets a year on commission, while funds that do lots of trading might end up spending almost 1.0%. By comparison, index funds typically spend less than 0.05% of fund assets a year on commissions. Keeping turnover low prevents these hidden costs from eroding returns.

Private Wealth Management

When a client hires Vista as their financial advisor, they are getting more than investment management services. Our experience in managing money for high net worth individuals and families makes us an ideal resource on financial issues ranging from retirement and estate planning to concentrated positions in a company stock. We encourage our clients to allow Vista to "quarterback" their financial team by working closely with the client's advisors in the areas of insurance, estate planning and taxes (or refer them to someone in our network of specialists in these areas). This ensures a comprehensive wealth management plan is in place to meet the client's goals. Beginning with this quarter's letter, we will include a summary of a timely wealth management topic.

Federal estate taxes and Oregon inheritance taxes continue to change, making it more important than ever to have an up-to-date will and estate plan. The federal estate tax laws changed in 2001 in favor of taxpayers, with the exemption amount gradually increasing through 2009, from \$675,000 to \$3,500,000. The tax is then repealed

completely in 2010, only to be reinstated back to \$1,000,000 in 2011 (only our government could design something so complicated). Unfortunately, the state of Oregon decided to make things more difficult. During the 2003 legislative session, the Oregon legislature decided to disconnect Oregon law from the federal law and adopt lower exemption amounts (in the past, the two had always been the same). For example, in the year 2006, the first \$2,000,000 in assets is exempt from federal taxes, but only the first \$1,000,000 for the state of Oregon. This change also created an unexpected consequence for some estate plans in that, depending on how your estate plan documents were drawn up, it is now possible for someone to owe Oregon inheritance taxes *at the time of death of the first spouse*. This would obviously be an unwelcome surprise to someone grieving the death of a spouse. If your assets put you above the state or federal exemption amount, it is probably an important time to visit with an estate-planning attorney.

Below you will see a table of 2004 returns for most of the major asset classes. As always, we welcome your calls and e-mails and look forward to our next account review or conversation. Thank you for your referrals and for being a client.

Sincerely,

Vista Capital Partners

Comparative Returns:

Index	2004 Returns	Description
S&P 500	+1.69%	<i>Large Cap Stocks. 500 of the largest U.S. companies in all sectors of the economy.</i>
Russell 2000	+6.30%	<i>Small Cap Stocks. A broadly diversified index consisting of about 2000 small companies.</i>
MSCI EAFE	+3.75%	<i>International Stocks. An aggregate of 21 major country indexes, excluding the U.S.</i>
Wilshire REIT	+12.07%	<i>Real Estate. Measures the performance of publicly traded real estate equity.</i>
Lehman Bros. Aggregate Bond	+1.73%	<i>Bonds. Represents the performance of the entire US bond market.</i>