VIEW FROM VISTA

July 6, 2004

Dear Valued Client,

Enclosed is your Quarterly Report from Vista Capital Partners for the second quarter of 2004. With all eyes on the Federal Reserve, the big story in the second quarter was the bond market, where bonds suffered their worst three-month period in a decade. With the U.S. economy and the job market heating up, the 10-year Treasury lost nearly five percent of its value, as its yield, which moves in the opposite direction of price, rose from 3.85% to 4.59% at the end of the quarter. While it was a rough quarter for bonds, it should be taken in context. Bonds had one of their best quarters in a decade in the first quarter of this year, when interest rates fell sharply. Compared to the bond market, the stock market was relatively tame, with nearly every major index finishing about where it started the quarter or, for that matter, where it started the year. With corporate earnings growing at near-record rates, we don't mind the stock market taking a breather as earnings catch up with expensive stock prices (which, we might add, is better than the reverse). Consider:

- Analysts are currently forecasting second quarter earnings gains of 21% for companies in the S&P 500-stock index. This would be the fourth quarter in a row of 20%-plus gains – a streak of gains that has occurred only five times in the past 50 years. *Thanks to low interest rates, stingy spending and hiring, and the increasing use of technology on the part of corporate America.*
- The Federal Reserve, on June 30th, raised its target for short-term interest rates to 1.25% from 1.0%. The Fed said it expects to raise rates "at a pace that is likely to be measured", which is interpreted to mean a quarter-point at a time. *No surprise here, one commentator compared it to "getting a tie on Father's Day", but the historic period of cheap money may slowly be coming to an end.*
- Based on reported figures so far this year, inflation is rising at an annual rate in excess of four percent, compared to two percent over the last couple of years. *Exactly why the Fed felt compelled to raise interest rates, as they have a long-term goal of keeping inflation around two percent.*
- On average, according to a study by Ned Davis, bull markets since 1900 have lasted about 718 days – just short of two years. The average gain during the first half of the bull markets was 43%, while the average gain in the second half was only 16%. *More reason to believe that most of the money to be made in the current bull market has already been made. The two-year anniversary of this bull market is October 9th.*
- China last year used 27% of the global supply of steel and 40% of the world's cement, while only accounting for 3.9% of world output. *Evidence of how incredibly fast China is growing, with some economists estimating the country currently accounts for one-fifth of world growth.*
- Consumer confidence hit a two-year high in June, helping to offset fears that consumers would stop spending due to rising interest rates, high oil prices and the fading effects of the last tax cut. A general perception that the job market is improving led the way. *Good news given consumer spending accounts for two-thirds of GDP.*
- Yale economist Robert Shiller has pioneered a valuation method that measures stock prices against an

average of net income over the trailing decade. When the stock market has boasted a P/E ratio similar to today's level, which is 27 using his calculation, stocks have historically logged essentially flat returns during the following decade. *Which means, as we implied earlier, either corporate earnings need to continue their rapid growth, or stocks are in for a period of below-average returns.*

Investment Focus

The bond market has been a source of anxiety for many investors lately. Rising interest rates pushed bond prices down in the second quarter. With this trend expected to continue, some investors are questioning the wisdom of holding bonds in their portfolios. Vista believes bond price volatility is overshadowed by the long-term benefits of holding bonds: Portfolio diversification and income generation.

All asset classes go through ups and downs that are impossible to predict. Since the highs and lows for stocks, bonds, real estate and cash usually occur at different times, diversifying a portfolio among all four provides a less volatile pattern of long-term returns. The value of portfolio diversification was certainly apparent during the bear market from 2000 to 2003.

The most important feature bonds offer investors is income generation. Price fluctuation is relatively insignificant when looking at bond returns over several years. Vanguard Investment Counseling and Research found that 96% of bond market returns during the past 17 years were attributed to income and interest on reinvested income while only 4% was attributed to changes in price. Rising interest rates, which cause bond prices to initially fall, allow bond income to reinvest and compound at higher rates of return. This leads to better returns for bond investors over the long haul.

Private Wealth Management

One of the key elements in retirement planning is determining the amount that can be safely withdrawn from an investor's portfolio each year. Everyone's goal is to be comfortable in retirement. Part of that comfort, however, comes from confidence that future financial needs can be met.

Vista typically recommends setting annual income withdrawals at 4-5 percent of the portfolio's beginning balance and adjusting for inflation each year thereafter. This is generally considered to be a prudent withdrawal method that significantly reduces, but does not eliminate, the chance of outliving your money.

Planning for flexibility in retirement income (adjusting income up or down when needed) also enhances a portfolio's ability to meet long-term goals. Portfolio returns can vary greatly year to year. The combination of a large withdrawal and a poor year of performance, especially early in retirement, can significantly reduce principal and potentially shorten the lifespan of a portfolio. The lower an investor's fixed expenses are, the easier it is to cut back withdrawals following a poor year of performance. Withdrawals can be adjusted upward in good years.

New at Vista

For those of you who have not already met her or talked with her over the phone, we would like to introduce the newest member of Vista's team, Heather Jackson. Heather comes to us from Franklin Templeton Investments, one of the country's largest investment advisors, based in Ft. Lauderdale, Florida, where she worked in their institutional marketing and client service division. Heather's experience also includes time spent at Key Bank, assisting members of their investment team. Although Heather and her husband Jeff are missing the sunny Ft. Lauderdale weather, they are looking forward to making the Pacific Northwest their new home and taking advantage of the quality of life it has to offer. Heather will be assisting Gordie and Michael in the areas of client service and business development. We hope you get a chance to meet Heather soon.

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 yours,

Vista Capital Partners

Comparative Returns:

Index	**2004 Returns**	**Description**
S&P 500	+2.60%	*Large Cap Stocks. 500 of the largest U.S. companies in all sectors of the economy.*
Russell 2000	+6.76%	*Small Cap Stocks. A broadly diversified index consisting of about 2000 small companies.*
MSCI EAFE	+3.05%	*International Stocks. An aggregate of 21 major country indexes, excluding the U.S.*
Wilshire REIT	+6.01%	*Real Estate. Measures the performance of publicly traded real estate equity.*
Lehman Bros. Aggregate Bond	-0.68%	*Bonds. Represents the performance of the entire US bond market.*