



VIEW FROM VISTA

October 8, 2004

Dear Valued Client,

Enclosed is your Quarterly Report from Vista Capital Partners for the third quarter of 2004. Economic news was dominated by the Federal Reserve, who raised its target for short-term interest rates by .50%, from 1.25% to 1.75%, and by the climb in oil prices to a 21-year high of over \$50 a barrel. In the face of such news, one would expect a rising interest rate environment damaging to bonds. The market, however, as it so often does, turned conventional wisdom on its ear and reacted by lowering interest rates. The result was a gain of nearly three percent for the average bond fund and a total return of +5.23% for the 10-year Treasury note (the best quarter for Treasury's since the third quarter of 2002). The yield on the 10-year Treasury note finished at 4.13%, down from a high of 4.90% just a few months ago. Stocks limped along for the quarter, with the Dow Jones Industrial Average posting a loss of 3.4%. The average diversified stock fund fell nearly three percent and clings to a one percent gain for the year.

This year was another good one for Vista's clients. In particular, our clients benefited from our philosophy of meaningful allocation to investments outside of mainstream U.S. stocks and bonds. Small company stocks, international stocks, REITs, Treasury-Inflation Protected Securities and high-yield bonds all outperformed the more widely-held and followed areas of the financial markets. On the heels of preserving our clients' assets during the bear market of 2000-2002, we are pleased to be participating, and then some, in the subsequent recovery. Consider:

- A study of mutual fund performance from 1975-1994, summarized in the August 2000 Journal of Finance, concluded that while the average stock bought by a fund manager outperformed the market by 1.5%, the average fund delivered annual returns that were .80% below the market's over that period. The culprit? Excessive costs. The average fund frittered away that 2.3% per year on a combination of expenses (1.1%), holding cash to meet redemptions and/or to time the market (.7%) and trading costs (.5%). *Even more reason to favor index funds and actively-managed funds with low expenses and low turnover.*
- Medical-care costs in this country have risen 50% since 1994 – nearly double the rise of inflation – and now amount to nearly 15% of gross domestic product. *A trend that is putting U.S. companies at a disadvantage to competitors in developed countries. GM, for example, now spends \$1,400 per vehicle on medical expenses.*
- The average cost of nursing home care jumped to \$192/day, up 6.1% from a survey a year ago. The average length of a nursing-home stay is 2.4 years. That means the typical bill would total approximately \$168,192. *Why long-term care insurance has a place with people that can't afford that type of bill.*
- At over \$50 a barrel, the price of oil has soared over 50% this year. *The dramatic rise in the price of oil seems to have less of an inflationary impact this time around due to less prominence in the total cost structure of companies, higher workforce productivity and intense competition from abroad which makes it harder for companies to pass on higher costs.*
- Starbucks raised its average beverage price by 11 cents a cup. *A move that some clients may feel more*

than \$50 barrel oil.

- The unemployment rate stands at 5.4%, the lowest since October 2001, and hourly earnings showed their largest back-to-back gain in wages in two years. *Signs the job market is much healthier than people realize.*
- Mutual funds that invest in real estate equity investment trusts (REITs) are up over 10% again this year and are averaging an incredible 17% annual gain over the last five years, compared with a nearly 2% annual loss for the S&P 500 Index. *While we are pleased with their returns, we are also cautious; investors have dumped nearly \$13 billion of new money into REIT funds during that time. REITs now trade at about 13 times their cash flows, compared with 11.5 times cash flow over the past 15 years (and just 8 times cash flow five years ago).*
- While the average mutual fund that buys taxable investment-grade bonds is up 2.6% this year, only 19% of these funds beat the Lehman Brothers Aggregate bond index's return of 3.6%. *No doubt due to the majority of the fund managers betting (wrongly) that interest rates would continue their rise. Another shining example of conventional wisdom among the masses being dead wrong.*

Investment Focus

They say timing is everything, but investors who have applied this notion to making investment decisions have found that in the market, not everything can be timed. The idea of market timing is certainly appealing: Buy an investment at or near the trough, sell at or near the peak, and move on to the next one. The problem is that only in hindsight are those peaks and troughs clearly visible. Numerous studies over various time periods have been conducted to test the effectiveness of market timing and all of them say the same thing: Markets move too sporadically and trends are too unpredictable to be consistently exploited by market timers. Market timing is really nothing more than a guess at short-term trends that, if wrong, can have a disastrous impact on long-term investment returns. Investors without a long-term plan or investment discipline fall prey to their own impulses and the chorus of media voices regularly telling them to do something, even though it's often better to do nothing.

Removing guesswork from the investment process is the best way to avoid the missteps which plague the average investor. Successful long-term investing is a function of persistence and patience, not timing. A well diversified portfolio can withstand market cycles and deliver solid, long-term returns without subjecting the investor to the risk and stress of choosing entry and exit points. Regularly rebalancing the portfolio to its asset allocation targets is also important as it establishes the discipline of buying low and selling high, counteracting the average investor's natural tendency to do the opposite. This simple strategy increases returns, decreases stress and protects investors from the "sirens' call" of the latest investment fad.

Private Wealth Management

Clients frequently ask us how they can most effectively utilize their net worth to benefit charitable organizations. You may already be aware of private foundations, charitable trusts or community foundations, as all are common ways to advance your charitable intent. A less widely known, yet powerful tool to help create a lasting philanthropic legacy is to establish an account with a Donor-Advised Fund.

A Donor-Advised Fund (DAF) is a tax-exempt vehicle that gives individuals an easy, flexible, and cost-effective way to donate to charity. A DAF can be as simple to set up as a regular investment account. Individuals open an

account with as little as \$10,000 and then direct gifts to charity whenever they would like. With this irrevocable contribution, donors receive an immediate tax deduction of up to 50% of that year's adjusted gross income (any unused deduction can be carried forward). DAF's function like a private foundation, but do not entail the substantial start-up costs or the ongoing administrative and financial expenses that can burden private foundations. Donor Advised Funds handle all of the start-up and ongoing administrative issues for donors. Balances remaining upon the donor's death are distributed to the charitable beneficiaries designated at account inception. Donors can select their own investment mix or choose to hire an investment advisor to manage accounts in excess of \$250,000.

New at Vista

We are pleased to introduce a new face in the office at Vista Capital Partners, Dougal Williams. Dougal joined Vista's investment team in late July as a research analyst and portfolio manager. Prior to joining Vista, he was the lead portfolio manager at Allen Trust Company, an independent trust company here in Portland. A Level III Candidate in the Chartered Financial Analyst (CFA) Program, Dougal brings with him a wealth of experience in equity analysis and mutual fund research, as well as portfolio management for trusts and charitable organizations. Dougal at one time was a world-ranked tennis professional, winning numerous regional and national titles. Although he still plays tennis, Dougal spends of his free time with his wife Katy; running, playing soccer, golfing and working on their home.

We would like to thank all of you who returned our client questionnaire/survey. We were grateful (some might say relieved!) to receive such high marks and appreciative of your suggestions for improvement. The results will help make us a better firm. 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 | +1.51% | <i>Large Cap Stocks. 500 of the largest U.S. companies in all sectors of the economy.</i> |
| Russell 2000 | +3.71% | <i>Small Cap Stocks. A broadly diversified index consisting of about 2000 small companies.</i> |
| MSCI EAFE | +2.27% | <i>International Stocks. An aggregate of 21 major country indexes, excluding the U.S.</i> |
| Wilshire REIT | +14.8% | <i>Real Estate. Measures the performance of publicly traded real estate equity.</i> |
| Lehman Bros. Aggregate Bond | +3.30% | <i>Bonds. Represents the performance of the entire US bond market.</i> |