



VIEW FROM VISTA

April 11, 2005

Dear Valued Client,

After back-to-back good years, both the stock and bond markets gave back some of their recent gains, with nearly every asset class flat or down. A relatively quiet quarter saw the average diversified U.S. stock fund drop 2.5% due to concerns over rich stock valuations, higher oil prices and interest rates. The average U.S. taxable bond fund was down 0.64% as the Federal Reserve raised short-term interest rates for the seventh time since June. The poorest performing sector was the technology and telecom heavy NASDAQ (-8.1%), while the best-performing asset class was international stocks with nearly flat returns. Consider:

- U.S. companies paid out a record \$181 billion in dividends in 2004 and Standard & Poor's estimates that 2005 will be another record year, with dividends increasing at least 12%. *After being out of favor for years, dividends are slowly making a comeback due to the 2003 dividend tax cut and pressure to start paying out some of their cash hoard. This is a welcome development as dividends have accounted for an astounding 40% of the S&P 500 returns over the last 80 years.*
- The dollar recently hit a two-month high versus the euro and a six-month high versus the yen. *Right at the point of maximum pessimism regarding the dollar's future, it suddenly begins to gain strength. Sound familiar?*
- On average, U.S. stocks are more expensive than other stocks around the world, selling at 16 times analysts average corporate earnings estimates over the next 12 months. That compares with 13 for Europe (excluding Britain) and 12 for Asia (excluding Japan). *Cheaper is better - one of many good reasons to own international stocks.*
- The amount of oil and gas needed to produce a dollar of economic growth dropped by 55% between 1973 and 2003. Moreover, U.S. energy expenditures have declined to about 7% of gross domestic produce (GDP) from nearly 14% in 1981. *Precisely why the economy continues to grow and inflation remains low despite \$50/barrel oil.*
- The S&P 500 now stands nearly 50% higher than it was just two years ago in March 2003. *50% in two years? Incredible when you think about it - with the media focused on all the bad news regarding the Iraq war, higher oil prices, a declining dollar, possible terrorist attacks, a divisive presidential election and fears of rising interest rates. More evidence of the financial media's tendency to focus on the negative and desire to create a sense of urgency.*

Investment Focus

An index fund is a diversified portfolio of securities designed to track the performance of an entire market or asset class. Unlike active managers, passive index funds make no attempt to forecast the market or the economy, and no effort to pick "attractive" securities over "unattractive" ones. They simply seek to track the

returns of an unmanaged benchmark index like the S&P 500.

The common belief is that a professional fund manager should be able to “beat the market.” In reality, the high fees and expenses associated with active management tend to result in performance that fails to match a passive, index strategy. The average actively managed fund fritters away 2.3% per year on a combination of management fees (1.1%), holding cash to meet redemptions and/or to time the market (.7%) and trading costs (.5%). The average fund must, therefore, outperform by 2.3% per year just to equal the market return. As it turns out, this is tough to do: of 1,033 U.S. equity funds analyzed over one ten-year study, 71% of the funds delivered less than the market return.

Savvy investors intent on buying only those funds with records of outperformance are likely to be disappointed. Consider, for example, the record of the best-performing domestic equity funds over the period from 1983 to 1993. Out of the top 20 funds over those ten years, 16 of the 20 failed to even match the market return in the subsequent decade. While there will always be actively-managed funds that outperform the market, this research delivers a powerful message: consistent outperformance is exceedingly rare.

Index investments also have an inherent tax advantage over actively managed funds. Because of their low turnover (trading), index funds distribute few, if any, capital gains. While typical actively managed funds distribute close to 50% of their annual return in the form of capital gains, index investments distribute less than 0.5%. This keeps more of the fund’s performance in an investor’s pocket.

Numerous studies show that this passive buy-and-hold approach outperforms the average active fund manager. While somewhat sobering (and potentially disillusioning), this seems intuitive: as a group, investors are the market and hence achieve the market return. One would therefore expect investors to collectively underperform the market after management fees, transaction costs and taxes. By minimizing these costs, index funds more closely track the market return and thus outperform a majority of actively managed funds. For these reasons, we employ index investment strategies throughout our clients’ portfolios.

Private Wealth Management

Instituting the discipline to save is the first and often hardest step to take in building a retirement nest egg. The next step, deciding where to put those savings, is also difficult due to the different savings vehicles available and our complex tax code. Understanding the tax advantages of 401(k)s and IRAs is essential for making the right choices and maximizing retirement savings. Here are our recommendations:

1. Those eligible for a 401(k) with a company match should capitalize on the “guaranteed return” by at least contributing up to the limit of the match. There aren’t many investments that guarantee an instant return, not to mention the pre-tax contributions and tax-deferred earnings.
2. If possible, 401(k) contributions should continue to be made up to the maximum amount allowed. Deductible IRAs also offer tax savings on contributions as well as deferral on earnings and should be used by those eligible.
3. A Roth IRA offers tax-free growth and is the next best spot to funnel retirement savings. The growth potential of tax-free compounding overshadows the fact contributions aren’t deductible. *For those with long time horizons, this saving option supercedes number two.*

4. Finally, any additional savings should be directed to an after-tax account. Here, short-term capital gains and interest income are taxed at ordinary income rates (up to 35%) while long-term capital gains and qualifying dividends are taxed at a maximum 15% rate.

Please note we have intentionally omitted making non-deductible contributions to IRAs and annuities. Tax deferral on earnings is not enough to warrant contributing to these types of accounts. The earnings will be taxed at ordinary income rates when withdrawn. With lower rates for long-term gains and dividends, an efficiently managed taxable account is a better choice.

New at Vista

Vista's continued growth has allowed us to further strengthen our investment team. Lindsey Williams joined us in February as a research analyst and associate portfolio manager. Lindsey recently graduated from the University of North Carolina where she earned her MBA with a concentration in investments and finance. Prior to business school, Lindsey worked in New York for Merrill Lynch as a research analyst and fund administrator on its U.S. small-cap growth mutual fund. She started her career with Merrill Lynch's private client group here in Portland as a registered client associate and is excited to return to her hometown. Lindsey enjoys playing tennis, snow skiing, road trips and spending time with her husband, Colin, and their families.

Below you will see a table of year-to-date 2005 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	2005 Returns	Description
S&P 500	-2.59%	<i>Large Cap Stocks. 500 of the largest U.S. companies in all sectors of the economy.</i>
Russell 2000	-5.60%	<i>Small Cap Stocks. A broadly diversified index consisting of about 2000 small companies.</i>
MSCI EAFE	-0.77%	<i>International Stocks. An aggregate of 21 major country indexes, excluding the U.S.</i>
Wilshire REIT	-7.30%	<i>Real Estate. Measures the performance of publicly traded real estate equity.</i>
Lehman Bros. Aggregate Bond	-0.48%	<i>Bonds. Represents the performance of the entire US bond market.</i>