



## VIEW FROM VISTA

July 10, 2006

Dear Valued Client,

Enclosed is your Quarterly Report from Vista Capital Partners for the second quarter of 2006. Following a lengthy period of relative calm, stocks reminded us how volatile they can be. The Dow Jones Industrial Average was up 8% for the year through May 10<sup>th</sup>, less than 100 points off its all-time high, before it began gyrating downward. While you wouldn't know it judging from the anxiety among investors, the Dow still had a positive return of 0.9% for the quarter and is up 5.0% for the year. Other parts of the market, however, suffered a little more pain in the second quarter, with the NASDAQ and the Russell 2000 small-cap stock index down 7.2% and 5.0%, respectively – both down 10% from their highs reached in May. The Fed's 17<sup>th</sup> rate increase since June 2004 sent the yield on the 10-year Treasury to 5.15%, up from 4.3% in January. Accordingly, bonds and bond funds had another slightly negative quarter, leaving the average bond fund down about one percent thus far in 2006.

Some of our observations on the financial markets:

- Small cap stocks are on track to beat shares of the nation's biggest companies for the seventh time in the past eight years, according to Russell Indexes. Over that stretch, the small-cap Russell 2000 index is up over 75% compared to a return of less than 5% for the S&P 500. *Investors have responded in predictable fashion; pushing total assets invested in small cap stock funds from \$108 billion at the start of 1999 to nearly \$364 billion today. Small caps no longer appear cheap, as this demand has pushed valuations 20% above their historical average and to their highest premium to large-cap stocks since 1983.*
- According to a recent report from the Investment Company Institute, the total cost of investing in stock and bond funds fell in 2005 for the third consecutive year, as stock-fund investors paid an average of 1.13% in fees and expenses. *Mutual fund companies may finally be responding to pressure from investors to more responsibly align their interests with shareholders. An increasing number of low-fee index funds and exchange-traded funds are competing for investors' assets.*
- The companies in the Standard & Poor's 500-stock index spent a record \$367 billion to buy back their own stock in the quarter ended March 31, 2006. *This is generally viewed as a positive for shareholders as it increases earnings per share. The record buybacks are a result of surging corporate profits and low capital expenditures.*
- Over the past 20 calendar years, there have been just three years when the S&P 500's annual return was between 6% and 16%, according to Chicago's Ibbotson Associates. *Volatility is the norm in the stock market. The 10%-12% average annualized return that stocks have been generous enough to provide long-term investors is just that, an average.*

*Investment Focus*

We have begun investing in international Real Estate Investment Trusts (REITs) for portfolios with a real estate allocation. REITs, which are required to pass at least 90% of their profits to shareholders as dividends, have largely been a U.S. investment structure until only recently. Today, more than a dozen countries offer REITs and several more are considering legislation to create them. We are attracted to REITs because they have historically provided returns similar to equities, but with a higher level of dividend income and low correlation with other stocks and bonds. Expanding the asset class to include international securities further enhances its overall diversification benefits.

After reviewing the investment vehicles in this category, we have selected the Alpine International REIT Fund (EGLRX). EGLRX is the oldest global REIT fund and has been run by the same portfolio manager since its 1989 inception. The fund further stands out from its international REIT peers for the following reasons:

- Low expense ratio for an international REIT fund – 1.18%
- At least 80% exposure to non-U.S. real estate investments
- One Source fund at Schwab (no transaction fee)

While there are currently no international REIT index funds available, we expect an offering within a year. At that time we will consider using an index fund for international REIT exposure.

*Private Wealth Management*

Recent tax law changes have many investors wondering whether they should convert their Individual Retirement Accounts (IRAs) into Roth IRAs. Currently, taxpayers can convert an IRA into a Roth IRA only if their adjusted gross income is under \$100,000. Under the new law, this income limit is removed in 2010. The question investors must consider is whether the tax consequences of converting (paying taxes now on IRA assets converted) are justified by the benefits (future tax-free withdrawals and no Required Minimum Distributions (RMDs) during the account holder's lifetime).

In theory, converting an IRA to a Roth IRA has appeal. Tax-free is better than tax-deferred and delaying RMDs allows more time for compounding. Furthermore, investors who expect to land in a higher tax bracket during retirement – or expect that tax rates overall will increase – stand to benefit by paying at current rates.

In reality, we believe conversion doesn't pencil out for many investors for the following reasons:

1. To benefit from a conversion, an account holder must be able to pay the taxes owed with money held outside the IRA. If you're under 59 ½, you'll be subject to a 10% penalty on IRA assets used to pay taxes on the conversion.
2. We doubt many account holders will opt to pay a large tax bill now (e.g. \$170,000 for a \$500,000 IRA balance at the 34% bracket) in order to enjoy benefits that may or may not materialize for 30 years.
3. Converted Roth IRA balances must be expected to remain untouched, growing tax-free for 30 or 40 years (or more), for real benefits to accrue from conversion.

4. If you assume no change in tax bracket between now and when IRA withdrawals begin (a fair assumption), there is very little benefit to conversion. You must expect your personal tax rate to increase substantially for there to be more than only marginal benefits.

On the other hand, if the goal is to maximize your estate for heirs and you won't need your IRA assets for retirement, taking advantage of the recent tax law change to convert from an IRA to a Roth may make sense.

Other

Hopefully, you've received the survey we sent you towards the end of June. Your feedback will help us evaluate our services and provide a basis for improvement in the future. Please let us know if you didn't receive the survey, so we can provide you with a copy. Thank you in advance for your time and consideration.

We are proud to announce Vista Capital Partners was recently selected by the Portland Business Journal as #23 on its list of the Top 100 Fastest-Growing Private Companies in Oregon. Vista was one of only a handful of the 100 companies listed to be profiled in an article by the publication. We thought you might enjoy reading the article and have included a reprint as part of this mailing. We are especially proud of our firm's achievement because we do virtually no marketing or advertising. This means our growth is the result of the positive experiences of our clients and their willingness to refer family and friends to Vista. Our resulting growth helps us attract the very best investment professionals and to raise our investment minimum for new clients (\$1 million) in order to keep our client-to-professional ratio low. Thank you for helping make Vista successful and for your continued trust, confidence and referrals. We welcome your calls and e-mails and look forward to our next meeting or conversation.

Sincerely,

Vista Capital Partners

Comparative Returns:

Index	2006 Returns	Description
S&P 500	+2.7%	<i>Large Cap Stocks.</i> 500 of the largest U.S. companies in all sectors of the economy.
Russell 2000	+8.2%	<i>Small Cap Stocks.</i> A broadly diversified index consisting of about 2000 small companies.
MSCI EAFE	+10.5%	<i>International Stocks.</i> An aggregate of 21 major country indexes, excluding the U.S.
Wilshire REIT	+14.5%	<i>Real Estate.</i> Measures the performance of publicly traded real estate equity.
Lehman Bros. Aggregate Bond	-0.7%	<i>Bonds.</i> Represents the performance of the entire US bond market.