



VIEW FROM VISTA

October 11, 2005

Dear Valued Client,

Enclosed is your Quarterly Report from Vista Capital Partners for the third quarter of 2005. In spite of all the concern – Hurricane Katrina, rising oil prices, interest rates and the war in Iraq – most segments of the financial markets managed at least a modest gain for the quarter, with the average U.S. stock fund posting a 4.7% gain. International stocks led the way, with the MSCI EAFE index up a strong 10.4%. Bonds barely lost ground in the quarter, down just 0.06%, a relatively minor loss considering the Fed's two interest rate hikes. As you will see from the comparative returns below, this leaves us with a mixed bag of year-to-date results for the major indexes.

Our clients continue to benefit from Vista's portfolio construction efforts and the resulting diversification beyond traditional large company stocks and U.S. corporate and Treasury bonds. Our investments in small company U.S. stocks, for example, have considerably outperformed large company stocks in each of the last six years. Our investments in small cap international and emerging market funds have significantly outperformed their large cap counterparts both in the U.S. and abroad. And Real Estate Equity Investment Trusts (REITs) remain on an unprecedented winning streak. Finally, our decision to include inflation-protected securities, as well as international and high-yield bonds, in our bond portfolios, has paid off with superior performance relative to the more widely owned corporate and Treasury markets. The benefits of diversification have rarely been more evident – not only through better performance but also by reducing overall portfolio risk, or volatility, versus a more traditional mix of investments.

Some of our other observations on the financial markets:

- Companies in the S&P 500-stock Index are expected to post double-digit earnings growth for a record 14th consecutive quarter (3 ½ straight years). *Despite this record earnings growth, the S&P 500 Index is trading at the same level it did nearly seven years ago. This shows how overpriced the stock market was in the late-90's. At least we have reason for hope going forward – we are seeing a lot of great companies trading at fair prices.*
- As the strong economy and company profit growth continues, cash is piling up on corporate balance sheets at a record pace. Companies in the S&P 500-stock index have salted away more than \$630 billion in cash, an increase of 54% in just two years. The level of cash and cash equivalents held by companies in the S&P 500 has reached 7.7% of their market value, up from 3.6% in 2000. *As shareholders, we hope to benefit from this via healthier balance sheets, higher dividends, share buybacks and smart acquisitions of profitable businesses.*
- Americans' personal savings as a percentage of disposable income was a negative 0.7% in August. It was also negative in June and July. And new research from the Fed's Alan Greenspan said American consumers have become enormously dependent on borrowing against their homes to fuel spending – adding a whopping \$600 billion to consumers' spending power last year alone. *Only in America – home of the world's most anemic savers! Another example of how a rise in mortgage rates could*

dramatically impact the economy.

- Thanks to a dramatic rise in crude oil and natural gas (up more than 50% this year), energy shares in the S&P 500 have risen nearly 40% in 2005. Of the index's remaining nine sectors, only two others – utilities and health care – are in positive territory. *Without energy, the S&P 500 would be down 2% for the year, instead of up 1.4%.*

Investment Focus

Studies show that over 90% of an investment portfolio's return variability is attributable to its asset allocation. Accordingly, many investors keep a watchful eye on their asset allocation, or mix of stocks, bonds, REITs and cash. Few investors, however, pay much attention to *asset location*.

Not to be confused with asset allocation, asset *location* refers to the placement of certain asset types in tax-deferred accounts - IRAs and 401(k)s - and other types of assets in taxable accounts. The concept is simple: place the most highly taxed assets in tax-deferred accounts, while putting more lightly taxed assets in taxable accounts. This means putting bonds and REITs, whose payouts can be taxed at income rates of up to 35%, in tax-deferred accounts. Investors should favor higher-yielding taxable bonds in their IRAs and 401(k)s over municipal bonds in taxable accounts. Equities, whose capital gains and dividends are taxed at a federal rate of 15%, should be invested in taxable accounts.

In addition to the benefit of lower capital gain and dividend tax rates on equities, many other reasons exist for favoring equities in taxable accounts. First, the taxation of capital gains can be deferred as long as investors continue to hold their positions. Second, capital gains can be avoided entirely if investors hold their stocks until death, at which point they are eligible for a step-up in basis when passed on to heirs. Third, capital losses on poor-performing equities can be used to offset realized gains on other stocks. This ability to tax-manage an account is not present in tax-deferred accounts. Finally, low cost basis positions can be gifted to children or charity, thereby escaping taxes entirely.

Despite the logic and simple math behind it, asset location is largely ignored. Vista has always paid close attention to asset location, having managed client portfolios on what we call a "consolidated" basis for years. Recent studies show our efforts in this area are the exception, rather than the norm. A 2004 Federal Reserve survey revealed Americans invest their taxable accounts and tax-deferred accounts almost identically, with about 65% of each devoted to equities. Investors who do this leave a lot on the table: according to Carnegie Mellon finance Professor Robert Dammon, allocating assets to the wrong type account can reduce a portfolio's ending value by more than 20%.

Private Wealth Management

Your investment portfolio is just part of your financial picture. Vista recommends you periodically review your overall plan to ensure all the pieces are in place and up to date. Failure to address the often-overlooked details can have serious consequences and undermine your long-term goals. To quickly test your plan's adequacy, ask yourself the following questions:

- Do you have an estate plan? *Recent surveys reveal many people don't. At the very least, you need a will naming a guardian for minor children, a personal representative, and beneficiaries. Trusts may be needed to shelter assets from estate tax and avoid probate.*

- Do you have adequate life, disability and long-term care insurance? *Life - estimate the income that would need to be replaced for your family if you died. Disability - there is a greater chance of becoming disabled than dying prematurely. Long-term care - the coverage is expensive to buy, but it may make financial sense in certain circumstances.*
- Have you designated beneficiaries for your IRAs? *Missing or outdated beneficiary information can create serious tax consequences for your heirs. When set up correctly, beneficiaries can still enjoy tax-deferred growth.*
- Is charitable and family giving part of your plan? *If so, there may be steps you should take now to accomplish these philanthropic goals as tax-efficiently as possible.*

At Vista, our goal is to be a resource for all of your financial needs. We will continue to reach beyond investment matters in our personal meetings. In the meantime, please contact us if we can provide recommendations or referrals in any of these areas.

Other

Vista reached a noteworthy milestone when our assets under management reached \$250 million in September. While we try to avoid the spotlight, this certainly makes us one of the fastest-growing investment advisory firms in the Pacific Northwest. We are grateful for our good fortune and thank each of you for helping make this possible – both for your decision to trust Vista with your hard-earned money and for your subsequent referrals. Our growth and reputation has allowed us to attract some of the most talented people in our business. To ensure manageable growth while maintaining the highest level of service, we have also raised our minimum to \$1 million for new clients.

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 meeting or conversation.

Sincerely yours,

Vista Capital Partners

Comparative Returns:

Index	2005 Returns	Description
S&P 500	+1.4%	<i>Large Cap Stocks. 500 of the largest U.S. companies in all sectors of the economy.</i>
Russell 2000	+2.5%	<i>Small Cap Stocks. A broadly diversified index consisting of about 2000 small companies.</i>
MSCI EAFE	+9.5%	<i>International Stocks. An aggregate of 21 major country indexes, excluding the U.S.</i>
Wilshire REIT	+11.2%	<i>Real Estate. Measures the performance of publicly traded real estate equity.</i>
Lehman Bros. Aggregate Bond	+1.8%	<i>Bonds. Represents the performance of the entire US bond market.</i>