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Money Matter\$



A quarterly newsletter from Sommers Financial Management

Phone (503) 397-1545 Email sommers@crpud.net

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Options Make Sense According to February 2003 SmartMoney Column

The Options Game—as James B. Stewart titled his column in February’s edition of the Wall Street Journal’s SmartMoney Magazine—highlighted the immense value of using options in an investment portfolio. Stewart starts off lamenting that **“For a long time I shunned options in the stock market as just another form of gambling.”** But after dabbling in some options a few years back, Stewart learned not only that “selling covered calls is deemed sufficiently conservative to be permitted in tax-advantaged retirement accounts,” but also that if you sell covered calls, your potential losses are capped by the fact that you already own the shares. Though he considers himself a cautious investor, he **now believes that options “Have a place in every investor’s arsenal.”** Stewart finds himself following a similar path as Sommers Financial Management when it comes to utilizing options: Sell only covered

calls, look for big premiums suggesting a euphoric market sentiment about a stock’s prospects, and sell short-term contracts. Using these guidelines, Stewart claims that **he has now sold calls on more than a dozen occasions, and every one of them has resulted in a net profit.** In other words, he takes the same cautious, common-sense approach to options trading as Sommers Financial Management. Like our investment philosophy, Stewart maintains that long-term, patient stock ownership remains the backbone of his investment approach, claiming that options are a very small percentage of his portfolio. **He also recognizes that “While [his] options trading has proven very profitable, curiously, [his] approach seems to be very unusual.”** I am often asked to explain why this approach is so unusual—maybe a better word is differ-

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Returns for the 2002 Calendar Year:

- Dow Jones Industrial 30 Average :
-16.76%
- Standard & Poors 500 Large Company Index:
-23.37%
- Nasdaq Composite Index:
-31.53%
- Russell 2000 Small Company Index:
-21.41%
- Integrity Investment Services, A small, private investment company managed by Adam Sommers - Registered Investment Adviser:
-14.07%

Sommers Financial clients can and are encouraged to convert their taxable accounts of less than \$10,000 into an account with Integrity Investment Services to obtain further diversification. Please call (503) 397-1545 for details!

Clients’ Taxable Accounts performed well in 2002...

As I summarized my investment transactions made on behalf of clients in 2002 while preparing my year end tax reports, I came upon some very positive results to report.

These are results from taxable accounts only, but are a good representation of my entire year in terms of investments in client accounts. Additionally, since these figures were prepared for tax purposes, only securities that ended up being sold, thereby resulting in a realized gain or loss in 2002, are included.

The annualized return for investments sold in 2002 came to 50.19%. Of course, we were not fully invested for the entire year in any account, so the 50% figure was not achieved by any client. However, for those periods we were invested, our returns trounced the general market by a landslide. Out of the 18 investments sold in 2002, 17 generated a posi-

tive return. The one investment sold for a loss was a loss in a small technology company of 10% over a period of 60 days.

Even with the one investment loss, **we averaged 8.9% on each investment, while holding the security an average of only 64 days, thereby limiting our exposure to the general market decline.**

Details:

- The security held for the longest period of time was in an account for a total of 191 days. The shortest time period in which we had exposure to an investment in 2002 was for a mere 32 days.
- The 18 investments included in the data can and do include the same securities held for different time periods and for multiple clients.
- Only one of the investments sold in 2002 did not include the use of covered call options.

Common Sense Regarding Options According to SmartMoney Magazine *(continued from page 1)*

ent— from the average investment professional’s strategy. After explaining the use of options to clients and prospective investors, they often ask me: “If you are so successful with the use of options, why isn’t everyone doing it?” Stewart figures that “Most options traders are technophiles and big institutions with sophisticated computerized strategies that seize on minor arbitrage possibilities and volatility aberrations.” In other words,

option investors are not your average, everyday folks building a portfolio for their retirement years or for their children’s college education. So far, I don’t have a better answer for the skeptics (Why *aren’t* more people doing this?), but I think that James B. Stewart’s article helps shed some light on the subject and prove we aren’t sitting on an undiscovered investment secret, we at Sommers Financial Management and Mr. Stewart may just be the only investors implementing it!

“Occasionally, successful investing requires inactivity” - Warren Buffett

As I write this, Sommers Financial Management’s accounts are positioned with more than 40% held in cash or money market funds. As an investment adviser, it is my duty to invest to

the best of my ability for the greatest return to my clients. At times I feel that by not investing your money, I am not performing my duty as described.

vestment approach.

“Think about that for a second. The man who loves investing like a sumo wrestler loves eating rice is suggesting your best investment strategy of the moment is to do nothing. You don’t have to be a rocket scientist...to realize that if one of our era’s great investors is sitting on the sidelines, perhaps you should be too.”

— Adam Lashinsky, CNN

To my and other cash-hoarding investment professionals’ defense, not losing money could be considered making money amidst a bear market like the one we’ve experienced over the past three years. The reward that Sommers Financial Management will provide you for placing your money in an account with us is that we can take advantage of the great investment opportunities that present themselves. With every downtick stocks become increasingly attractive due to our value-oriented in-

The Great Oracle of Omaha — my mentor – Warren Buffett, in his recent letter to Berkshire Hathaway shareholders states, “...I love owning common stocks— if they can be purchased at attractive prices. With short-term money returning less than 1% after-tax, sitting it out is no fun. But occasionally successful investing requires inactivity.”

I agree that sitting on the sidelines is no fun— that is, until a great bargain stands out and we are able to ride the upward momentum and be rewarded for our diligence. We patiently await the upcoming opportunities...

Dividends—Are they meaningless or more important than ever?

Thanks to the big “Dubya” in DC, chatter on Capitol Hill about dividends has begun to spread to Wall Street, as legislators and investment gurus the world over review the Bush Tax Proposal that would change the manner in which corporate dividends are taxed at the individual investor level.

Aside from this proposal, there are and have always been other persuasive reasons for investors to favor a dividend. Investors have always believed dividends were a positive feature of owning a stock, but the 1990 Nobel Prize for Economics was awarded for the theory that dividends didn’t matter. In fact, what really matters is not *if a company pays a dividend*, but the company’s *ability to pay* one.

Since returns to investors in *any* form are derived from earnings, the much-watched dividend yield is basically meaningless over the long-term. It only tells how much of your entitled profits will be paid out to you in a given year. One positive result of dividends: Management’s capital allocations will suffer more scrutiny—they will be less likely to unwisely invest your profits. A dividend can be understood as a signal that the growth era may be over, as management and the board of directors envision the shareholder better able to invest their rightful earnings. Over time corporations that retain more capital than they need will be apt to squander it. Any parent knows this—if you give a child (e.g. a CEO) too much spending money, he will blow some of it on video-

games, candy, acquisitions, etc. Warren Buffett defines the proper point at which to issue a dividend: “When a company can reinvest at higher rates than shareholders can earn on their own, it should keep the money. When not, pay a dividend.”

A second positive result of dividends is that they must be paid with real money, which requires cash flow; Hence companies with ample dividends are less likely to be involved in crooked accounting scandals and chicanery.

These two factors point to companies that pay dividends as more conservatively run—a **good thing when it comes to managing shareholder funds**.

Below is a list of interesting dividend-paying stocks and their yields .

Dividend Stocks	Symbol	Yield
• Plum Creek Timber	PCL	6.6 %
• Heinz Company	HNZ	5.5 %
• Albertsons Grocery	ABS	4.2 %
• US Bank	USB	4.0 %
• Bank of New York	BK	3.6 %
• Washington Mutual	WM	3.4 %
• Merck	MRK	2.8 %
• MBNA	KRB	2.4 %
• Pfizer	PFE	2.0 %