



Address Label

Risk is not knowing what you're doing—
Warren Buffett

“GRAHAM’S PREMISE WAS THAT THERE WOULD PERIODICALLY BE TIMES WHEN YOU COULDN’T FIND GOOD VALUES, AND IT WAS A GOOD IDEA TO GO TO THE BEACH.”

“There seems to be some perverse human characteristic that likes to make easy things difficult.”

“Money, to some extent, sometimes lets you be in more interesting environments. But it can’t change how many people love you or how healthy you are.”

“RESTRUCTURINGS—THAT’S A WORD FOR MISTAKES.”

“It looks impressive if it comes out of a computer. But it’s frequently nonsense. The person who’s making the decision is far more important.”

—Excerpts from “Thoughts of Chairman [Warren] Buffett”- compiled by Simon Reynolds

Stock Spotlight — Federated Investors (FII—\$29.07)

Federated Investors Inc. is a publicly owned investment manager with approximately \$235 billion in assets under management. With investor sentiment down and a lot of cash in money market reserves awaiting a market bottom, Federated is poised to maintain a relatively stable level of assets under management when compared to other equity-focused fund companies.

The firm provides its services to individuals, banking or thrift institutions, investment companies, pension and profit sharing plans, pooled investment vehicles, charitable organizations, state or municipal government entities, and registered investment advisors. Through its subsidiaries, it manages separate client-focused equity, fixed income, and money market mutual funds. The firm invests in the public equity and fixed income markets across the globe.

FII’s Notable Statistics	
Market Capitalization	\$ 2.96 Bil.
5 Yr. Annual Growth Projection	12 %
SFM’s Price / Earnings Ratio	10.0
SFM’s Calculated ‘Payback Ratio’	10 %
Net Profit Margin	16 %
Dividend Yield	3.3 %
3 year average Return on Equity	37 %
Debt / Assets	0.30



Should I make extra payments to my mortgage and aim to pay it off early?

By Adam Sommers

One of my favorite topics of discussion when sitting down and discussing a financial plan is your home mortgage—or any debt for that matter. Often, people have an inherited urge to be debt free and owe money to no one; quite a normal, healthy emotional indoctrination. Fortunately, when it comes to money, I set aside emotion and look at the necessary figures.

Outside of emotion (what one client calls the ‘pillow test’ - can she sleep at night knowing how her money is situated?), there are just a few items you need to analyze when deciding if debt repayment is the best use of your dollars:

1. Is the interest tax-deductible?
2. What is the interest rate you must pay the lender?
3. What is your marginal tax rate?
4. Have you maxed out all of the tax-advantaged savings plans available?

The first thing I like to calculate is my after-tax cost of borrowing the money. If the interest is not tax-deductible, then I know that my after-tax cost of borrowing is the stated interest rate. However, if the debt is a mortgage, business loan or student loan, the federal government often gives you a tax break by allowing you to deduct the interest from your income when calculating your income taxes.

Using my own situation as an example, my mortgage interest is tax-deductible, and I am borrowing the money at a stated 5.5%. My marginal tax rate is 34% (25% federal, 9% state). To calculate my after-tax cost, I multiply the 5.5% interest rate by one minus my tax rate of .34 (.055 x .66), arriving at an after-tax interest cost of 3.63%.

Once I’ve calculated my after-tax cost of the money, I must decide if I can earn a better after-tax return on my investments. It is a good idea to look at paying your mortgage as an investment, as you want to make the best investment with every dollar. I now know that paying more toward my mortgage will give me a guaranteed after-tax return of 3.63%. Similarly, paying off a credit card might give me a guaranteed after-tax 19% return.

I also know that if I put money into my retirement plan at work I will be allowed to deduct those contributions from my income when figuring my income taxes. Knowing that my marginal tax rate is 34%, I realize that **in just the first year, not including any earnings on those retirement funds, I will earn 34% by simply avoiding taxes on that money. That 34% is equal to nearly 10 years of extra payments on my mortgage—in just the first year!**—so I essentially could earn nothing on those funds for 10 years and still be economically equal with the alternative of making extra payments to my mortgage.

Considering that even a bank CD in a tax-deferred IRA or 401k these days pays 4%, I can beat my after-tax cost of 3.63%. Add in my 34% gain from the tax benefit in year one and you have the answer to the headline question.

Some folks may say I’m “leveraged to the hilt”, and may have uneasy feelings about being in debt. However, I know that heading for \$1,000,000 in my retirement account and \$300,000 in debt gives me a higher net worth (\$700,000) than owning a \$500,000 home outright with little or no retirement savings. My aim is to continue to analyze for clients the real cost of their debt, to keep an eye out for IRS incentives, and attempt to earn a satisfactory return on your investments.

Five Year Average Annual Returns

- Dow Jones Industrial 30 Average: 3.4 %
 - Standard & Poor’s 500 Index: 3.4 %
 - NASDAQ Composite Index: 3.3 %
 - Russell 2000 Small Company Index: 7.8 %
 - SFM’s MODEL 25 PORTFOLIO: 9.9 %
- (see inside the newsletter for updates to the Model Portfolio)

**Sommers Financial Management's
AGGRESSIVE Stock Portfolio**

Company Name	Risk Grade	P/E Ratio	Growth Rate	Payback Yield
Analog Devices	C	13.4	20%	11%
American Eagle Outfitters	C	9.6	13%	14%
Franklin Resources	B-	11.3	11%	12%
Biovail	D	8.2	6%	18%
Syneron Medical	C	11.5	14%	14%
Enesco International	C	7.3	16%	20%
Federated Investors	C	10.9	12%	10%
Forest Laboratories	C	7.7	9%	18%
Corning	C	14.1	15%	16%
Genco Shipping	F	2.3	26%	16%
Microsoft	A-	10.9	11%	10%
New Frontier Media	D	7.1	15%	16%
NetEease	C	13.7	14%	12%
NutriSystem	F	6.9	18%	21%
OptionsXpress	D	9.8	18%	12%
Occidental Petroleum	B	5.8	19%	17%
Southern Copper	D	6.1	1%	11%
Pfizer	B+	8.1	4%	12%
Phillipine Long Distance	C	8.6	8%	9%
Taiwan Semiconductor	B-	15.2	18%	15%
Texas Instruments	B	10.1	15%	14%
Viropharma	C	42.4	26%	25%
MEMC Electronics	D	7.5	26%	26%
World Acceptance	D	7.6	15%	10%
Exxon Mobil	A-	6.5	10%	12%
Averages:		10.5	14%	15%

**Sommers Financial Management's
Conservative INCOME Stock Portfolio**

Company Name	Risk Grade	P/E Ratio	Div. Yield	Ret. on Equity
Accenture	A-	10.8	1.2%	57%
AstraZeneca	A-	8.4	2.5%	25%
Boeing	B	8.4	2.6%	55%
Anheuser-Busch	A+	16.9	2.3%	52%
Colgate-Palmolive	A+	17.0	2.0%	67%
Chevron-Texaco	B	6.0	3.3%	24%
Federated Investors	C	10.9	3.0%	37%
Heinz	A-	14.1	3.2%	39%
IBM	A-	11.2	1.7%	34%
Johnson & Johnson	A+	14.2	2.6%	25%
Kellogg's	A-	15.1	2.4%	43%
Coca-Cola	A-	16.5	2.8%	25%
Eli Lilly	B+	10.8	4.2%	26%
McGraw-Hill Publishing	B+	11.0	2.2%	44%
3M	B	10.8	2.9%	30%
Microsoft	A-	10.9	1.7%	43%
Novartis	A-	14.6	2.7%	18%
Occidental Petroleum	B	6.9	1.6%	27%
Pepsi	A-	17.6	2.3%	35%
Pfizer	B+	8.1	7.2%	14%
Taiwan Semiconductor	B-	15.2	4.4%	14%
Texas Instruments	B	10.1	1.8%	28%
US Bank	B-	11.2	5.0%	19%
US Tobacco	A+	15.5	3.7%	200%
Exxon Mobil	A-	6.5	2.2%	34%
Averages:		11.9	2.9%	41%

**Sommers Financial Management's
ORIGINAL "Model 25" Stock Portfolio**

Company Name	Value Grade	Cash Flow	Risk Grade	Market Cap
Accenture	B	C	A-	Large
Analog Devices	B	A-	C	Mid
Applied Materials	C	B	A-	Large
Boeing	A	C	B	Large
Franklin Resources	C	A-	B-	Mid
Biovail	A	A-	D	Small
Cherokee	C	A+	C	Micro
ConocoPhillips	A	D	B	Mega
Chevron-Texaco	A	C	B	Mega
Syneron Medical	C	A+	C	Micro
Enesco International	B	B+	C	Mid
Federated Investors	B	A	C	Small
Graco	C	A-	B	Small
Johnson & Johnson	C	C	A+	Mega
Microsoft	C	A-	A-	Mega
Nokia	A	C	C	Large
New Frontier Media	A+	B	D	Micro
Occidental Petroleum	A	B	B	Large
Pfizer	B	B-	B+	Mega
Phillipine Long Distance	B+	A-	C	Mid
Taiwan Semiconductor	B	B+	B-	Large
Texas Instruments	B+	B	B	Large
US Tobacco	D	A	A+	Mid
Exxon Mobil	A	C	A-	Mega
Zenith Insurance	A	C	C	Small

Commentary and Ramblings

By Adam Sommers

Lehmans, Tembecs, and Bailouts—oh my. “I smell fear. Is it fear of more bankruptcies? I can’t convince myself that’s the source.” Bankruptcies of prominent institutions like Lehman Brothers create volatility in the market whereby all companies get painted with the same “toxic” brush, no matter their strength—creating long-term buying opportunities.

“Since I’m the lone worker-bee in the office these days after Jake moved on to a bigger employer with deeper pockets, the fear I smell *must* be internal.” However, I recognize the discounted bargains today, with companies like US Tobacco and Anheuser Busch becoming so attractive that they’re being wholly acquired at a premium to where we were buying them. “So what is it that could be causing these uneasy feelings?”

For those of you who don’t already know, **Teresa and I are expecting our first child—a girl—in early November. While I have confidence in financial markets and my ability to navigate them, a baby is uncharted territory for me.** Yes, I’ve coached middle and high school students in sports like soccer and basketball over the last decade. *But babies are different.* They can’t feed, move, or potty themselves—heck, they can’t even communicate clearly—and they are SO impressionable. My high school athletes unfortunately (or fortunately depending on your perspective) influence *me* more than I do them.

This past weekend, Teresa and I spent time in the nursery decorating and organizing—stemming from Teresa’s natural nesting instinct. I have instincts besides fear of course, which have caused me to do some thinking on how best to save for college.

For those interested, my current plan is to save \$500/month for Little Miss Sommers into two kinds of plans: An Oregon College Savings Plan (529) with \$4,000 annually in order to maximize the *increased* allowable Oregon tax deduction—thereby saving us an annual \$360 in Oregon income taxes (at the current 9% Oregon tax rate).

With the other \$2,000 per year I plan to max out a Coverdell Education Savings Account. Both plans offer the benefit of tax-free withdrawals for college. The reason I’m choosing to contribute the other \$2,000 into the Coverdell rather than the 529 is twofold: First, the Coverdell can be custodied at TD Ameritrade, and I can have control over the investment selection. (The Oregon College Savings Plan has selected a handful of Oppenheimer and Vanguard funds from which we can choose.) Second, the Coverdell ESA can be used to pay for qualified educational expenses prior to college as well, in the event we’d like to send Little Miss Sommers to a private high school; whereas the 529 funds are limited to college or university expenses.

The fear I smell comes more from the unknown—like *what do I do* with this little person to have it all turn out well? I feel ill-prepared knowing I don’t have any credible experience when it comes to raising a child. My fear is lessened by the fact that for ten years Teresa has successfully shaped and influenced children as an elementary school teacher. With that in mind, our combined strengths “should” be able to cultivate a positive, contributing citizen over the next couple of decades. Bring her on!

SFM AGGRESSIVE Stock Portfolio vs.

Relevant Benchmarks

	SFM Aggressive	Russell 2000 Index	Nasdaq Index
3 Month Return:	- 10.2 %	- 1.6 %	- 9.2 %
12 Month Return:	- 23.1 %	- 15.7 %	- 22.9 %
3 Year Average Annual:	N/A	0.6 %	- 1.1 %
5 Year Average Annual:	N/A	7.8 %	3.3 %
ROR Since 4/1/2007:	- 14.4 %	- 10.1 %	- 9.3 %

SFM Conservative INCOME Stock Portfolio vs.

A Relevant Benchmark

	SFM Income	Dow Jones Industrial Avg.
3 Month Return:	- 4.4 %	- 4.4 %
12 Month Return:	- 14.0 %	- 21.9 %
3 Year Average Annual:	N/A	0.9 %
5 Year Average Annual:	N/A	3.4 %
ROR Since 4/1/2007:	- 6.9 %	- 8.1 %

SFM ORIGINAL Model "25" Portfolio vs.

A Relevant Benchmark

	SFM Model 25	S&P 500 Index
3 Month Return:	- 12.3 %	- 9.0 %
12 Month Return:	- 27.0 %	- 23.7 %
3 Year Average Annual:	- 2.4 %	- 1.7 %
5 Year Average Annual:	9.9 %	3.4 %
ROR Since 6/1/2003:	13.2 %	3.8 %