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Money Matter\$



A quarterly newsletter from Sommers Financial Management

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The Steadily Rising Market Leaves Little Premium For Option Sellers

Market volatility is at a seven year low, and option prices reflect this statistic. Sommers Financial Management tries to spread investment risk by using an option strategy called "selling covered calls", but lately call premiums have not been as juicy as in 2001 and 2002.

Call options give a right to the buyer to purchase shares of stock from the seller (us) at a predetermined price by a predetermined date. For giving them this right, they in turn pay us a premium—which is deposited directly into our account while we wait to see if they will "call" away our stock by the third Friday of next month.

When market volatility is high like in 2001 and 2002, these **option premiums were earning our clients between 2 and 5% per month after commissions**, while protecting

our investment and lowering the risk of owning the stock. Great companies like Microsoft and Costco had the potential to earn you 5% per month while protecting the owner of the stock from a 10% drop over the next 30 days.

Over the past few months, we've had to turn to smaller companies to earn acceptable option premiums, in addition to capitalizing on companies who become volatile due to news releases. One such company we purchased in the last month is Concord EFS. Concord is a credit/debit card transaction processor that is attempting to merge with First Data Corp. The Department of Justice stepped in to review the merger, and lined out stipulations that must be met. While the DOJ was investigating, the volatility of Concord EFS stock allowed us to

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Returns Since June 1, 2003

- Dow Jones Industrial 30 Average : 16.04 %
- Standard & Poors 500 Index: 13.33 %
- Nasdaq Composite Index: 24.04 %
- Russell 2000 Small Company Index: 25.36 %
- Sommers Financial Management's MODEL PORTFOLIO (see next page for an update): 26.29 %

Stock Profile – China Yuchai (CYD)

I have been aggressively buying China Yuchai in client accounts. Growth in China is expected to be double that of the United States and Europe, and the call option premiums (5% per month) on CYD make this stock a great buy for both the short and long-term. China Yuchai International Ltd. is a medium-duty diesel engine manufacturer in China that also produces diesel power generators and diesel engine parts. The Company owns a controlling interest in Guangxi Yuchai Machinery Company Limited (Yuchai) and owns, through six wholly owned subsidiaries, 76.4% of the outstanding common shares of Yuchai. Yuchai primarily manufactures and sells diesel engines for medium-duty trucks in China. Yuchai's primary products are its 6105QC and 6108 medium-duty engines, which are princi-

China Yuchai Statistics	
Growth Projection—next 5 years	30%
Dividend Yield	2.86%
Price-Earnings Ratio	13.3
5-year Beta	0.88
Return on Stockholder Equity	19.1%
Return on Assets	10.3%
Debt/Equity	0.15
Profit Margin	13.6%

pally used in medium-duty trucks with a load capacity of five to seven tons. In addition, Yuchai also offers the 4-Series light-duty engines and the 6112 heavy-duty engines. Besides diesel engines, Yuchai produces a limited number of diesel power generators and diesel engine parts. \$

Low Volatility = Low Option Premiums

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capitalize on a **7% return in 35 days** as long as the stock didn't drop more than 12%. With the stock already at rock bottom due to news of the DOJ investigation—and our graphical analysis showing the next move being up, the 12% drop seemed unlikely. In the two weeks since our purchase in our more aggressive accounts, it is now up over 10%. Due to selling the call, our clients will earn a 7% return from the call premium, but our risk was lessened, and our reward still great!

One Company that continues to offer excellent returns with the selling of covered calls is China Yuchai, profiled on page one. We expect to earn 6% per month after commissions selling covered calls on CYD in aggressive accounts, just as we did for clients in November and December. \$

2003 Biggest Movers

The S&P 500 had some very big winners this year, with three of the top five being technology stocks, and the other two energy stocks. Below is a list of the biggest winners and losers in the S&P 500 during 2003 (as of December 24th).

<u>Winners</u>		<u>Losers</u>	
Avaya (AV)	+394.3%	Winn-Dixie	-38.2%
Ebay (EBAY)	+277.6%	Eastman Kodak	-25.5%
Williams Co. (WMB)	+267.8%	Newell Rubbermaid	-24.4%
Dynegy (DYN)	+255.1%	Qwest	-24.2%
PMC-Sierra (PMCS)	+251.6%	AT&T	-22.2%
Novell (NOVL)	+216.2%	Kohl's	-21.2%
Corning (GLW)	+208.2%	Schering-Plough	-21.1%
AES (AES)	+194.0%	King Pharma	-14.5%
Sanmina (SANM)	+176.8%	Merck	-13.4%
Yahoo! (YHOO)	+173.8%	DTE Energy	-12.0%

Sommers Financial Management's MODEL PORTFOLIO Update

Back on June 1st, I created a model portfolio that would keep track of my stock-picking performance aside from individual portfolios that are tailored to my clients. While researching potential investments, I place every stock into a proprietary spreadsheet created by Sommers Financial Management. The spreadsheet takes into consideration data from financial statements and from industry analysts, and gives a numerical score to each stock (including closed-end mutual funds). The stocks are then ranked in order from best to worst score, with the top 20 being held in the Model Portfolio.

Since June 1st, this portfolio has increased more than 26% to over \$252,000 by late December. That is an annualized return of 45%, and was measured in a time when the S&P 500 increased only 13%, or 22% annually. So in the first seven months of the portfolio's existence, the Model Portfolio has succeeded in doubling the market's return.

During the last quarter I replaced a few of the stocks in the portfolio and continued to hold the top 21 stocks of interest. Outgoing stocks included Coca Cola Femsa and Pfizer, due to taking on excessive debt in completing acquisitions; and Mentor, Pier One Imports and Possis Medical, due to rising prices and higher valuations. Added to the portfolio were China Yuchai—profiled on the first page, Cytec, K-Swiss, Lennar, NVR.

Currently, we are over-weighted in homebuilding stocks, accounting for four of the 21 holdings. Homebuilders are growing their profits substantially while maintaining relatively low-priced stocks. I expect this trend to change when the housing boom slows, but this portfolio is based on fundamentals only, and the homebuilding sector is fundamentally strong in the current low-interest rate environment. \$

<u>Rank</u>	<u>Company Name</u>	<u>Symbol</u>	<u>Industry</u>
2	Abercrombie & Fitch	ANF	Retail Clothing
20	China Yuchai	CYD	Diesel Engine
21	Cytec	CYTC	Medical Devices
6	Doral Financial	DRL	Mortgage Bank
18	Eaton Vance	EV	Asset Management
11	Harley Davidson	HDI	Motorcycles
12	IPC Holdings	IPCR	Life/Health Insurance
19	Johnson & Johnson	JNJ	Consumer Healthcare
15	KB Home	KBH	Homebuilder
16	K-Swiss	KSWS	Shoe Manufacturer
9	Lennar	LEN	Homebuilder
5	Altria Group	MO	Tobacco/Foods
7	Merck	MRK	Brand Name Drugs
13	Mylan Labs	MYL	Generic Drugs
14	Nokia	NOK	Electronics
1	NVR, Inc.	NVR	Homebuilder
17	Oracle	ORCL	Computer Software
8	Ryland Group	RYL	Homebuilder
4	SEI Investments	SEIC	Financial Services
10	US Bank	USB	Regional Bank
3	Washington Mutual	WM	Banking

Returns for the Model Portfolio versus the S&P 500 Index

	<u>Model Portfolio</u>	<u>S&P 500</u>
This Quarter	10.5%	10.0%
One Year	NA	24.6%
3 Years	NA	(16.9%)
Since Inception 6/1/2003	26.3%	13.3%