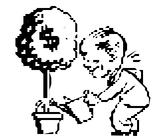
JULY 1, 2004

Money Matter$



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DIVERSIFICATION—Ideal for the Faint of Heart

In last quarter's newsletter, I highlighted some wealth-building methods used by some of the most prolific members of the Forbes 400. I stated that "concentration" was a common ingredient, and that diversification is a "*risk-reducing*" strategy not employed by the likes of Bill Gates, Warren Buffett, or Michael Dell. However, diversification can play a key role in *your* portfolio – in the event that you are more risk-averse than those elite few Forbes 400 members.

The basic idea behind diversification is simple enough. All investments have a long-term average rate of growth known as "alpha." Investment results also change dramatically as the economy changes. This volatility is known as "beta." In general, the riskier the investment, the higher return it must offer in order to attract investors. This stems from the fact that we as human beings *are* naturally risk-averse.

The most successful investment portfolios, therefore, try to achieve the highest level of return for a given level of risk. Risk can be held to a minimum by combining investments that offset each other's volatility. By combining assets that zig and zag at different times, you're left with pure alpha, stripped of the randomness known as beta.

The key to building a successfully diversified portfolio is in selecting shares of companies or funds that react in opposite ways to likely economic changes. A higher oil price that hurt oil-burning utilities, for instance, would help an oil and gas producer.

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Stock Profile — Doral Financial (DRL)

Doral Financial has been a favorite of ours since showing up on the radar one year ago. CEO Salomon Levis professes that Puerto Rico is immune to a mortgage slowdown regardless of impending interest rate increases. DRL has managed to increase earnings and cash dividends for 18 consecutive quarters. Doral Financial Corporation is a diversified financial services company engaged in mortgage banking, commercial banking, institutional broker-dealer activities and insurance agency activities. Its activities are principally conducted in Puerto Rico and in the New York City metropolitan area. The Company operates 56 mortgage banking offices in Puerto Rico and one office on the United States mainland. It is engaged in commercial banking activities through its subsidiary, Doral Bank PR, which operates through 37 branches in Puerto Rico. The Company conducts its mortgage banking activities in Puerto Rico primarily through its HF Mortgage Bankers division. On the United States mainland, it conducts its mortgage banking activities through its subsidiary, Doral Money, Inc. $

DRL Statistics

Market Capitalization	$3.69B
Growth Projection—next 5 years	19%
Fwd. Price-Earnings Ratio	9.8
5-year Beta (volatility)	.14
Return on Stockholder Equity	24.1%
Dividend Yield	1.8%
Net Profit Margin	25.9%
Operating Margin	38.6%

Annual Returns

- **Dow Jones Industrial 30 Average :** **16.1 %**
- **Standard & Poor's 500 Index:** **17.1 %**
- **Nasdaq Composite Index:** **26.2 %**
- **Russell 2000 Small Company Index:** **31.9 %**
- **Sommers Finanical Management's MODEL PORTFOLIO** *(see next page for an update)***:** **32.9 %**

Diversification *(continued from page 1)*

How many stocks does it take to achieve balance? Some experts say you need more than three dozen to eliminate so called diversifiable risk. Others say you can get rid of most of that risk with fewer than 10 stocks. If you rely on fewer than 10 holdings, every one has to pull its own weight in response to economic changes. The true art is making sure that your stocks are as different as possible. Sommers Financial Management's "Model Portfolio" is concentrated in 20 holdings that are not ideally diversified. At right is a list of nine holdings that would make a well-diversified U.S. stock portfolio (not taking into consideration fixed-income, market cap, or international investments). We start with leading companies in five of America's top growth industries. Then for balance: four stocks that represent

9 Stocks for a Diversified Domestic Equity Portfolio

1. Microsoft (MSFT)—Technology
2. Merck (MRK)—Pharmaceuticals
3. Washington Mutual (WM)—Financial Svcs.
4. Disney (DIS)—Entertainment
5. Johnson & Johnson (JNJ)—Consumer Prod.
6. Alcoa (AA)—Raw Materials
7. Chevron-Texaco (CVX)—Energy
8. Plum Creek Timber (PCL)—Land Develop.
9. United Parcel Svc. (UPS)—Transportation

Sommers Financial Management's MODEL "20" PORTFOLIO Update

Since June 1st of 2003, this portfolio has increased nearly 33% to $265,834 by June 30, 2004. This return was measured in a time when the S&P 500 increased only 17.1%. With the Federal Reserve raising interest rates the final day of the quarter, the portfolio's concentration in homebuilders and financial services hurt our return as the market anticipated this imminent rise in rates earlier in the quarter. This is the first down quarter for the portfolio since inception on June 1st, 2003—and hopefully the last!

Over the last quarter I replaced a few of the stocks in the portfolio and now hold the top 22 stocks of interest.

Outgoing stocks include:

- **Charter One Financial**—the Royal Bank of Scotland decided to acquire CF, so after holding only 2 months, we exit with a healthy 30% return - Thanks, Scots!
- **Harley Davidson**—due to the addition of new, more attractive holdings and the rising valuation, HDI was sold after rising 50% over the past year.
- **Polymedica**—this stock has risen more than 20% since joining the model portfolio just two months ago, and after reaching $30 has become too richly valued at 21 times earnings to remain in the top 22.
- **Radian Group**—RDN barely made the cut last quarter and now sits at #31 on our want list, disqualifying it for the model portfolio.

Incoming stocks to the portfolio include:

- **Christopher & Banks**– this stock was purchased in accounts back in March of 2003 at $15, and proceeded to rise to over $30. After falling back under $20 per share, it fits right in at #19 in the model portfolio.
- **China National Offshore Drilling**– Rising oil prices and a red-hot economy in China make this stock with a P/E ratio of 12 a compelling value.
- **KB Home**– Makes another appearance alongside fellow homebuilders after a brief stint out of the top 20.
- **Pier One Imports**—PIR has been a real dog since joining the portfolio. It has become even more attractive since falling, trading at 13 times earnings with an expected growth rate of 14% per year and a dividend yield over 2%.
- **Par Pharmaceuticals**—generic drugs are the wave of the future, and a PE of 12 makes Par very attractive at #14. $

Company Name	Symbol	Industry	SFM Rank
Abercrombie & Fitch	ANF	Retail Clothing	17
Christopher & Banks	CBK	Retail Clothing	19
China Nat'l Drilling	CEO	Chinese Gas/Energy	5
Doral Financial	DRL	Financial Services	4
IPC Holdings	IPCR	Life/Health Insurance	2
J2 Global Comm.	JCOM	Technology	21
Johnson & Johnson	JNJ	Consumer Healthcare	22
KB Home	KBH	Homebuilder	9
K-Swiss	KSWS	Shoe Manufacturer	11
Lennar	LEN	Homebuilder	7
Altria Group	MO	Tobacco/Foods	6
Merck	MRK	Brand Name Drugs	16
Mylan Labs	MYL	Generic Drugs	13
Nokia	NOK	Electronics	15
NVR, Inc.	NVR	Homebuilder	1
Oracle	ORCL	Computer Software	18
Pier One Imports	PIR	Retail Stores	20
Par Pharmaceuticals	PRX	Generic Drugs	14
Ryland Group	RYL	Homebuilder	10
SEI Investments	SEIC	Financial Services	8
US Bank	USB	Regional Bank	12
Washington Mutual	WM	Banking	3

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

	Model Portfolio	S&P 500
This Quarter	(1.3%)	1.3%
One Year	32.9%	17.1%
3 Years	NA	(2.3%)
Since Inception 6/1/2003	32.9%	17.1%