

April 1, 2005

# Money Matter\$



A Quarterly Newsletter from Sommers Financial Management

Ph. (503) 397-1545 [www.sommersfinancial.com](http://www.sommersfinancial.com)

Volume 3, Issue 2

## How to invest in bonds during rising interest rates

The investment texts all say, as interest rates fall, bond values rise, and **as interest rates rise, bond values fall**. We have all heard uncle Alan remark of his plan for future rate hikes to battle inflation caused by rising oil prices—so should we hold any bonds in our portfolio?

The answer is: If you're planning to hold the bond to maturity and the issuer doesn't default, it won't matter what interest rates do in the market—you'll get paid exactly what you expect at maturity, and with regard to the interest received along the way.

One way to ensure that you get to participate in rising interest rates is to "ladder" your bond holdings. Laddering means that your bonds all mature in

stages, such as every 6 months, or every year—so that when one matures, you invest the proceeds into a longer term bond at the going rate. You buy the top rung of your ladder based on a fixed timeframe. **A seven year bond ladder is the longest I recommend**—as you can't predict the issuers ability to pay too far into the future, the marginal rate increase is slight from 7 to 20 years, and you don't want to be locked in for too long if interest rates spike to levels last seen in the 1980's...you wouldn't want to miss out!

In client accounts, I have been building such ladders with investment grade corporate bonds, as they yield about 1% more than comparable term government bonds. A five-year ladder purchased today would have an average yield of nearly 5%. Call my office for more details!

Be sure to make your 2004 IRA Contribution by April 15th!!!

### One Year Returns

- Dow Jones Industrial 30 Average : 1.4 %
- Standard & Poor's 500 Index: 4.8 %
- Nasdaq Composite Index: 0.3 %
- Russell 2000 Small Company Index: 4.2 %
- Sommers Financial Management's MODEL PORTFOLIO (see next page for an update): 20.3 %

## Stock Profile – NetEase.com (NTES)

NetEase is a stock of "a Chinese YAHOO!" that we've been adding to client portfolios for diversification internationally. It falls in the top 10 of our fundamental analysis, and the call premiums alone return over 3% a month. It is volatile, so be prepared to ride the roller coaster—but plan to be rewarded handsomely in the long-run.

NetEase.com, Inc. through its subsidiaries and contracts with the Company's affiliates, operates an interactive online and wireless community in China and is a provider of Chinese language content and services through its online games, wireless value-added services and Internet portal businesses. The Company generates revenues from fees it charges users of the online games and wireless

NTES Statistics	
Market Capitalization	\$ 1.57B
Fwd. Price-Earnings Ratio	22.2
P/E to Growth (PEG)	0.74
Operating Margin	52.3%
Net Profit Margin	51.1%
Debt/Equity	0.69
5-yr Proj. Earnings Growth	30%
5-year Beta (volatility)	1.77
Return on Stockholder Equity	40.1%

value-added and other fee-based premium services, as well as from selling advertisements on the NetEase Websites. Its basic service offerings on the sites are available without charge to users.

## Sommers Financial Management's MODEL "24" PORTFOLIO Update

2005 had a rough start, with January being the first down January in over a decade. February treated our portfolio well, seeing us jump in value by more than 10%, only to be dragged back down in March. With rising oil prices and rising interest rates, stock buyers have been reluctant to accumulate shares of *any* companies. We end the quarter down 5%, while the S&P lost 3%. Only 6 stocks were turned over this quarter, due to either more attractive issues coming onto the radar, rising valuations, or dimming prospects. Additionally, we have dumped the royalty trusts from the portfolio, even though they sit at #'s 1 and 2 on my fundamental list, because the return on investment includes a return of capital, and when the reserves are tapped, the company is only worth the land they hold—no longer having any oil & gas to sell.

**Outgoing** stocks besides the San Juan Basin Royalty Trust include:

- **Altria**—Big MO, the parent of both Kraft Foods and Phillip Morris, finally fell from our list as the dividend yield settled down around 4.5% and future annual growth is projected at only 9%.
- **Mylan Labs**—Our favorite generic drug maker of the past few years has finally nixed their bad idea to take over King Pharmaceuticals. All the while they thought the merger activity would distract us from seeing their poor profit growth. They couldn't fool us.
- **Lennar**—This homebuilder is a like a yo-yo, coming in and out of the portfolio every quarter.
- **Shire Pharmaceuticals**—This British manufacturer of Adderall found out that Canada is banning the sale of the popular ADHD drug due to unwanted side effects...could the US be next?
- **Timberland**— This is still an attractive stock—even when compared with industry foes Nike and K-Swiss—and holding all three might be your best bet. All three are profitable and undervalued—but just not good enough for our elite list.

**Incoming** stocks to the portfolio include:

- **Allergan**— A big player in the Botox industry, AGN has a healthy balance sheet and trades at a PE of 22.
- **Federated Investors**— FII sells loaded mutual funds, and was not tarnished in the recent mutual fund scandal. Trading at 15 times earnings and with a dividend yield of nearly 2%, this small money manager cracked the list at #22.

<u>Company Name</u>	<u>Symbol</u>	<u>Industry</u>	<u>SFM Rank</u>
Allergan	AGN	Biotech/Pharma	19
China Nat'l Drilling	CEO	Chinese Gas/Energy	12
Colgate-Palmolive	CL	Consumer Products	3
DR Horton	DHI	Homebuilder	16
Doral Financial	DRL	Financial Services	7
Federated Investors	FII	Asset Management	22
Forest Labs	FRX	Generic Drugs	13
Harley Davidson	HDI	Motorcycle Manufacturer	19
H&R Block	HRB	Tax Preparer	23
International Gaming	IGT	Gaming Manuf.	26
Ipsco	IPS	Steel Manufacturer	5
J2 Global	JCOM	Technology/E-commerce	11
Johnson & Johnson	JNJ	Consumer Healthcare	24
MBNA Bank	KRB	Consumer Finance	20
Linear Technology	LLTC	Semiconductors/Tech	10
New Frontier Media	NOOF	Entertainment	17
NetEase.com	NTES	Chinese Internet	9
NVR, Inc.	NVR	Homebuilder	4
Oracle	ORCL	Computer Software	14
SEI Investments	SEIC	Asset Management	21
Taiwan Semiconductor	TSM	Semiconductors/Tech	6
US Bank	USB	Regional Bank	15
Winnebago	WGO	Recreational Vehicles	25
Washington Mutual	WM	Banking	8

- **H&R Block**—“What is the answer that knocked Ken Jennings off of Jeopardy after winning over \$1.3 million and crossing over two seasons!” A P/E ratio of 15 and a dividend yield near 2% work for us again here.
- **Ipsco**—a steel pipe manufacturer in North America with a P/E of 6, growth projected at 21% a year, a healthy balance sheet, huge margins, and a token dividend make this stock look great at #5.
- **MBNA Bank**— I have a credit card from them, don't you? A dividend that yields over 2.3% and a P/E of just 10 brings KRB in at #20.
- **Linear Technology**— This semiconductor manufacturer is very profitable, financially healthy, and expected to grow at 20% over the next 5 years.
- **SEI Investments**— This is a stock that had a brief stint out of the portfolio, but comes back in after falling 15% in value—it appears it should go back to \$43.

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

	<u>Model Portfolio</u>	<u>S&amp;P 500</u>
This Quarter	-5.4 %	-2.6 %
One Year	20.3 %	4.8 %
Since Inception 6/01/2003	62.5 %	22.1 %