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First Class Stamp

Address Label

Easy access to funding tends to cause undisciplined decisions—Warren Buffett

"GOOD PROFITS SIMPLY ARE NOT INCONSISTENT WITH GOOD BEHAVIOR."

"I wouldn't buy any stocks I would not be happy owning if it stopped trading for three years. If you can find companies that you will want to be an investor for in five or ten years, you'll probably do reasonably well."

"It's only when the tide goes out that you learn who's been swimming naked."

"YOU SIMPLY HAVE TO BEHAVE ACCORDING TO WHAT IS RATIONAL RATHER THAN ACCORDING TO WHAT IS FASHIONABLE."

"The fact that people will be full of greed, fear or folly is predictable. The sequence is not."

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

Stock Spotlight — Graco, Inc. (GGG)

Everyone confuses this industrial equipment company with a company that makes cribs and strollers for babies; the two couldn't be more different. Graco, Inc. is a (relatively) small company that pays a reasonable dividend, and is currently out of favor with investors due to their marriage to the auto industry, and other industrials. Fear of slower consumer consumption and a possible recession have created a buying opportunity in the stock.

Graco provides fluid handling systems and components. The company's products move, measure, control, dispense, and apply a range of fluids and viscous materials used in vehicle lubrication, commercial, and industrial settings. It operates in three segments: Industrial, Contractor, and Lubrication.

Graco's Notable Statistics	
Market Capitalization	$ 2.24 Bil.
5 Yr. Annual Growth Projection	12 %
SFM's Price / Earnings Ratio	12.2
SFM's Calculated 'Payback Ratio'	8 %
Net Profit Margin	15 %
Dividend Yield	2.0 %
3 year average Return on Equity	52.8 %
Debt / Assets	0.54

Funds, Funds, and More Funds—Part II (a.k.a. Why Closed-End Funds?)

By Adam Sommers

This is the second article in my series dissecting well-known mutual funds, enigmatic closed-end funds, and the hot new investment vehicle—exchange-traded funds (ETFs).

Last quarter, I indicated that when investing in funds, I prefer to invest client money in index mutual funds, closed-end funds, and index-ETFs due to the less than stellar cost/reward ratio that comes with actively managed mutual funds. One point I failed to make was that when mutual fund companies have an under-performing fund/manager, in order to clean up their record, they simply fold the poor fund into a good one, and the historical record of the poor fund disappears. Nice.

So how do I decide when to use index mutual funds? **There are only three situations for which I utilize mutual funds:** a) the client has less than $1,000 in an account, b) the client makes systematic deposits every month, or c) the client requests certain socially responsible investments.

The reason I choose index mutual funds over index-ETFs in the first two cases are because of the transaction fee involved in purchasing an ETF. The situation involving socially responsible criteria is due to the fact that there are far more mutual funds aimed at certain socially preferential causes, while ETFs are just beginning to dip their toe into this pool.

So in all other cases when investing client assets in funds, I prefer to invest in either index-ETFs, or closed-end funds.

Why actively managed closed-end funds, but not actively managed mutual funds? **There are three main advantages to closed-end funds:** First and foremost, closed-end fund managers undertake management of a fixed amount of money at the onset of the fund, and know for the duration of their term (barring any rare buybacks or new issuances), they will be working with only that pile of money (plus or minus gains or losses earned and/or distributed). Contrast this to mutual fund managers, who when they perform very well, get flooded with new money by investors chasing returns—and when they under-perform, have money yanked out as fast as they can sell holdings.

I know from experience that managing a (relatively) static pool of money is much easier and more efficient than when clients pull a sum of money out one month, only to deposit a larger sum the next, etc. Upon withdrawal, what securities do I hold, and what do I sell? Upon a new flood of money coming in, how fast can I put it to work so as not to dilute the return by holding cash, but also be cognizant not to purchase over-priced assets just to be fully invested? Additionally, **these transactions aren't free—so by nature, mutual funds have higher costs than closed-end funds**.

Secondly, closed-end funds are much easier to buy and sell than mutual funds. You can utilize stop orders, limit orders, options and margin—any time the market is open for trading.

Finally, closed-end funds are able to "trade at a discount" to net asset value. This means that you can potentially purchase $1 worth of assets for 80 cents. I appreciate buying things on sale, and closed-end funds give me that opportunity. In the situation just referenced, if the fund were to be liquidated immediately, that would mean **a 25% return in one day. I like that.**

Next month, I'll begin discussing what I'm sure everyone has been waiting for—what's generating all the buzz in the financial press these days—ETFs.

2007 Returns

• Dow Jones Industrial 30 Average :	6.4 %
• Standard & Poor's 500 Index:	3.5 %
• NASDAQ Composite Index:	9.8 %
• Russell 2000 Small Company Index:	-2.7 %
• SFM's MODEL 25 PORTFOLIO:	10.6 %

Sommers Financial Management's AGGRESSIVE Stock Portfolio

Company Name	Risk Grade	P/E Ratio	Growth Rate	Payback Yield
Actions Semiconductor	D	6.7	25%	249%
American Eagle Outfitters	C	9.2	14%	15%
Asta Funding	D	3.6	8%	12%
Franklin Resources	B	12.2	12%	11%
Biovail	D	7.8	6%	20%
Dow Chemical	B-	11.7	26%	12%
Syneron Medical	C	10.1	14%	13%
Ensco International	C	8.1	22%	19%
Freeport McMoRan	C	7.5	26%	14%
First Marblehead	F	2.3	26%	35%
Graco	B-	12.4	12%	8%
Greywolf	C	10.0	18%	16%
Halliburton	A-	11.8	14%	9%
J2 Global	D	12.8	20%	12%
Lam Research	C	8.6	15%	19%
Microsoft	A+	13.3	13%	9%
NetEase	C	13.3	16%	14%
NutriSystems	F	5.1	19%	35%
NVR	D	8.4	10%	11%
OptionsExpress	C	10.2	19%	12%
Pfizer	A-	9.9	4%	11%
Palomar Medical Tech	D	11.8	10%	14%
Taiwan Semiconductor	A-	15.1	19%	10%
Texas Instruments	A-	12.3	16%	10%
Viropharma	D	13.3	17%	42%

SFM AGGRESSIVE Stock Portfolio vs. Relevant Benchmarks

	SFM Aggressive	Russell 2000 Index	Nasdaq Index
3 Month Return:	**- 7.9 %**	- 10.0 %	- 14.1 %
12 Month Return:	**- 12.2 %**	- 13.9 %	- 5.9 %
3 Year Avg. Annual:	**N/A**	4.0 %	4.7 %
5 Year Avg. Annual:	**N/A**	17.8 %	14.0 %

Sommers Financial Management's Conservative INCOME Stock Portfolio

Company Name	Risk Grade	P/E Ratio	Div. Yield	Ret. on Equity
Boeing	B+	10.5	2.1%	45.2%
Anheuser Busch	A-	13.6	2.7%	59.1%
Cherokee	C	14.8	8.2%	89.8%
Colgate-Palmolive	A-	17.6	2.0%	76.0%
ConocoPhillips	A-	6.6	2.5%	13.4%
Chevron-Texaco	A-	8.1	2.7%	23.9%
Dow Chemical	B-	11.7	4.5%	14.9%
General Electric	B+	11.7	3.3%	17.3%
Halliburton	A	11.8	1.0%	41.9%
Intel	A-	15.1	2.3%	16.3%
Johnson & Johnson	A+	13.7	2.6%	24.4%
Coca Cola	A-	19.4	2.5%	27.5%
3M	B	12.0	2.5%	34.2%
Altria	A+	13.1	4.1%	43.1%
Microsoft	A+	13.3	1.5%	37.7%
Nokia	A-	13.1	2.5%	30.4%
Novartis	A-	14.1	2.9%	18.5%
Pepsi	A-	17.7	2.1%	32.8%
Pfizer	A-	9.9	6.2%	18.6%
Qualcomm	A+	19.2	1.4%	20.2%
Taiwan Semiconductor	A-	15.1	3.3%	17.8%
Texas Instruments	A-	12.3	1.4%	26.6%
US Tobacco	A-	12.9	4.5%	181.8%
Verizon	B	11.2	4.7%	10.9%
Exxon Mobil	A+	9.1	1.6%	32.9%

SFM Conservative INCOME Stock Portfolio vs. A Relevant Benchmark

	SFM Income	Dow Jones Industrial Avg.
3 Month Return:	**- 5.9 %**	- 7.6 %
12 Month Return:	**- 2.8 %**	- 0.7 %
3 Year Avg. Annual:	**N/A**	5.6 %
5 Year Avg. Annual:	**N/A**	10.7 %

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

Company Name	Value Grade	Cash Flow	Risk Grade	Market Cap
Actions Semiconductor	A+	A+	D	Micro
Asta Funding	A	A-	D	Micro
Franklin Resources	C	A-	B	Large
Cherokee	C	A+	C	Micro
ConocoPhillips	A-	D	A-	Mega
Chevron-Texaco	A-	C	A-	Mega
Dow Chemical	A-	C	B-	Large
Syneron Medical	C	A+	C	Micro
Ensco International	A-	A-	C	Mid
Freeport McMoRan	A-	B-	C	Large
Graco	C	A-	B-	Small
Halliburton	C	B-	A-	Large
Intel	C	B-	A-	Mega
McGraw-Hill Publishing	B+	B+	B-	Mid
3M	B-	B-	B	Large
Altria Group	B-	B-	A+	Mega
Microsoft	C	A-	A+	Mega
Nokia	C	B-	A-	Mega
Novartis	B-	B-	A-	Mega
Pfizer	B+	C	A-	Mega
Qualcomm	D	A-	A+	Large
Taiwan Semiconductor	C	A-	A-	Large
Texas Instruments	B-	B+	A-	Large
US Tobacco	D	A+	A-	Mid
Exxon Mobil	B-	C	A+	Mega

SFM ORIGINAL Model "25" Portfolio vs. A Relevant Benchmark

	SFM Model 25	S&P 500 Index
3 Month Return:	**- 8.3 %**	- 9.9 %
12 Month Return:	**0.0 %**	- 6.9 %
3 Year Average Annual:	**8.9 %**	4.0 %
5 Year Average Annual:	**Next Qtr.**	11.2 %
ROR Since Inception:	**21.7 %**	7.6 %

Commentary and Ramblings

By Adam Sommers

I'm intrigued by the new Barron's 400 Index. Back in October, I wrote about how the subsidiary of Fox News and sister to the Wall Street Journal's selection of stocks placed in their new index was eerily similar to my own criteria for the Model Portfolios. It also boasted of how over the past 10 years—similar to the SFM Model Portfolio over the past 3 years—the index has 'walloped' the S&P and the Dow. Last week, in the March 24th issue of Barron's, they provided an update:

"Including back tests to 1998, the Barron's 400 piles up the vast majority of its outperforming periods in rising markets, although its emphasis on profitable names has allowed it to withstand market declines fairly well." Sounds again like the SFM Model Portfolio. About a year ago I had a client say he loved my picks when the market went up, but cursed my name when it went down. Ah, how I wish I could control the action of Mr. Market. However, in investing, patience is definitely a virtue.

Barron's is in the same boat as most investors—being down over the past six months. Their index lost 17% compared to 13% in the S&P 500, and only 11% in the SFM Model.

I'd like to steal their marketing prose for myself, as Barron's says "the index methodology ensures that it is selecting the most fundamentally sound and enticingly valued stocks as investors await market stability. It is based on 24 rating factors that focus strictly on reported company earnings, growth, profitability, valuation and—to a small degree—stock action."

In regard to my portfolios, in the past six months I have refined the stock selection criteria wherein I analyze 98 pieces of data, calculated into 24 metrics that fit into three categories: Value, Cash Flow (Profitability), and Risk (including stock action)—each with eight factors.

There is an ETF being created to track the Barron's 400. At first I was interested in it as an investment, but—even better—I thought, maybe I should create a fund to market to the masses based on my selection process. In researching 'behind the curtain' at Barron's, their selection methodology points to a company called MarketGrader. This quantitative research service has been around since 1999, so I can't cry copycat on them.

In fact, it appears that MarketGrader and I are attempting to mold a market-beating stock selection system out of the same raw materials: Value Line founder Arnold Bernhard's scoring process, Warren Buffett's financial statement acumen, Ben Graham's value tilt, Charles Schwab's letter grading program, along with research from leading academic economists Eugene Fama, Kenneth French and Jeremy Siegel.

As an aside, 24 of the 51 stocks I watch daily are in the Barron's 400—less than 50%. So even though it sounds like we take a similar approach to discovering hidden values among stocks, there are material differences in our processes. However, I surmise our performance will track similarly throughout time—with the SFM Model being slightly more volatile due to being focused, holding only 25 stocks rather than 400.

Time will tell; and in the meantime, I'll enjoy the process.