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A BETTER WAY TO MANAGE MONEY
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# Up 12% for 2006

Our stock accounts were up about 12% after fees for 2006. I say *about* because this number is unaudited and varies per account depending on when the client began investing and how much fixed income they own. Overall, I am pretty pleased with the outcome.

We did quite well with international investments. Some of our successes included **Aegon**, **ING**, **Peugeot**, **Tesco**, and **Toyota Motor Industries**. The foreign markets had another strong year and the dollar's weakening helped these investments too.

Some of our success stories in America were **United Dominion**, **JoAnne Stores**, **Universal American Financial**, **CIT Group**, **UnumProvident** and **IDT**. The only industry that dragged us down was insurance.

**Mercury General**, **State Auto Financial**, and **American Safety Insurance** did okay but the sector lagged because of fears of another hurricane. We have bought an exchange traded fund named **Streettracks** that owns twenty-five of the largest insurance companies in America. Some accounts are heavily invested into Streettracks. So far, it is up about 4% from when we bought it. Assuming that we do not have a repeat of 2005 and the industry has not gotten too competitive, we should do quite well in these investments.

My feelings on the insurance industry are that insurance companies are like casinos—they are basically "the house". Insurance companies agree to one year contracts. If terms are unfavorable, they merely change the terms of their contracts. If the atmosphere changes in the future, insurance companies will change what they will insure, the premiums they charge, or get out of a market all together.

Some of our investments that had been lagging have fought their way back. The two fighters are **Helen of Troy** and **The Finish Line**. Both are retailers who had off years and were brutally punished. When things brightened, the stocks' performance turned around.

Our two biggest dogs of 2006 were **Krispy Kreme** and **Pier One**. Actually, some people did quite well in Krispy Kreme but I always count from my initial buy. Krispy Kreme had franchises going bankrupt, ethics problems with the CEO, and accounting problems. As for Pier One, it looks like they might be having too much of a problem competing with Target and Ikea in the home furnishings business. I might make an exit when there is even a modicum of good news about this stock as it rises.

## Finish Line

I made an onsite inspection of **The Finish Line** shoe store in Tampa Bay, Florida. Investors have owed this stock for over two years. It has been quite volatile for us. At times, it has been up 50% and down about that much too. The reason it has been down is due to the fact that it did not originally carry Puma and that hurt sales. Puma was quite hot last year.

The store that I visited seemed very busy and had a large inventory of children's, women's, and men's shoes. FINL now has a large inventory of Puma merchandise. People with whom I speak with seem quite happy with the shopping experience at FINL. The stock is almost up to where we began buying in 2004. Long term, I think they will do well as they have been expanding in malls across the country.

FINL has no debt on its balance sheet. My feelings about companies with no debt is that they are conservatively run and management is probably not going to try to trick shareholders with any funny accounting.

## Toyota Motor Industries

We have held this company for about two and a half years and have doubled our profits. This was Toyota Motor companies parent that originally made looms. TYIDF.PK owns a huge portfolio of Toyota stock. If you were to break up TYIDF.PK and sell off the assets, it would be worth more than what it is trading at right now.

## Margin of Safety

In the 1940's, two famous finance professors from Columbia's Business School named Benjamin Graham and David Dodd wrote a famous book entitled *Security Analysis.* This has become the Bible for people like myself who like to buy stocks at a discount. Otherwise known as value stocks. Warren Buffet left Nebraska and studied under these two at Columbia's business school in the 1950's.

The two professors postulated an idea of buying stocks with a margin of safety. That is, buying stocks when you know that if they drop to a certain point, the company is backed by enough assets so, hopefully, your stocks will not drop too much further.

This is what I try to do with clients' investments. **IDT** trades for $14 a share and has about $8 of that in cash in the bank. **Finish Line** trades at 1.6 times what the equity (assets minus liabilities) are worth. **Mercury General** trades at 1.7 times what the equity is worth and also has a 3.6% dividend. **Toyota Motor Industries** owns a huge portfolio of Toyota Motor stock and other Japanese companies.

As one can see, each of these stocks has what I hope to be a margin of safety. The idea is that there are tangible assets like cash, real estate, and merchandise that these companies own and that will buffet against too large a stock drop.

## Third Avenue Value

Third Avenue mutual fund had another great year up 14.7% according to its web site. Also according to the web site, if you had invested $100,000 when the fund was founded in November of 1990, you would now have $1,128,730. Not bad!

As mentioned in previous newsletters, Third Avenue likes to invest in value companies that are down and out. One recent example is that they invested in K-Mart and Sears before the big turn around. This fund is well managed and has done very well for my clients. I hold some of the same stocks for my clients that Third Avenue owns such as: **IDT**, **CIT Group**, and **Toyota Motor Industries**.

## Fairholme Fund

I have begun investing new, smaller accounts into the Fairholme Fund. This fund was founded on 12/29/99 and is up 221.46% versus 8.58% for the S&P 500. This is the total return, not the annual return. Fairholme is managed by Bruce Berkowitz who is one of the best fund managers around. Like Third Avenue, Fairholme invests in value companies. Some of its holdings include **Berkshire Hathaway**, **IDT**, **Sears Holdings**, and **Leucadia National**. As you can see, they own some of the same stocks that Third Avenue and I own for my clients. Leucadia is an interesting stock that does not get a lot of coverage that you might find very interesting (we do not own shares at this time).

## Leucadia National

The closest company that compares to Leucadia is Berkshire Hathaway. Like Berkshire Hathaway, Leucadia is a conglomerate comprised of privately and publicly held companies. The difference between Leucadia and Berkshire is size. Leucadia is much smaller and I feel has much more room to grow over time. Berkshire Hathaway is one of the largest companies in America and even Buffet has admitted will not grow at the pace that it did in the past.

Some of Leucadia's holdings include health care, real estate development, communications, insurance, a copper mine in Chile, and two wineries. The best known division is it's Pine Ridge Winery in California.

Basically, Leucadia invests in unloved industries and either keeps them or sells them when things turn around. According to Leucadia's annual letter from its president, the stock has grown at an annual compound rate of return of 25.1% from 1979 to 2005.

The management runs the company the way a publicly held company should be run: for the shareholders. Management does not pay themselves exorbitant salaries and maximizes the investments it makes. Most companies now pay their executives too much. Look at how much Home Depot was paying its CEO: about $200 million a year.

**Experience for Holmes Osborne, CFA**

Holmes Osborne began his career as a financial consultant for Merrill Lynch Private Client Group in Naples, Florida. At Merrill Lynch Mr. Osborne assisted clients in asset management and estate planning. After Naples, Mr. Osborne managed trust portfolios for Merrill Lynch Trust Company (a division of Merrill Lynch's mutual fund division) in Boca Raton, Florida. The trust department managed over $1 billion in clients' assets. Upon leaving Florida, Mr. Osborne worked in management for Farmers Insurance Group in Los Angeles, California.

Mr. Osborne has a degree in finance from the Martin J. Whitman School of Management at Syracuse University. Member of the CFA Society and holder of the Chartered Financial Analyst designation. Mr. Osborne is also a member of the National Association of Business Economists, Los Angeles Venture Capital Association, and Malibu Rotary.

***Fidelity Investments***
http://www.fidelityinvestments.com

Clients' assets are held in custody at Fidelity Investments. At Fidelity, clients may have online access and will receive monthly statements.

All clients' information is kept in the strictest confidence. Mr. Osborne can be reached at 310-452-0910.

The performance data quoted represents past performance, and is no guarantee of future results. Your returns and the principal value of your investment will fluctuate so that your investment, when redeemed, may be worth more or less than its original cost. Current performance may be lower or higher than the performance quoted above. You should consider the investment objectives, risks, charges and expenses carefully before investing.

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