January 7, 2002

Dear clients,

Greetings and Happy New Year!! It's about time for a new year don't you think? Believe it or not I'm not going to spend a lot of space in this letter extolling the virtues of diversification and a long-term time horizon because quite frankly most of you already understand this message and probably are somewhat sick of hearing me repeat it all the time. Rather, in this quarter's letter, I want to look at and analyze the results of a fascinating study that was recently completed on how the average investor behaves.

According to the financial-services research firm DALBAR, most mutual fund investors who hop in and out of the market do it quite poorly. Here is some of the evidence as gleaned from a study that was done from January 1984 through December 2000:

- ✓ The average bond investor realized an annualized return of 6.08% while the long-term Government Bond Index returned 11.83% annually.
- ✓ The average stock investor realized an even lower annualized return of 5.32% while the S & P 500 returned over three times more, or 16.29% annually, for the same time period.

What gives? The explanation is actually quite simple and can be found in human nature. Almost everybody knows that when it comes to investing you're supposed to "buy low and sell high" but precious few actually adhere to this discipline. To have achieved the double digit bond and stock market returns over this period, the average investor would have to have mastered the art of doing **NOTHING!!** No buying, no selling, just leaving his or her investments all alone to do their thing - an idea anathema to today's typical stock picker and market timer. We aren't quite this passive in management of your portfolio but not too far from it. Minor rebalancings when necessary and slight skewing of your portfolios to try and capitalize on markets' tendencies to regress to the mean are what we do best and what the average investor should do a whole lot more of. Much more on this topic in future quarters I promise. Remember however - with solidly constructed portfolios - doing less often returns more.

Your envelopes are a little thicker this time around. In addition to your usual report, those of you with non-IRA accounts may find tax reporting documents that you may use or give to your tax preparer. These documents are not meant to replace the official 1099 forms you will soon be getting from Vanguard and/or Schwab but rather as a supplement. Please call me or have your preparer call me if you have any questions. Also, to ensure compliance with the SEC and all the states in which I advise, I am including a separate billing invoice that details my fee calculation. Your fee will continue to be directly debited from your account and from the specific fund noted at the bottom of the invoice. No action is required on your part and there is no change in the way your fee is being calculated. This is just informational.

Until next quarter, remember that it is OK for your portfolios to be boring. There is a mountain of evidence that supports the idea that low-cost, long-term, buy and hold, diversified investing is the way to go (had to get the message in just one time ☺). Save the thrill seeking for the part of your life that is not so directly tied to your financial future and well-being. Best regards always. Stay warm and well.

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