CORE Comments
ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

November 20, 2003

MILLIONS OF PENNIES
The Mutual Fund Scandals

The Mutual Fund Scandals Show Fund Insiders Enriching Themselves at the Expense of Fund Shareholders

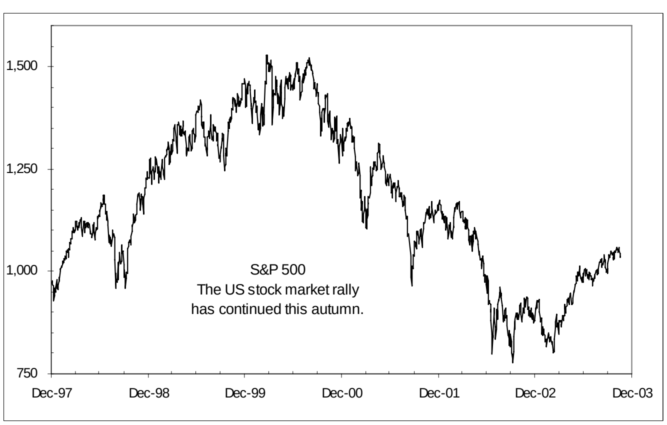
John N. Mayberry

The mutual fund scandals are so complex and—like much about mutual funds—so opaque that it is difficult to present a picture of the situation as it unfolds. In this letter, I will set out what we know now and what effect on your investments the practices may have had. I will also describe Core's actions in monitoring the situation and discuss changes we may make in our investment practices.

Preliminary conclusions. Before getting into details, some conclusions: in general, the various practices that are the subject of investigation and of criminal and civil penalties involve schemes that enable mutual fund managers and some favored customers and brokers to profit at the expense of mutual fund shareholders. Although the total sums involved may prove to be large, the impact on an individual mutual fund shareholder is probably small. It is too early to quantify these matters precisely, but the practices may be characterized as skimming pennies, millions of pennies.

The impact on accounts we manage is probably very small. The safety of your accounts is not in question.

To give an example, consider a mutual fund with a share price of $20 per share. It may be that the abuses described below might have reduced the share price by 10 cents or so. Thus, if the manager of our hypothetical fund had not breached its fiduciary duty to its shareholders, a fund share might be worth $20.10 instead of $20.00. The actions are wrong and the shareholders should recover the sums from the wrongdoers, but the amounts per share are probably quite small.



Safety of accounts at Schwab. Charles Schwab & Co. announced that it received a subpoena from the SEC and that Schwab's internal investigation shows that some of the wrongdoing by brokers (described below) occurred at Schwab. There is nothing to suggest that accounts of any Core clients for which Schwab is the custodian are at risk or suffered losses from the actions described. Based on everything we know, your accounts at Schwab are as safe as ever.

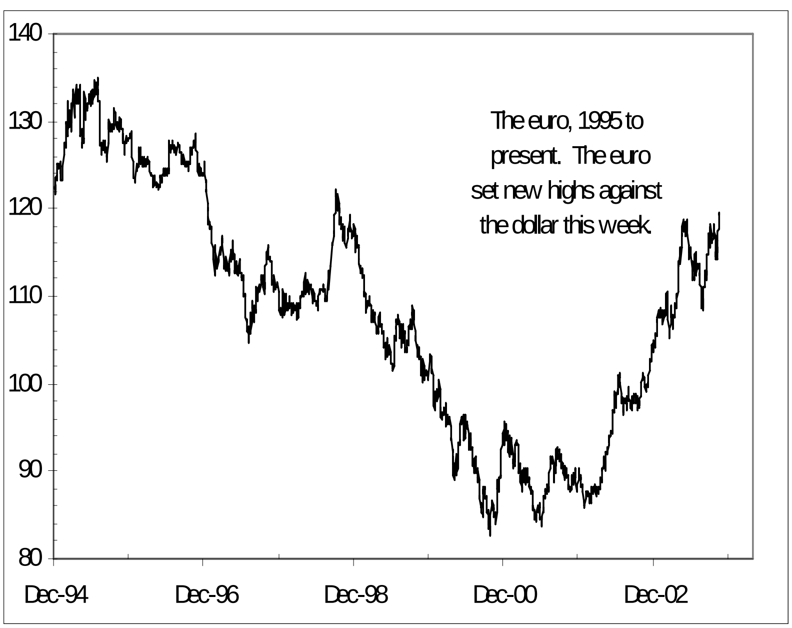
Schwab's internal investigation shows that some of the wrongdoing by brokers (described below) occurred at Schwab. There is nothing to suggest that accounts of any Core clients for which Schwab is the custodian are at risk or suffered losses from the actions described. Based on everything we know, your accounts at Schwab are as safe as ever.

In the last few weeks, the dollar has again been very weak. In addition to other problems, Bush's protectionist trade policies create fears of trade wars and further depress the dollar's value.

Continued gains in stocks and REITs are welcome, but they push these markets into positions of high risk and unsustainable valuations.

What Core is doing. We are following matters very closely. We are watching to see if any funds in which we have made investments for you are ones in which these actions occurred. We will inform you what we learn. If we find that there has been wrongdoing, we will consider what we as investors may do to seek recovery of losses we may have incurred. I expect that it will become clear in time that some fund groups have acted as honorable fiduciaries of their investors. We will focus on those for our investments. We will continue to invest in other pooled investment vehicles, including the so-called "exchange-traded funds". ETFs are like mutual funds in some ways, but because of differences in trading and pricing, they may not be abused in ways that mutual funds have been.

In sum, although these mutual fund scandals are full of dispiriting revelations of insider enrichment and fraud at the expense of individual mutual fund investors, the problems appear to be limited. Moreover, we have good investment alternatives, so that we can continue to invest conservatively and productively for you. I believe we can avoid the traps that have been set in recent years.



Types and scope of wrongdoing. The variety of activities used by insiders in the mutual fund industry to enrich themselves at our expense indicates how widespread has been the fraudulent conduct in the mutual fund industry. A common characteristic of these schemes is that the costs to investors may amount only to pennies per share, but the sum of these thefts of millions of pennies is quite large. So far, at least four different types of practices have come to light; I suspect we will be learning about more in coming weeks.

Each year, Core Asset Management Company files with the SEC a Form ADV with information about the company. If you would like to receive a copy of Part II of Form ADV, please contact us and we will send one to you.

Late trading. Mutual funds are priced once a day, at prices as of 4 pm New York time, the closing time for the New York

To give an example: assume that after the market's 4 pm close, Intel makes an announcement that it is receiving a much higher level of orders for its semiconductors than it had expected. This news will cause the price of Intel stock to rise and, because of the importance of Intel and semiconductors to technology stocks generally, the price of many other tech stocks will rise. An investor who can buy a fund with technology stocks at the 4 pm, pre-announcement price is likely to reap a profit. Eliot Spitzer, the New York Attorney General, whose office is leading the investigations, characterizes late trading as placing a bet today on the outcome of yesterday's horse race.

Economic Expansion and the Bond Market

The economic stimulation of Fed policy, high and rising government spending, and tax cuts have created a more rapidly growing economy.
They have also planted the seeds of future inflation. Higher inflation will depress bond prices and continue to push the dollar down.
We have reduced US bond positions further recently.

"Market timing" is the term applied to rapid trading in fund shares, involving many purchases, sales, repurchases, and further sales in a short period of time. Many funds and brokerage firms, like Schwab, specifically forbid short-term trading and impose minimum holding periods. As it turns out, many funds and brokers with such proscriptions in fact have invited certain customers to engage in the practice; in some funds, the fund managers have engaged in this trading. One reason why short-term trading is discouraged is that the costs to the mutual fund—costs borne by the shareholders who do not engage in such trading—are high. Commissions on the stocks bought and sold to accommodate the purchases and sales of market-timing traders are significant. The benefits of market timing go to those who engage in it. The costs are borne by the fund shareholders who are not involved in that trading.

Failure to give volume discounts in load funds. As you know, sales commissions for purchases of mutual fund shares are called "loads". Funds that charge commission on the purchase (or sale) of their shares are referred to as "load funds". "No-load" funds are bought and sold without commissions. Among load funds, a typical load that may be 6% for a small investment, is decreased at "break points" for larger investments. In general, for investments of $1 million or more, the load is waived altogether. (It is through this volume discount effect that Core is often able to buy load funds for clients without the commission charge. Our orders for all our clients in a given fund are aggregated and treated, for these purposes, as one order. Thus, we may buy $2 million of a given load fund for 100 or more client accounts. This purchase will be effected without commission.)

The ways in which mutual fund insiders have "gamed" the system are numerous and complicated.
Probably we will learn of still other schemes.

The SEC appears to have ignored tips and warnings about these practices. Once again, it is New York's Attorney General Eliot Spitzer's work that has revealed the abuses. Firm regulatory action is needed to restore confidence in the mutual fund industry.

It has come to light that some brokerage firms and mutual funds have failed to charge the lower commission (or no commission) on large orders, with the result that the brokers and the fund may receive a $50,000 commission for a $1 million order, when, by the fund's rules there should be no commission.

Directed commissions. Brokers and mutual fund managers have another approach to benefit themselves at the expense of mutual fund investors. In this, fund managers agree to direct commissions to a brokerage firms in exchange for the broker's placement of its clients' assets in the funds. Thus, the mutual fund managers and management companies have gotten increased assets in their funds and increased management fees for themselves. In exchange, the fund managers place trades for their funds with the brokers who direct their clients to invest in the funds. Individual investors in the fund (who, after all, are the legal owners of the fund) are the losers in this scheme. Their fund pays more in commission costs than it would in a fair system of bargaining. Additionally, an investor who buys shares in the fund at his or her broker's recommendation is not getting unbiased advice. He or she is being steered to invest in certain funds, not because of the fund's investment merits, but because of the directed commission agreement.

There are good mutual funds in which we can invest with confidence. We will invest in funds that demonstrate integrity and openness in their work.

We will be writing more on this subject as it develops.

More revelations ahead. These malefactions have come to light and been reported widely in recent weeks. Each day brings new reports. It is a certainty that we will learn about other forms of looting fund shareholders in coming weeks. One area that may emerge will be manipulation of stock prices of large positions in relatively thinly traded stocks. Who knows what else?

Core's Plans

Good funds and bad funds. We must look skeptically at all mutual funds now. An ever growing number, including some (previously) highly respected firms, have engaged in actions that put the interests of the fund insiders ahead of those of the fund investors. There is more to be learned about all of this. I suspect that, in time, it will be known that some fund groups have acted as honorable fiduciaries of the investment capital of the shareholders of their funds. We will invest in those funds and will avoid the funds whose principals have breached their fiduciary duties. We will also monitor the news about funds in which we now have or previously held investments. If we learn of wrongdoing, we will inform you and propose a plan of action.

Investment comments

A brief remark: Stocks and REITs have been quite strong; the dollar has been very weak; bonds are neutral. Inflation is ahead of us and bonds will do poorly. We recently sold a short-term bond fund we held for many clients; even it will be weak as bond prices rise.

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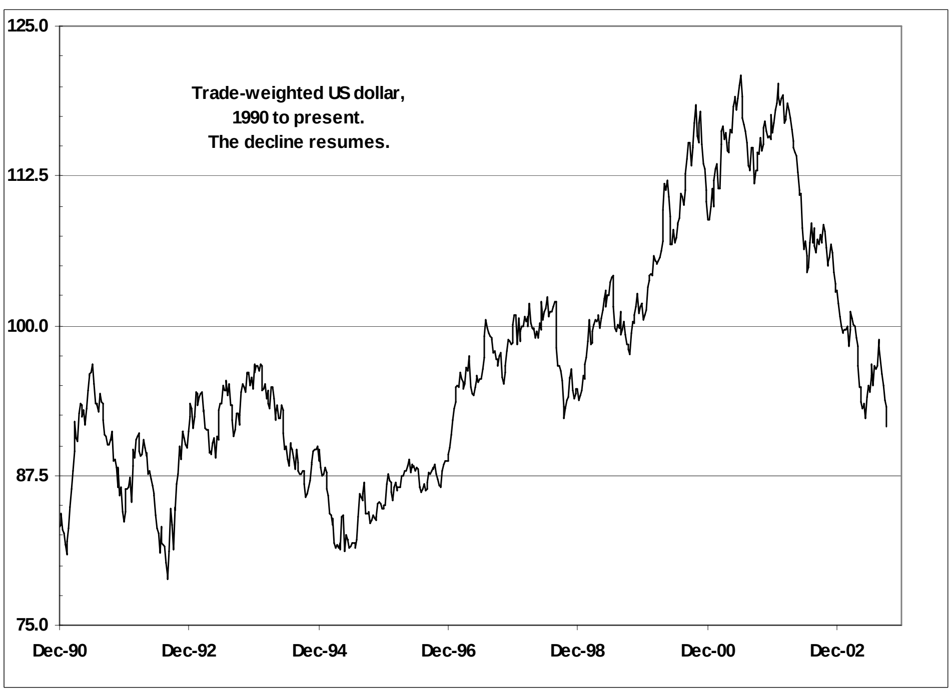
CORE Comments
ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

October 14, 2003

THE DOLLAR AND BOND PRICES FALL, STOCKS AND REITs GAIN.

After its summertime rally, the dollar is falling again. Now the Japanese yen is rising. Until recently, the euro had been gaining, but not the yen.

Treasury Secretary John Snow is campaigning actively to weaken the value of the dollar on foreign exchange markets. First came a well-publicized trip to Japan and China during which he argued that those currencies should be allowed to rise against the dollar. This was followed last month by a meeting of finance ministers of the G-7 countries that ended with a call for "flexible" exchange rates. This was widely taken to mean that Japan and China should allow their currencies to rise against the dollar. These actions have convinced traders that the likeliest course for the dollar is down. As a result the dollar has fallen sharply in recent weeks and resumed its decline. Most significant is the dollar's fall against the Japanese yen; Japan's treasury has bought scores of billions of dollars of US Treasury bonds this year in an effort to hold the value of the dollar at 115 yen or higher. Since September, the dollar has fallen to 108 yen.



Two opposing factors are at work in the currency markets. The first is the enormous and rising current account deficit of the United States. (In very rough terms, the current account is the difference between the amount of foreign goods and services Americans buy and the amount of US goods and services sold to foreign buyers.) The countervailing force is the relative dynamism of the American economy: to the extent that America's economy grows faster, it tends to attract foreign investment into dollars. Between these opposing forces, American dynamism was the stronger force until the beginning of last year, when the magnitude of the growing current account deficit began to exceed foreign investment in the United States. I expect

By:

John N. Mayberry

the dollar to continue its decline; we have established new foreign bond investments to benefit from this trend.

Economic growth is reasonably strong, but employment remains very weak.

The stock market and REITs have continued to rally.

The US economy has been growing in recent months, although the job situation remains quite poor. For stock market investors, economic growth in the absence of job growth—the situation that has characterized 2003—leads to strong gains in corporate profits. This comes about, of course, from better "labor productivity", i.e., making and selling more stuff without hiring more workers. When will the growing economy begin to produce new jobs? Total job loss has exceeded 2 million since 2001, but there are signs that job creation is at the point of expanding finally.

The stock market has remained quite strong since March, when fears around the Iraqi war depressed stock markets around the world. Companies have just begun to report third quarter earnings; these reports will probably make good reading for investors.

S&P 500
The US stock market maintained strength through the summer months.

Because interest rates and inflation are so low, because very accommodative fiscal policy and monetary policy encourage risk taking by investors, it is not hard to expect stock prices to keep climbing this autumn. However, many areas of the stock market are quite expensive. Any of a number of potential problems could undermine the willingness of investors to pay high prices for stocks: Inflation will probably increase. The decline of the dollar may impel foreign investors to sell dollar assets, including US stocks and US treasury bonds. My expectation is that stocks will continue to rally, but, in light of these risks, Core's stock investments will remain low for now.

Bonds. We have investments in your portfolios in inflation-protected bonds, discussed in our letter from late August. If inflation does increase, these bonds will perform better than conventional bonds. We also hold bonds with very short maturities; these maintain their value better than long-term bonds as interest rates rise.

Real Estate Investment Trusts. REITs have enjoyed strong returns in recent months. As the economy improves, so do prospects for commercial real estate. These improved prospects, coupled with the high dividends REITs pay, have given REITs a lift. Although not overvalued, REITs are unlikely to produce such gains quarter after quarter.

Please call at (800) 451 2240, if you wish to discuss your investments.

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CORE Comments
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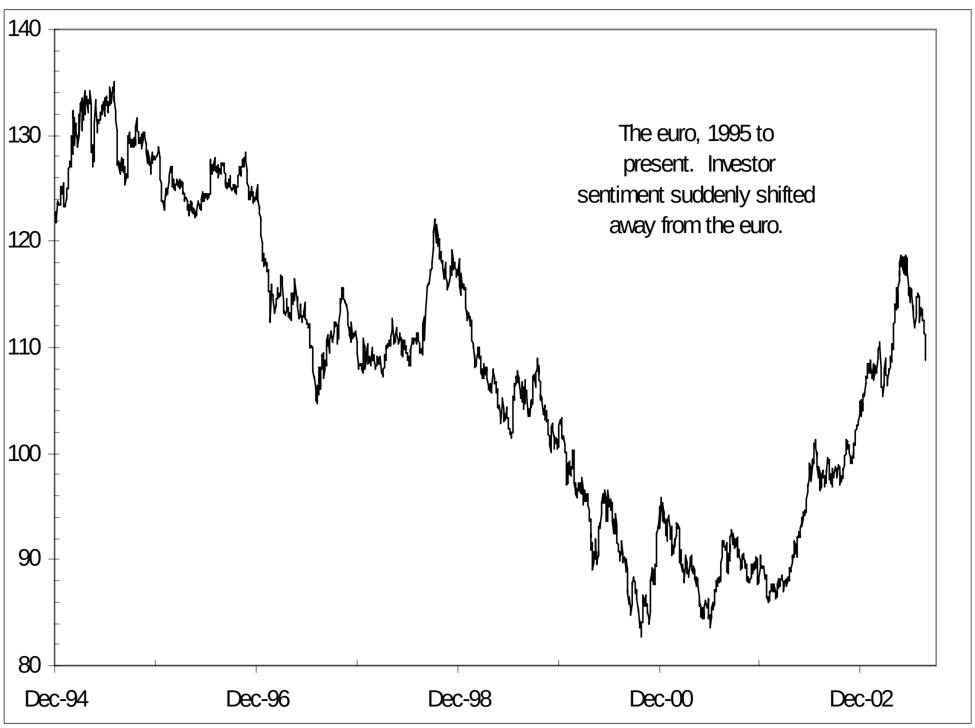
August 25, 2003

A SHIFT IN THE ECONOMY AND THE DOLLAR. DECISIVE?

The economy appears to be growing faster. This is attracting capital back to the dollar and to US markets

There are increasing signs that the US economy is growing at a faster rate. The effects are appearing in different investment markets and we are adjusting the investment portfolios of Core clients in light of the changing environment. I have written recently of the abrupt turn in the US bond market, a turn that has caused interest rates on long-term bonds to rise markedly in the last two months. As explained in previous letters, we sold the intermediate– and long-term bonds in your portfolios and, with the proceeds, made investments in international equities, added to REITs, and purchased shorter-term bonds.



Indications of a more rapidly growing economy have influenced the currency markets, as well. Gone, for now at least, is the sentiment that caused the dollar to fall so sharply, particularly against the euro, in the last year. The view that the United States will grow more vigorously appears to be drawing foreign capital to America and to US stocks. This is having a direct impact on currency exchange rates: the euro, having attracted capital for more than a year, is now losing ground against the dollar. Because of this, we have sold your investment in international bonds.

By:

John N. Mayberry

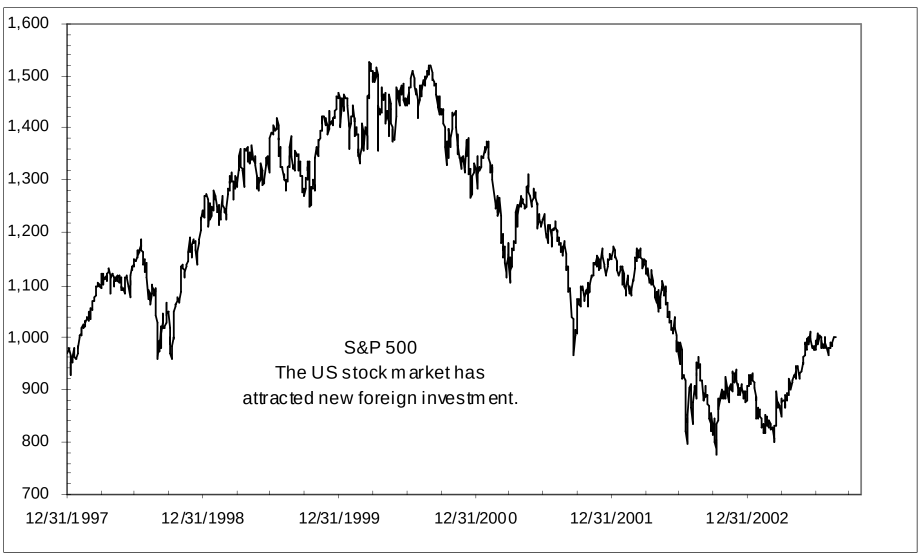
Recall that most of these bonds, generally government bonds of European countries, are denominated in euros. As the euro has increased in value against the dollar, this investment has appreciated. In the recent several weeks, as sentiment toward the dollar has improved, euro-denominated bonds have decreased in value.

In recent months, we have shifted capital from bonds, US and foreign, and into value-oriented stocks and REITs.

Economic reports and Fed policy point toward somewhat more rapid economic growth.

Core's portfolios. With proceeds from recent bond sales, we have made modest increases to stock and REIT investments. We are increasing equity holdings by another increment with proceeds of the international bond sales. We are considering investment in inflation-adjusted bonds, discussed below. We may retain some temporary cash investments.

What's next? We argued over the last eighteen months that the dollar would weaken against other currencies, particularly against the euro. We noted the large and growing current account deficit in the United States, the corresponding current account surplus in Europe, and the anomaly of higher interest rates in Europe than in America. The euro appreciated considerably during that time, from 86 cents at the beginning of 2002 to $1.19 in June. I have thought it likely that the euro would climb still higher, and, indeed, it may. At present, however, the currency, bond, and stock markets are focused on the prospect of relatively rapid economic growth in Japan and the United States. The yen and the dollar, the Japanese and US stock markets are attracting investment, while bond markets around the world are losing capital and falling in value.



We have shifted your capital away from bonds and into US and foreign stocks in the last three months. My enthusiasm for stocks is tempered, however, by the sense that stock prices already reflect profit growth likely to be generated by the stronger economy. To put this another way, I still feel that US stocks are quite expensive. Our additional investments have been in the less costly sectors of the market. Our utility stock and REIT investments are examples of value-oriented investments.

Inflation-protected bonds. As discussed in earlier letters, Fed policy and the Bush administration's fiscal policy are designed to stimulate the economy and to give rise to some inflation. Inflation probably will rise. For traditional bonds, inflation is poison, but there is a type of bond, issued by the US Treasury, designed to protect principal in inflationary environments. These are so-called "Treasury Inflation-Protected Securities" or "TIPS". Each year, the principal amount of the bond is increased by the rate of inflation as measured by the CPI. Thus, the purchaser of the bond earns the stated interest payment and realizes an increase in the bond's principal value. Hence, a positive, after-inflation investment return. We have made small investments in TIPS. We expect to make more.

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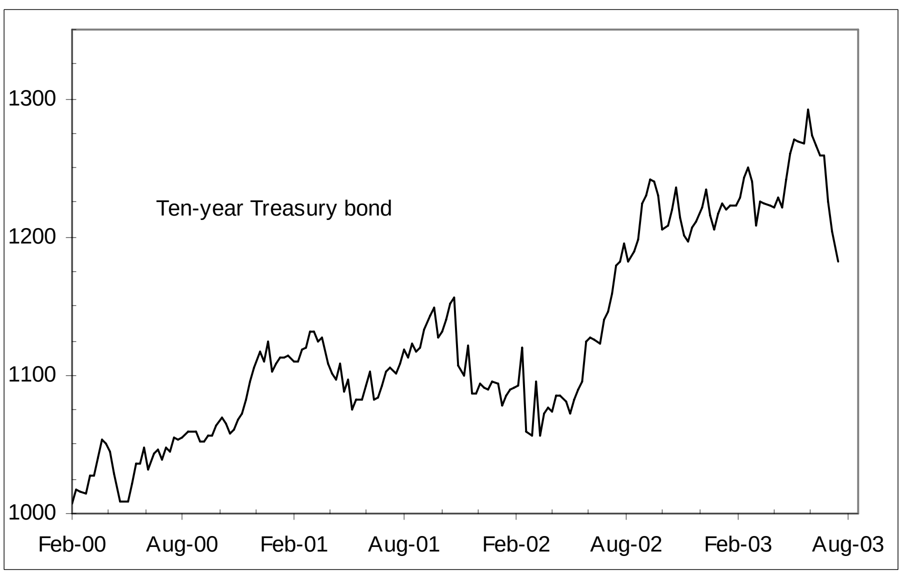
August 5, 2003

BOND PRICES FALL SHARPLY

US government bonds have fallen sharply in price since mid June.

The bond market has been gripped by tremendous selling in Treasuries and in mortgage-backed securities. Beginning in May, before the selling began, and continuing through recent weeks, we have been selling intermediate-term bonds in your accounts. I thought it useful to write briefly to put the market and our actions into context.

The very dramatic rise in yields on the benchmark ten-year treasury bond has lifted yields from 3.11% on June 13 to 4.45% last week and 4.32% yesterday. Because yields and prices move inversely, the price of the ten-year bond fell by about 10% over the last six weeks. It is the sharpest and fastest decline in bond prices since the early 1980s. The bull market in bonds is well and truly over.



Since last autumn and especially during the spring, investors were concerned that the economy might slip into deflation — the condition of falling prices. The Federal Reserve Board discussed the issue extensively and promised to pursue monetary strategies to prevent deflation from occurring. When concerns about deflation were pronounced, bond yields fell to remarkably low levels and their prices soared. Among other things, interest charges on mortgages fell dramatically, and another wave of mortgage refinancing developed.

In mid-June, the market's perceptions changed and yields began to march higher. The interplay between rates on the ten-year treasury bond and those on mortgage-backed securities has magnified the selling and the speed with which rates have changed.

By:

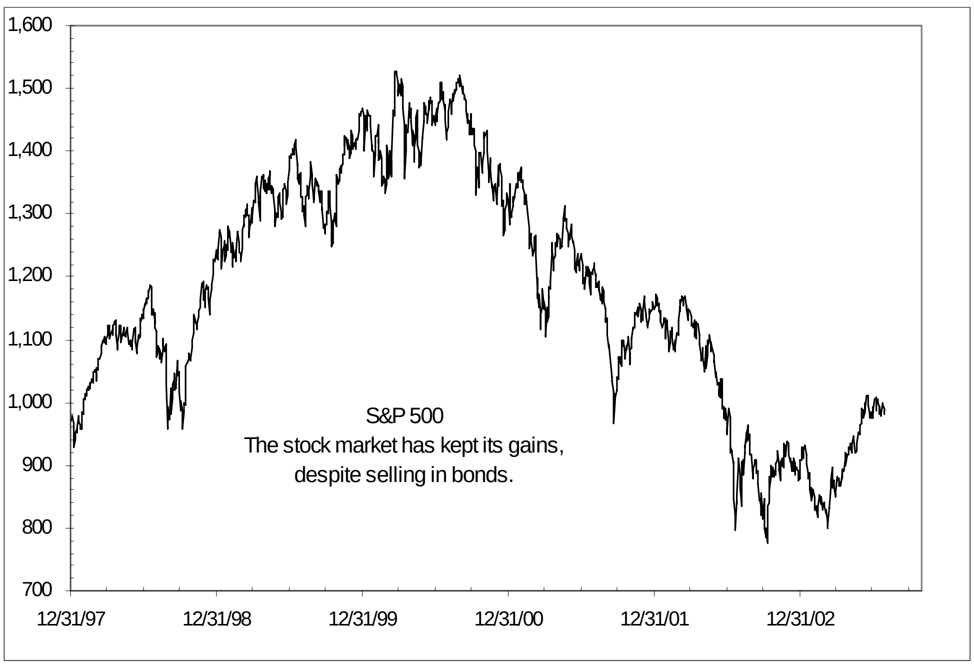
John N. Mayberry

Core's portfolios. For most clients, we have had large investments in US bonds for the last three years. For much of 2002, these investments were in treasury bonds (via a government securities mutual

The collapse in bond prices may hurt the economy. Mortgage refinancing will dry up while the job market continues to shrink. The stock market could suffer if bonds continue to fall in price and rise in yield.

fund) and in intermediate-term corporate bonds. Last autumn, we began to sell our treasury bond fund holdings and reinvested the proceeds in high-grade intermediate term bond funds that emphasized less pricey corporate bonds. Beginning in May and June, we began to sell those bond funds and to invest proceeds outside of the bond market. In June we bought funds holding public utilities companies. With the proceeds of bonds in early July, we purchased non-US stocks. Over the last week, we have sold remaining holdings of intermediate-term US bonds. With the proceeds of these sales, we are buying short-term bonds and public real estate funds called REITs.

This series of investments—selling US bonds and buying other assets—has been designed to lower risk, by eliminating what had become a very overpriced asset and replacing it with more fairly priced investments in utilities, REITs, and international stocks.



What's next? Such concentrated selling in a short time in this very important market may have broad effects across many markets and the economy. The mortgage-refinancing boom of the last three years has been a sturdy prop to the economy as a whole. As home owners have decreased their mortgage payments and, in many cases, extracted equity from their homes, they have spent more money. This consumer spending has sustained modest economic growth during a time when business spending has been weak and jobs have been lost. This support for the economy has been unceremoniously kicked away, creating some risk in this uncertain time.

The stock market has not been hurt yet by the bond market's problems. Stock prices have kept most of the gains earned from March through June. The dollar has strengthened somewhat since mid June. REITs have been quite strong in recent weeks. They appear to be attracting renewed interest on the notion that the economy will expand. However, until the bond market calms down somewhat, it is difficult to have certainty about these markets.

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CORE Comments
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June 16, 2003

DEFLATION AND REFLATION. GERMANY AND THE UNITED STATES.

All Assets Rally. What Do the Markets Say about the Economy?

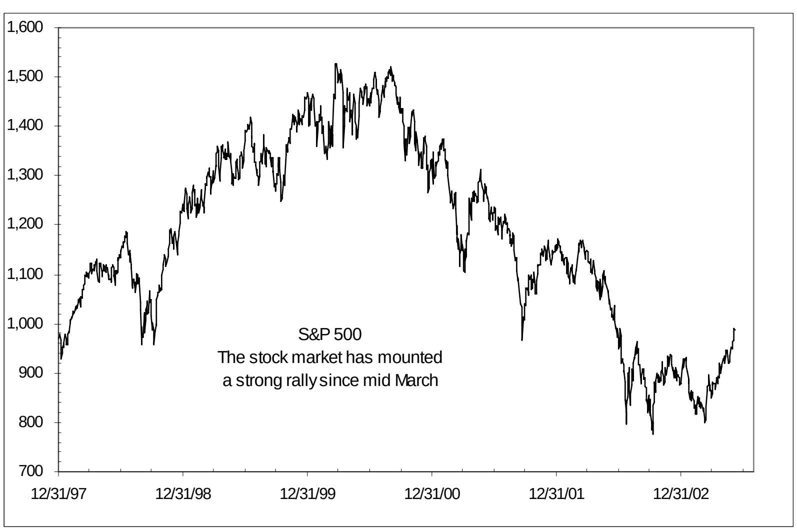
John N. Mayberry

The bond market predicts deflation and recession. The stock market points to economic expansion and reflation. Which is sending the right signal?

In the last two months, our portfolios have appreciated in every asset category. For most Core clients, portfolios are broadly diversified among US and foreign bonds, US stocks and real estate investment trusts ("REITs"). Recently, all have increased in value. While we can only be pleased to watch this, fashioning an internally consistent explanation for it is rather difficult. Here's why:

The stock market rally seems to point toward strengthening economy and improving corporate profits. Likewise, the smart rise in prices of REITs suggests the same: economic growth and improving prospects for commercial real estate. The bond market makes the counter argument. There has been an unusually strong rally in bonds, especially government bonds. Bond prices have risen and yields have fallen dramatically in recent weeks. The bond market rally must be signaling sustained weakness in the economy.

To further complicate things, consider the relentless decline of the US dollar against the euro. What message is being given by the appreciation of the euro and the rally in European bond markets? Our large investments in foreign bonds have produced unusually strong gains. The month-by-month fall in the value of the dollar probably helps the US economy, by stimulating exports to Europe. However, the message of the European bond market is that economies in Europe are very weak and unlikely to be creating much demand for US goods and services.



Deflation risk. The central question concerns the risk of deflation. Recall that deflation—essentially the opposite of inflation—refers to the general decline of prices in an economy. Severe deflation caused immense problems in the United States in the early 1930s. Since the late '90s, Japan has suffered from a regime of falling prices for goods and services. Deflation can have dreadful economic impact: if one expects the price mid March. The strongest sector of the market is technology and the gains have extended even to very weak and speculative companies. For example, the Nasdaq 100 index is up by more than half since October. There is a decided air of speculative excess in recent weeks, reminiscent of trading before the bubble burst: The market seems focused on the favorable economic reports and ignores the bad news. Some of the weakest companies have experienced the most dynamic stock price gains, without any apparent improvement in their underlying business. Despite the brilliant performance in stocks in recent weeks, I believe that risk in the market is quite high now. Our small addition to stock positions—the investment in utilities stocks—is a cautious step into a quiet part of the stock market.

European bonds. For many Core clients, the biggest single investment is in European bonds, mostly German, denominated in euros, not dollars. This has been a very successful investment. In the year since we made our first purchases, returns have exceeded 20%, caused by a happy combination of rising bond prices and the appreciation of the euro against the dollar. I expect that German bonds will rise in price markedly over the next year. As for the euro, it has already risen very dramatically, and I am less confident about its future appreciation. Hence, my strategy is to stay with the bonds, but to lessen the currency exposure.

These two elements of this investment—bonds and currency—must be analyzed separately: first, German bond prices. The IMF published an extensive report recently assessing the risk of deflation in major economies around the world. According to the IMF, deflation risk is higher in Germany than in the US or elsewhere in Europe. Recent economic reports and estimates for this year bear this out. Inflation is lower in Germany than in the US and the German economy is expected to shrink slightly or to grow by less than 1%. Under these circumstances, German bond yields should be lower than those in the US, but in fact, yields remain higher in Germany than in the US. It is very likely that our holdings in German bonds, which now yield about 3.5%, will increase in value as their yields fall further. Indeed, the appreciation of the euro itself, discussed below, depresses Germany's export-oriented economy, suppresses inflation, and leads to lower interest rates.

The euro and the dollar. Since my last letter, the euro has gained a few more cents against the dollar. It now costs $1.18 to buy a euro; last June the euro was worth 95 cents. The remarkable speed with which the euro has gained is shown in the chart on page 2. The fundamental conditions behind this appreciation remain; the US has a huge trade imbalance with the rest of the world. The Fed and the Treasury Secretary, John Snow, have made it clear that the United States is happy to see the dollar's value decline. (The Fed sees this as a way to create a little inflation here and to ward off the deflation; the administration notes that a cheaper dollar is good for our exporters.) Because the Japanese central bank is selling yen and buying dollars by the tens of billions to prevent the yen from appreciating against the dollar, and because the Chinese currency is linked to the dollar, most of the dollar's depreciation has been against the euro. At some time, and perhaps soon, the pain to Europe from the expensive euro will cause intense political pressure to stop the dollar's decline.

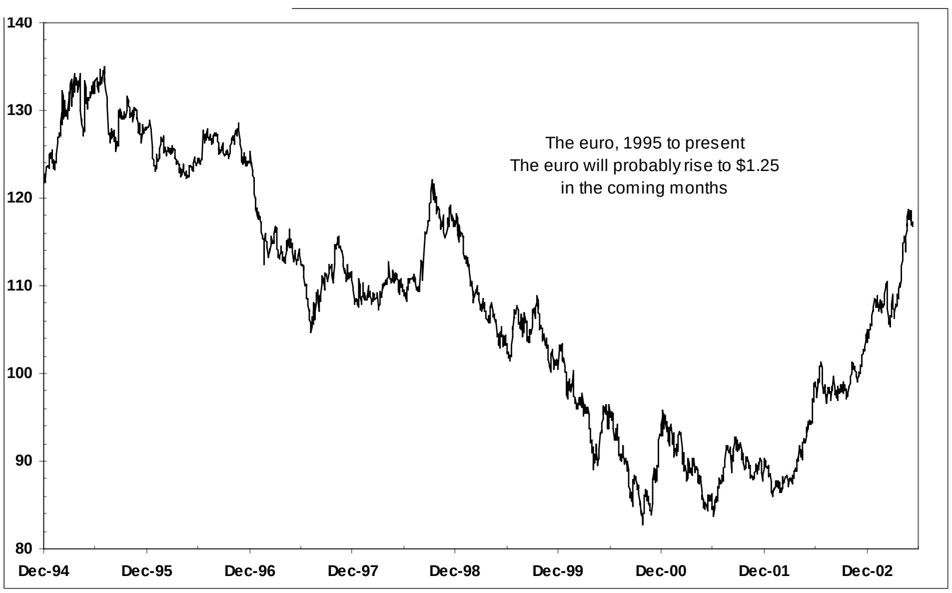
When this happens is uncertain. When the euro's value reaches $1.25 or $1.30, the currency risk in our foreign bond investment will become greater. As this happens, we will begin to sell our investment in the American Century International Bond fund, which does not hedge the currency risk away, and invest in a foreign bond fund with a similar portfolio but with the euro currency exposure hedged back into dollars. (We have identified this fund already and can act quickly when it seems appropriate.) With this approach, we will be able to maintain our investments in German bonds, but with less currency risk .

Investment risk. Because of our concentration in rather undervalued investments over the last and declining prices, economic growth will suffer. Companies and people who owe money have to repay their borrowing in dollars with greater value. Deflation is good for creditors and poison for debtors.

The Fed's monetary policy and the Bush administration's fiscal policy are aligned and encourage economic growth and inflation.

Japan and China have purchased tens of billions of dollars of treasury bonds in the last month to keep their currencies weak against the dollar. This accounts for a big part of the bond market's rally.

In January, I wrote about the November speech by Fed Governor Ben Bernanke on the Fed's plans to prevent deflation. In that speech, Bernanke stated specific actions the Fed could take if the need arose. In the Fed's announcement following its May 6 meeting of the Federal Open Market Committee, the risk of deflation was mentioned as justification for easing monetary policy. (In typical Fed-speak, the statement reads: "In contrast, over the same period, the probability of an unwelcome substantial fall in inflation, though minor, exceeds that of a pickup in inflation from its already low level. The Committee believes that, taken together, the balance of risks to achieving its goals is weighted toward weakness over the foreseeable future.") The announcement had an electrifying effect in the bond market and sparked a sharp rally that brought yields on ten-year Treasury bonds to 3.10%, the lowest levels in more than forty seven years. Bond investors interpret the Fed to be promising not to raise interest rates for a long time, even as the economy grows and inflation begins. The bullish view about bonds must be that rates will stay low because either (a) the economy slides into deflation leading to even lower bond yields, or (b) the economy continues its modest recovery without stimulating enough inflation to cause the Fed to push interest rates up.



Core has had large investments in US bonds for clients for more than two years. We are in the process of taking some profits in these positions, and investing proceeds of bond sales in high-yielding utilities stocks. My view is that the risk of deflation in the US is rather low, particularly because the Fed's monetary policy and the Bush administration's fiscal policy aim to stimulate and reflate the economy. Because utility stocks yield about 4%--more than ten-year treasury bonds--they are an attractive and low-risk substitute for bonds, particularly in light of new, lower tax rates on stock dividends.

Many clients receive our newsletter via email. If you would like to be added to this list, please email me at JNMayberry@coreasset.com

Stocks and deflation risk. The stock market seems to be shrugging off deflation risk and even the risk of sustained sub-par economic growth. A "relief rally" after Iraqi the war was a reasonable response, but the stock market has continued to gain week after week. There appears to be a strong conviction that corporate profits will grow sufficiently to jus-

The euro and the dollar. Since my last letter, the euro has gained a few more cents against the dollar. It now costs $1.18 to buy a euro; last June the euro was worth 95 cents. The remarkable speed with which the euro has gained is shown in the chart on page 2. The fundamental conditions behind this appreciation remain; the US has a huge trade imbalance with the rest of the world. The Fed and the Treasury Secretary, John Snow, have made it clear that the United States is happy to see the dollar's value decline. (The Fed sees this as a way to create a little inflation here and to ward off the deflation; the administration notes that a cheaper dollar is good for our exporters.) Because the Japanese central bank is selling yen and buying dollars by the tens of billions to prevent the yen from appreciating against the dollar, and because the Chinese currency is linked to the dollar, most of the dollar's depreciation has been against the euro. At some time, and perhaps soon, the pain to Europe from the expensive euro will cause intense political pressure to stop the dollar's decline.

The euro will rise further, but we will begin to hedge currency risk for our foreign investments if the euro continues to rise rapidly.

When this happens is uncertain. When the euro's value reaches $1.25 or $1.30, the a science; our attempt is to make reasonable evaluations and to err on currency risk in our foreign bond investment will become greater. As this happens, we will begin to sell our investment in the American Century International Bond fund, which does not hedge the currency risk away, and invest in a foreign bond fund with a similar portfolio but with the euro currency exposure hedged back into dollars. (We have identified this fund already and can act quickly when it seems appropriate.) With this approach, we will be able to maintain our investments in German bonds, but with less currency risk .

Please contact us if there are changes to your personal financial position.

We will explain our various portfolios and will make recommendations to meet your goals with the minimum level of risk.

Investment risk. Because of our concentration in rather undervalued investments over the last year, your portfolios have only been exposed to a modest degree of investment risk. The German bonds and the euro have both been undervalued, as have US bonds and REITs. The stock market has been risky throughout this period--and remains risky now--but our investment in it has been small. Now the US bond market has become riskier and we are selling some bonds. As the euro rises in value, investment risk associated with ownership of euro-denominated bonds increases. We will sell the unhedged euro positions and lower the currency risk in your portfolios. Assessment of investment risk and of prospective investment return is not the side of conserving capital. Please call me (800 451 2240) or email me at (JNMayberry@coreasset.com) with any questions.

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CORE Comments
ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

July 11, 2003

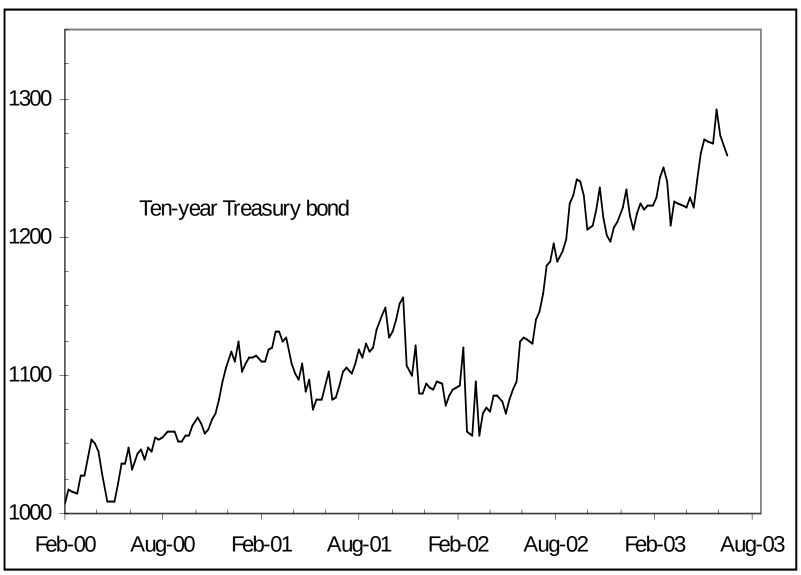
A SHARP TURN IN BONDS

US government bonds have fallen sharply in price in recent weeks.

The bull market in bonds may be over.

The Federal Reserve Board has embarked on a course wholly at odds with its mission of the last several decades. The Fed is trying to create a modest degree of inflation in the economy, in order to prevent deflation—falling prices—from occurring. The Fed has apparently made the judgment that damage that may arise from inflation is less worrisome than the damage that could occur from a period of deflation. Without attempting to assess the Fed's judgment, let us consider the investment implications.

First, the stock market: the Fed welcomes the stock market rally of the last three months and would like to have it continue. In sending interest rates so low—money market funds essentially pay no interest dividends now—the Fed is driving people to take investment risk, including in the stock market. For now, Fed actions encourage stock investments, despite economic weakness and uncertainty of sustained growth in corporate profits.



Second, the bond market: the Fed is making an implicit promise to keep short-term interest rates low until there is a real pick up in the economy and in inflation. Additionally, the Fed has said that it may make outright purchases of long-term treasury bonds, in an effort to keep long-term rates low. Fear of deflation has been so pronounced since November that long-term rates reached unsustainably low levels four weeks ago. In mid June, the ten-year treasury bond traded at a yield of 3.10%. Since then, the yield has spiked up to 3.73%. This is sudden and pronounced loss of principal shows that bonds with such low yields have become quite risky. The nearby chart shows the price of the ten-year treasury bond and its recent sharp decline.

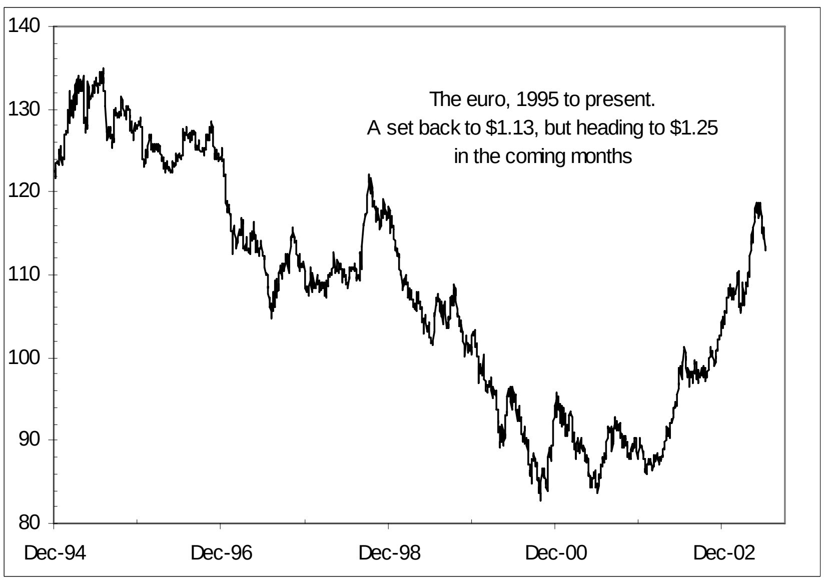
By:

John N. Mayberry

Because the Fed is so determined to keep rates low, and because the economy remains rather weak, it is unlikely that bond yields will continue to rise so sharply. However, the safe course is to reduce investments in long-term bonds. Last month, we sold a portion of bond investments for many clients and purchased utilities, an investment that preserves income generation and lowers risk.

Third, non-dollar investments: For more than a year, we have held foreign bonds, mostly denominated in euros. This has been a very successful investment. The Fed's strategy includes, or at least welcomes, a weaker dollar and a stronger euro. This suggests that our euro-denominated foreign bonds will continue to gain in value. Since my last letter, the dollar has gained five cents in value against the euro; as I write, the euro is worth $1.13, against $1.18 last month. This will prove, I suspect, to be a brief pause in a longer-term slide in the dollar's value.

Yields of government bonds in Europe have been higher than of US treasuries, a condition inconsistent with relative growth rates and rates of inflation. Economic growth in America, though scarcely robust, is higher than in France and Germany; inflation in the US is also higher than in those countries. Germany is at far greater risk of deflation than the United States. Its economy has shrunk in the last two quarters and inflation this year and next is expected to be under 1 percent. In such an economic environment, German bonds should gain in price and fall in yield. We expect your foreign bond investments to grow in value.



Real estate investments have remained strong all year and the Fed's policy favors commercial real estate, by encouraging both economic growth and inflation.

We are in the process of another investment change for most clients, by selling another portion of US bond investments and buying non-US stocks. The sale of the bonds is a further step in reducing investment in this now risky and overpriced asset. We have not held international equities for some time. You may recall that non-US stocks generally did less well than US stocks in the late 'nineties. Then, when the stock market bubble burst here in 2000, international equity markets fell by more even than the US markets. Now, however, in the context of a weakening dollar and world-wide economic and monetary stimulus, it will probably be useful once again to have non-US stock investments. We are making a small shift away from US bonds and into foreign stock markets.

Office move. We have moved our office from our Smith Ranch Road location to an office building near the Civic Center in San Rafael. Our new address is 4000 Civic Center Drive, Suite 500. We look forward to welcoming you to our new digs. Please call us for directions when you

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CORE Comments

ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

March 24, 2003

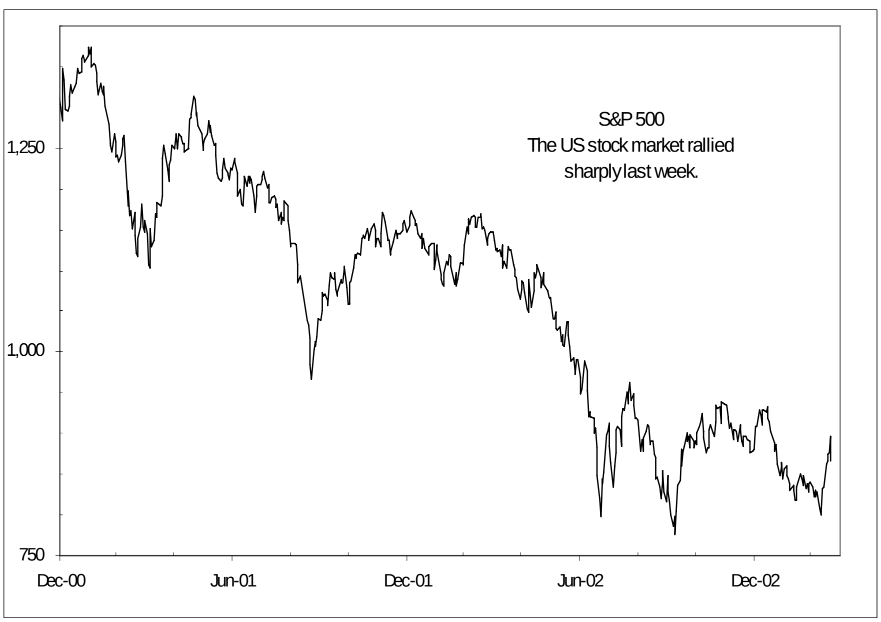
A NOTE ON OUR INVESTMENTS AND OUR SYSTEMS DURING WAR

Contingency plans for war and terrorism.

We will post updates as needed on our website www.coreasset.com

War is now underway in Iraq. For us in the United States, there is increased risk of terrorism, of disruption to financial markets, and of damage to financial and banking systems. I write to describe preparations Core has made, both in investments and systems.

First, systems and communications. As we remember from the September 11th attacks, there are vulnerabilities in the nation's financial and communications systems. At that time, the attacks on the World Trade Center shut down trading on the New York Stock Exchanges and other financial markets for four days. Destruction of certain communications facilities in downtown Manhattan caused potential problems in settlement of stock trades.



Recognition of these vulnerabilities provided the impetus for changes in systems for banks, brokers, investment advisors and all others in financial services. For example, the SEC, which regulates investment managers like Core, has required comprehensive contingency plans. In a periodic examination of Core Asset Management last autumn, the SEC paid particular attention to our contingency plans. A few key points: We back up information on our computer servers every night and we keep a current copy of all our electronic data off site. We have arrangements with an outside firm to use its computer systems with our data if the network in our office is damaged. We also have the capacity, which we use regularly, to work from remote locations on our computer network.

By:

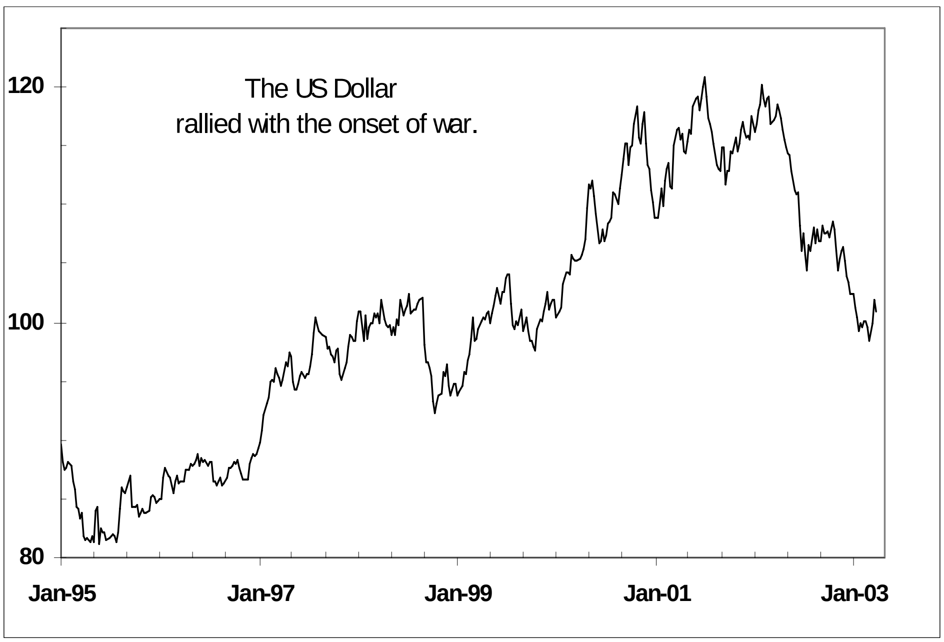
John N. Mayberry

The uncertainties presented by the war and the risk of terror attacks make judgments about investments more difficult than usual.

Our investments reflect our very cautious views.

As we know, in a massive terrorist attack, disruptions might be far reaching. We intend to post information on our web site as needed during this time of increased risk. If you have questions and cannot readily reach us by telephone or email, please look at our website, www.coreasset.com, for updates.

Investments. Over the last several months, most clients have been receiving notices of various trades we have placed in your accounts. We have been selling equity positions and buying bonds, including international bonds. I continue to feel that the stock market carries a good deal of risk, both because of uncertainties engendered by war and terrorism, as well as from stubbornly high oil prices and a weak economy. As a result, we hold only small stock positions for clients and rather large investments in bonds.



Until about ten days ago, several important markets were rising, several others were falling. US treasury bonds, crude oil, and the euro had all been rising, while stocks and the dollar had been falling. In the last week as diplomatic efforts failed and war became imminent, everything changed directions. It is very likely that all major markets will be very volatile and very changeable in coming weeks. War news will almost certainly dominate short-term trading and investment decisions. In this situation, it will be hard to make meaningful assessments about these markets.

An interesting measure of financial market and economic uncertainty was demonstrated last week by the Federal Reserve Board. The Fed's Open Market Committee met, as it does about every six weeks. It determined to leave interest rates unchanged, but did not give its view of the "balance of risks" in the economy, as has been its practice. It stated that geopolitical uncertainties were too great to make such an assessment.

In anticipation of this uncertainty and concerned with risks, we established conservative positions for clients several weeks ago. At present, our investment positions present relatively low risk. When the world becomes calmer and the strength of the economy can be more reasonably assessed, we will review investments. For now, we are quite cautious. Please contact us at 800 451 2240 if you wish to speak about this.

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CORE Comments
ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

March 5 , 2003

WAITING FOR WAR,
CALCULATING RISK

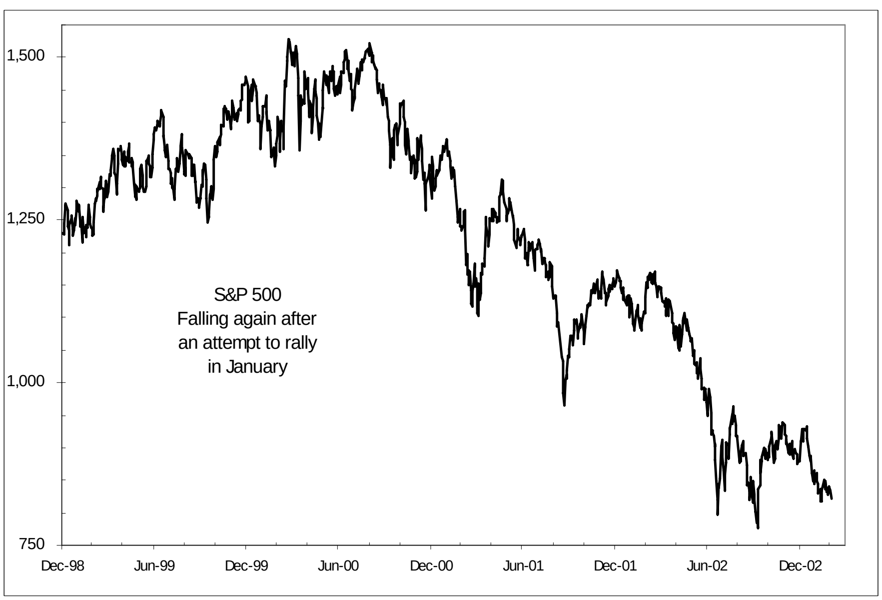
Inexorably, the world moves closer to war. Opposition to war grows in the United States and the rest of the world, but the Bush administration expresses no doubt that war will follow unless Saddam Hussein voluntarily disarms and leaves Iraq.

War approaches.

A stock market rally on a "good" outcome may be temporary. A "bad" result will surely result in further selling.

Putting aside questions about *whether* the United States should go to war, I address in this letter the investment risks posed by war. Consider the possible outcomes to the situation with Iraq; how will these affect the investment markets?

Already, anxiety about the onset and the outcome of war has had a severe effect on the economy and on financial markets. Business plans and investments have been deferred because of the uncertainties about Iraq. And, just as businesses small and large have been awaiting developments, so investors have withheld their capital from the stock market causing stocks to fall by about 10 percent since mid January. What happens now? There are, it seems to me, four possible outcomes.



First, war may be avoided and a diplomatic solution found. In this event, the stock market would surely rally strongly.

By:

John N. Mayberry

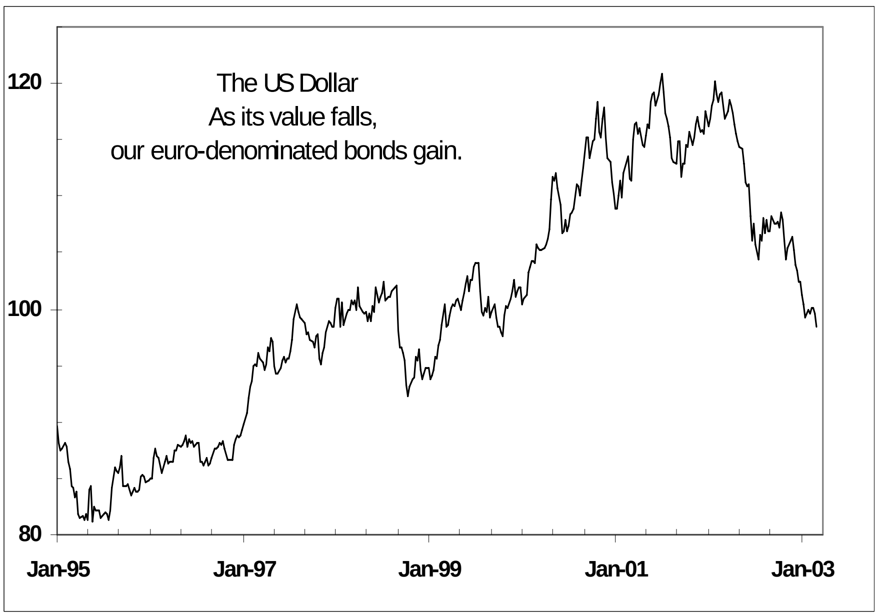
Second, the war may be short and end in a decisive victory for the United States, with minimal US casualties. This, too, would lead to a stock market rally.

A third possibility is a lengthy war with substantial casualties and destruction of Iraq's oil fields. This would surely be a bad outcome for the stock market and lead to a serious further decline.

Many consider the rise in oil prices to be temporary, but the high prices are a result of production cuts in Venezuela as well risks of destruction of Iraq's oil production capabilities.
High oil and gas prices amount to a very large tax on the economy and restrain already weak growth.
The continuing economic weakness is bearish for stocks but bullish for our large bond investments.

The fourth outcome to consider is a war in which Iraq used weapons of mass destruction against US troops or Israelis and which gave rise to serious acts of terrorism in Europe and the United States. This also would lead to sharp and prolonged selling in the stock market.

Oil Prices, the War and the Economy. Oil prices have risen very sharply in recent months. War fears have caused part of this increase; there is concern that Iraq production will be lost for a long time if the oil fields are damaged. The strike in Venezuela has cut its exports sharply; this is an important factor in the oil price increase. There is little spare capacity within other OPEC countries to make up for the likely loss of Iraqi oil. Because of this, it seems quite possible that oil prices may remain very high even if war in Iraq is short. This is a serious problem for the world's economy. The high prices for gasoline, natural gas, and heating oil are a significant drag on the economy, one that may persist for many months.



Core's Investments. In the recent months, we have continued to reduce equity positions in your portfolios and to increase our investments in bonds, both US bonds and European bonds. We have sold international equity investments for many clients and have reduced investments in Real Estate Investments Trusts by a small amount. We have increased bond purchases, particularly of foreign bonds. Bond investments have gained in value in the context of the weak economy and war fears. European bonds have continued to do especially well because of the increase in value of the euro against the dollar. The general weakness of the dollar will probably continue, although a favorable outcome to the war may temporarily boost the dollar's value. US treasury bonds have rallied sharply recently and approach the historically high prices (and low yields) of last autumn. We may sell government bond positions while they are so strong and shift our US bond investments toward corporate bonds that offer better value.

Conclusion. Because of the risks to stocks presented by Iraq, our equity investments are quite small. Our large bond investments are earning attractive returns with very low risk. The likelihood that oil prices will remain high and that the dollar will continue its weakness—unfortunate though these may be—give us the opportunity to earn attractive returns without taking much risk, even during this very dangerous period.

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CORE Comments

ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

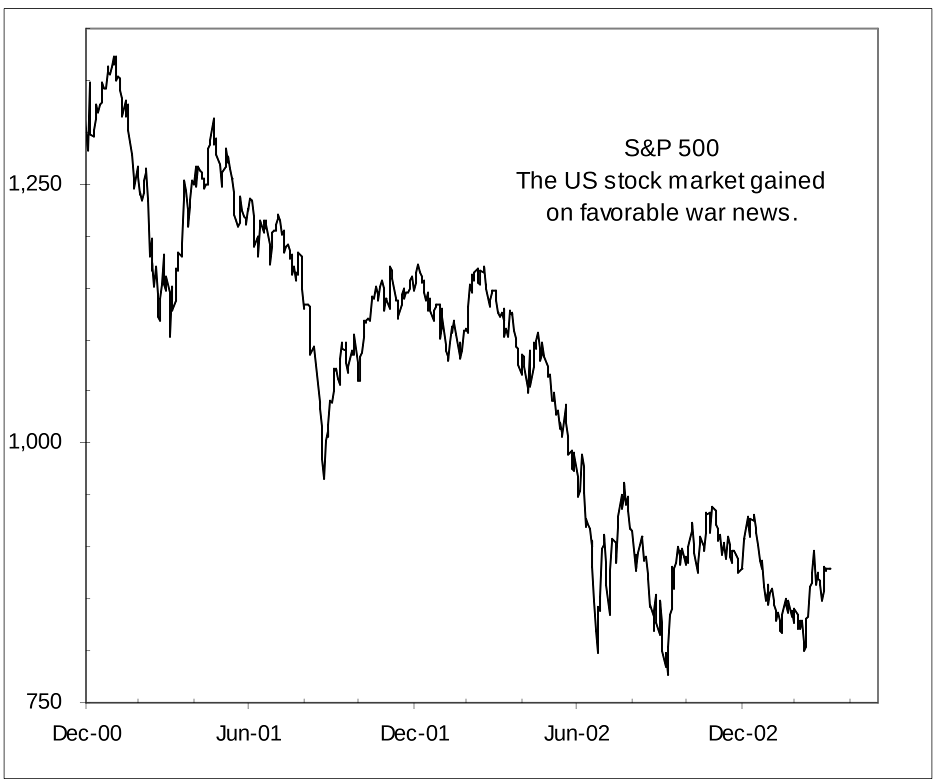
April 9, 2003

AFTER THE WAR

We will post updates relating to Iraq or other matters on our website, if the need arises. See www.coreasset.com

We now have answers to some important questions that created such uncertainty and misgiving in the weeks leading up to the war. Some new, as yet unanswered questions have been thrown up. This letter will consider some matters that have bearing on our investments and on the economy.

Iraq's oil fields do not seem to have been significantly damaged; only a few wells were set afire. The countries around Iraq, including Saudi Arabia, Israel, and Iran were not attacked by Iraq and have not been drawn directly into the conflict. As of this writing, there have not been significant acts of terrorism outside of Iraq.



These are unreservedly good outcomes. Many perils remain, even if we only consider those that bear directly on the economy and investments. The biggest questions involve post-war developments in Iraq. Will a safe and sane society that provides for the well-being of Iraqis emerge? Will the new government be seen as the puppet government of the occupying army and be subject to attack by the disaffected in and around Iraq?

The parallels between this Iraqi war and the Israeli action in Lebanon in 1982 are disquieting; that "roadmap" (to use the term now employed in discussing a proposed Israeli/Palestinian settlement) is one that we should not follow. The battlefield has its dangers; the post-war world will have different ones.

By:

John N. Mayberry

Recent economic reports in the United States are troubling. The US economy is weakening; jobs are being lost on a big scale. In four of the last five months, the number of people employed in the United States has fallen, by nearly one half million in February and March alone. Manufacturing activity contracted in March. Although crude oil prices have fallen by about one fifth since pre-war peaks, the still-high prices for gasoline and home heating oil restrained consumer spending throughout recent months. For the last eighteen months there has been the risk that falling consumer spending would pull the economy down before very depressed levels of business spending would pick up. Economic reports from February and March suggest that risks are tipping back toward recession.

The bullish argument for the economy is that the uncertainties of war have restrained consumer and business spending. A favorable outcome to the war will, the argument goes, revive confidence and the economy will strengthen. The same points are made to support the view that the stock market is ready to rally.

The less sanguine view is that the effects of the capital spending binge of the late 'nineties and the collapse of the stock market bubble still overhang the economy and the stock market. New post-war problems and the newly-roused enmity of many peoples through the world for the United States may disrupt economic activity and unsettle investment markets. Our cautious investment approach is the safer course while these uncertainties prevail.

LEON LEVY

Leon Levy, one of the greatest investors of the last half century, died on Sunday. Leon began his career at Oppenheimer & Co., a small New York brokerage firm. In 1959, he formed the Oppenheimer Fund, an early mutual fund. Later, and for more than twenty years, Leon and Jack Nash ran Odyssey Partners, one of the most successful investment partnerships in Wall Street's history.

Leon and his wife Shelby White formed the finest collection of Greek and Roman antiquities in the United States and he has been one of the great philanthropists in New York in this generation. In recent years, Leon made important gifts to Rockefeller University, the Metropolitan Museum, Bard College, the New York Botanical Gardens, the American Civil Liberties Union, The Institute for Advanced Study at Princeton, and many other organizations. He chaired investment committees for a number of endowment funds.

I had known Leon slightly for a number of years. Two years ago, I asked him to serve as an advisor to the endowment fund of Planned Parenthood of New York City, for which I have responsibility as a long-time board member and chair of the investment committee. Once Leon agreed to join my committee, it was easy for me to recruit a number of other eminent persons to serve with him. Over the last eighteen months, I met with Leon every few weeks, either in our advisory committee meetings or privately in his gorgeous office, filled with magnificent Roman and Greek sculptures. We discussed investments, political affairs and the arts, and he helped me with the specific investments and projects with which I am involved.

He was an extraordinarily wise, acute, and generous man. Happily, Leon published his memoirs, The Mind of Wall Street, just a couple of months ago. The book is a delight, far the most interesting investment book I have ever come across. I feel saddened by his death and enormously privileged to have worked with Leon and learned from him over the last year and half. (A warm obituary of Leon from the New York Times may be read at http://www.nytimes.com/2003/04/08/obituaries/08LEVY.html)

Each year, Core Asset Management Company files with the SEC a Form ADV with information about the company. If you would like to receive a copy of Part II of Form ADV, please contact us and we will send one to you.

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CORE Comments
ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

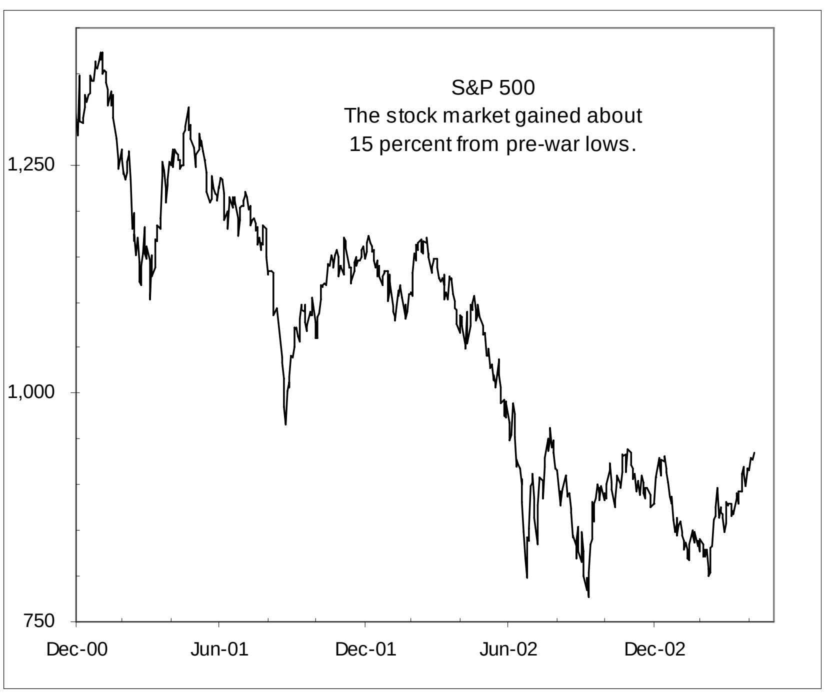
May 6, 2003

OPTIMISM RETURNS TO THE STOCK MARKET

All of Core's investment assets—stocks, REITs, US bonds, and foreign bonds—have gained in value this year.

The active phase of war in Iraq ended and uncertainties that afflicted financial markets faded. Against a backdrop with some notably positive features, the stock market staged a modest celebration and rallied by about 15% from its pre-war lows. Indeed, optimism flowed through many markets, and all of Core's investments gained last month. Stocks, real estate investments (REITs), US bonds, and foreign bonds appreciated. Added to modest gains in Core's portfolios in the latter part of 2002, our investment accounts are solidly in the black.

The economy. Is the stock market's recent optimism warranted by prospects for economic growth and corporate profits? In the first quarter, GDP rose by 1.6%. On the positive side, oil prices fell by about one third from pre-war peaks and consumer confidence improved markedly. However, employment shrank again in April; over 500,000 jobs have been lost in three months. The manufacturing sector contracted further. Until very recently, states and local governments have been adding jobs. Given very poor finances of most big states and cities, large-scale layoffs of their workers is almost certain. Profits of big public companies were generally favorable in the first quarter, although a meaningful portion of profit growth came from the continuing and relentless cost cutting by companies, not from growing revenues. Additionally, oil companies in the S&P 500 accounted for much of the earnings growth, but, with lower oil prices again, this looks like a one-time event. Demand for goods and services remains weak and there is little prospect for increased capital spending. At its meeting today, the Fed described economic risks and set the stage for another rate cut in June. Against this uncertain background, the S&P 500 is trading at 33 times earnings for the last twelve months, and 18 times expected earnings for the next twelve, high levels indeed. In general, stock market risk remains high; corporate profits are unlikely to grow rapidly.



By:

John N. Mayberry

Munis and REITs. We sold certain municipal bond funds held by clients because those funds held—and planned to keep holding—so-called

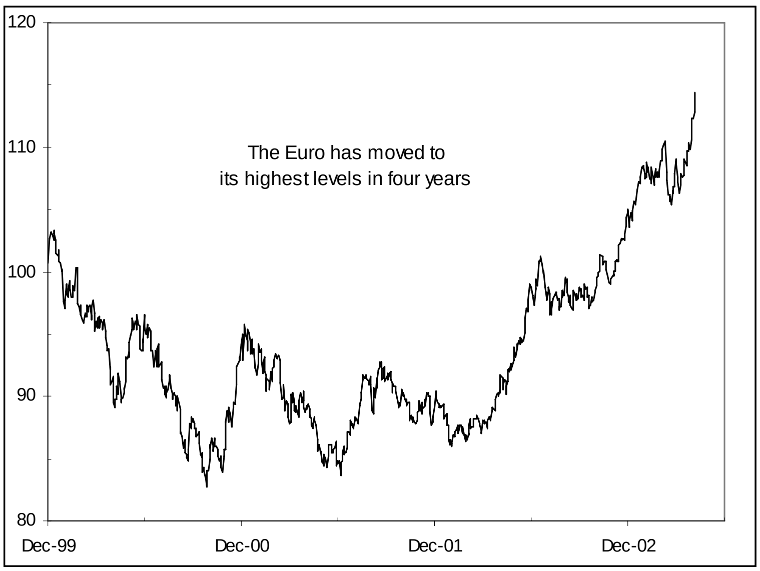
We sold municipal bond fund because of tobacco problems and higher fees.

We took profits in one REIT and made a new purchase of another.

Our best investment has been in Euro-denominated bonds. Prospects are good for European bonds.

"tobacco bonds". Recall that in 1998, tobacco companies settled litigation with a number of the states and agreed to make payments to the states totaling over $300 billion over a period of about 20 years. Some states have since issued bonds backed by the future payments. A few weeks ago, a trial judge in Illinois required Philip Morris to post a $12 billion bond in order to appeal an adverse judgment in a case involving low-tar and "light" cigarettes. Philip Morris warned that, if required to post the bond, it might be unable to make scheduled payments to the states. On this news, the price of tobacco bonds fell sharply. After a two-week skirmish (with heavy lobbying by many states, now close allies of Philip Morris), the judge reduced the bonding requirement to $6 billion, and the tobacco-backed bonds regained some of their losses.

I spoke with the managers of the municipal bonds funds held by our clients to discuss the holdings and decided to sell a fund with a rather large holding in these when its manager told me he would maintain the investments. My concern is that other cigarette litigation may threaten future payments. Tobacco-litigation risk need not be a feature of municipal bond investing. (Additionally, we sold another municipal bond fund when it announced the imposition of new fees.)



Quite separately, we recently sold investments in Weingarten Realty, a REIT held by many clients. Weingarten, which owns shopping centers in the southwest, has been a splendid investment for over a year. With the recent rally in the REIT market, the price of Weingarten stock has risen above the value of the real estate it owns. We took profits in this REIT and purchased Post Properties, an Atlanta-based owner of upscale apartments. Post Properties sells for more than 10% less than the value of its apartments and pays a 7% dividend.

French and German Bonds. By far, our best investment of the last twelve months has been in Euro-denominated government bonds of European countries. For some clients, we hold French and German government bonds directly; for others, we have the investment through the American Century International Bond fund. In all cases, we are enjoying the fortuitous confluence of falling interest rates in Europe and the strengthening of the Euro against the dollar.

In Germany and France, inflation is lower than in the United States, while short- and long-term interest rates are higher. (This is not the norm: for decades, interest rates on German bonds have been lower than rates on American securities.) Economic growth has been weaker in Germany and France than in the United States in the last twelve months and is expected to be weaker in the coming year. Weaker growth, lower inflation and higher interest rates should lead to lower yields and higher prices for French and German bonds. The United States has a huge current account deficit, exceeding 5% of GDP; France and Germany each have surpluses in their current accounts. The growing current account deficit in the United States and stimulative fiscal and monetary policy here should cause the US dollar to fall further against the Euro. Although the Euro has gained about 25% in value against the dollar in the last year, it will probably appreciate further. Our foreign bonds remain an attractive investment.

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CORE Comments
ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

January 28, 2003

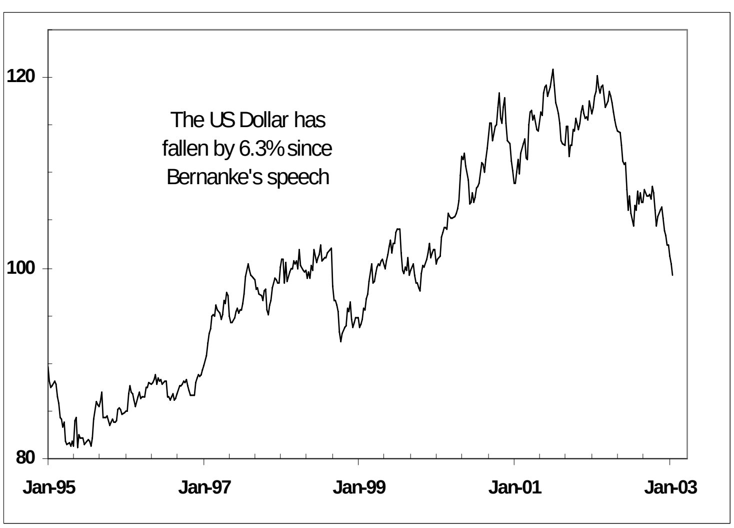
DEFLATION, THE FEDERAL RESERVE AND INVESTMENTS

In a recent speech by a governor of the Federal Reserve, the Fed declared its absolute intention to use its enormous and varied powers to prevent deflation--i.e., falling prices. This unusually clear statement of future actions by the Fed has profound consequences for inflation, economic recovery, and for the values of a variety of investment assets.

A primary effect of the Fed's reflationary policy is the decrease in the value of the dollar against other major currencies and the increase, in dollar terms, of foreign (non-dollar) bonds.

Two years ago, in January 2001, the Fed first began to cut interest rates. The stock market had peaked in March 2000, and had already begun its descent. The economy was beginning to weaken and credit conditions made it difficult for some troubled but important corporations (Lucent and Xerox, for example) to obtain credit. After two years and a dozen interest rate cuts, inflation is extremely low, economic growth is weak, unemployment is rising, and the stock market is prostrate. Had the Fed cut short-term rates from 6.5% to 1.25% at any other time in the last two decades, it is quite likely that inflation would have risen and the economy would have grown strongly. Because this has not come about, the members of the Federal Reserve Board appear to have concluded that deflationary forces--the risk of falling prices--are strong and dangerous.

In the two decades after Paul Volcker became Fed chairman, the Federal Reserve waged a ceaseless and entirely successful war to subdue inflation. During the late nineties, three tremendous bubbles inflated: stock prices, capital spending by corporations on information technology equipment and software, and indebtedness by corporations. The bursting of these bubbles has exerted powerful downward pressure on prices and has restrained economic growth. By November 2002, Alan Greenspan and other members of the Federal Reserve concluded that inflation was no longer the enemy. The Fed finds that the risk of deflation is unacceptably high, and that it must take action to prevent its occurrence.



By:

John N. Mayberry

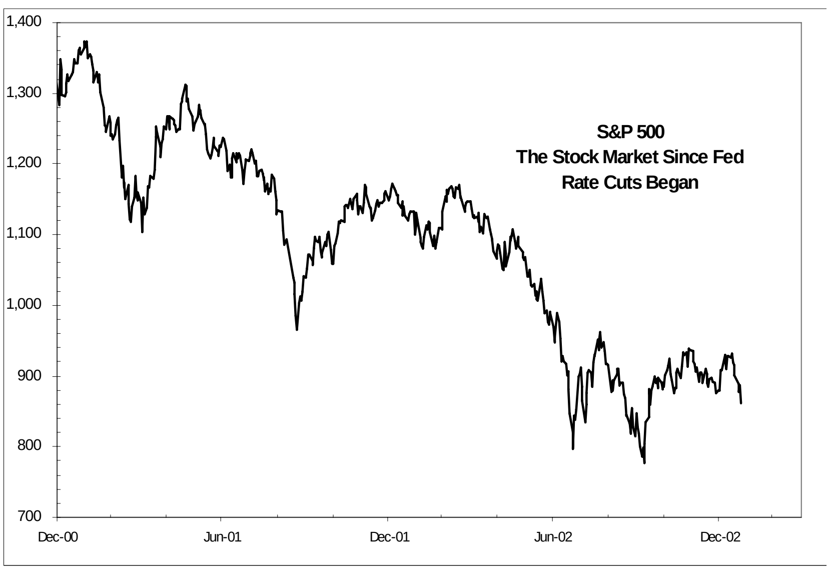
The Depression of the 1930s was accompanied by falling prices to the ruin of debtors, for whom the real cost of debt service (paying interest on loans) and debt repayment rose sharply. The last decade in Japan, following the collapse of its real estate and stock market bubbles, has been one of persistent economic weakness and periodic bouts of deflation. In a speech on November 21, Federal Reserve Governor Ben S. Bernanke laid out the risks of deflation. He referred to monetary policy mistakes of the Federal Reserve in the thirties that worsened deflation, and he stated that the Fed would assure that deflation would not occur in the United States. The title of his speech is unambiguous: "Deflation: Making Sure "It" Doesn't Happen Here". (This speech may be read on the Fed's website: www.federalreserve.gov/boarddocs/speeches/2002/20021108/default.htm.)

The Fed's Tools

Recall that at the time of this speech last November, the Fed had just cut the rate on Federal Funds by 0.50% to 1.25%—not too far from 0%. Recall also that short-term interest rates in Japan have been near zero for some years, and that Japan has suffered from persistent recession and occasional deflation. With rates so low, there is widespread concern that the Fed has run out of ammunition to stimulate economic growth. Governor Bernanke addressed this directly.

The Fed is ready to buy US and foreign government bonds if needed to combat falling prices and to stimulate demand.

Bernanke stated that the Fed has the power--and the will--to use any or all of four different tools to prevent deflation or to end it if deflation should occur. These tools involve injecting a sufficient amount of money into circulation to reverse deflation, i.e., running the printing press. The specific actions include (a) unlimited (Bernanke's term) Fed purchases of longer-term treasury notes and bonds, (b) purchases of government agency securities (e.g., Ginnie Maes), (c) zero-percent loans to banks collateralized by bank loans to corporations (in effect, direct purchases of private debt), and (d) Fed purchases of foreign government loans. Without going into the details Bernanke gave of the tools available to accomplish reflation, I simply quote his statement of the Fed's powers and intended action:



"The Congress has given the Fed the responsibility of preserving price stability (among other objectives), which most definitely implies avoiding deflation as well as inflation. I am confident that the Fed would take whatever means necessary to prevent significant deflation in the United States and, moreover, that the U.S. central bank, in cooperation with other parts of the government as needed, has sufficient policy instruments to ensure that any deflation that might occur would be both mild and brief."

I commend to your reading Mr. Bernanke's entire speech, an extremely interesting document. Note the reference in the quotation above: "in cooperation with other parts of the government". The fiscal policies of the government strongly support the reflation aims of the Fed's monetary policy. Ever-widening budget deficits and tax cutting policies of the Bush administration are both stimulative and inflationary.

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The Investment Implications of Reflation

Fed Governor Bernanke has given investors a road map. The general intent and effect of this reflationary policy is the restoration of economic growth and the avoidance of a severe, deflation-induced recession of the kind plaguing Japan these many years. In light of these announced policies, we can have more confidence—in time—in the strength of the economy, higher corporate profits and improving commercial real estate. In the shorter term, we can expect a weaker dollar—especially against the euro—and higher commodity prices.

Governor Bernanke outlines prospective Fed purchases of 2 year to 6 year US treasury securities and of the bonds of foreign governments. Additionally, Bernanke discusses steps by the Fed "to influence directly the yields on privately issued securities," i.e., commercial paper and corporate bonds. In plain terms, Mr. Bernanke indicates that, to prevent deflation and stimulate the economy, the Fed will cause the dollar to fall in relation to other currencies, will keep treasury note and bond yields low, and will support corporate bond prices.

European government bonds will continue to gain in dollar terms. As I read this speech, the Fed actions described by Governor Bernanke lower the risk and increase prospective returns for investors in bonds issued by European governments. We have made large investments over the last year in these bonds, in some cases directly, in other cases through the American Century International Bond fund. Because the dollar has fallen in price against the euro and because the yields on those bonds has fallen, we have earned double-digit returns on this investment since our initial purchases last spring and summer.

The tide of foreign investment in dollar-based assets is ebbing. The central banks in China and Russia recently announced that they are shifting portions of their reserves from dollars to euros. Reports from Japan indicate that private investment flows to the dollar are declining while flows into the euro are increasing. These actions, and many similar ones around the world, are causing the euro to gain in strength.

In effect, the Fed has declared victory in the twenty-year war against inflation, and announced that it is reversing strategy to inflate the prices of certain assets. Thus, the two-decade bear market in gold is over; this implies that gold's recent price increase from $280 per ounce one year ago to $369 per ounce today is not merely the result of geopolitical jitters. Further, it suggests that when political tensions in the Middle East abate, gold will still gain against the dollar. Likewise oil prices will probably increase, even from today's high levels. Consider that India, China and the Southeast Asian countries, whose economies are all growing rapidly and whose populations collectively far exceed two billion, consume less oil as a group than the United States, with its 280 million people. Will demand for oil grow in coming years? Pretty likely.

Investment Strategy

The announced policy of the Fed will cause the dollar to decline further against the euro and will cause our holdings of European government bonds to appreciate further.

We intend to increase your investments in these bonds.

Commercial real estate will benefit from the Fed's reflationary policy. Because almost all commercial real estate employs debt, deflation would be a crushing burden for real estate. A moderate degree of inflation and of economic growth is a benefit to real estate. Since the new year began, REIT prices have fallen by a few percent, perhaps because of the uncertainty around the Bush proposal about taxation of dividends. At this writing, REITs generally trade at a discount of about 10% to the underlying value of their holdings. Although REIT earnings are likely not to grow this year from 2002 levels, the high dividend payments are safe for the better managed REITs. Prospects are good for returns in the range of 6% to 10% this year.

US Bonds and Stocks. The Fed's November rate cut and the subsequent policy discussions give strong assurance that low interest rates in the US will continue for many months, if not for the whole of 2003. US bonds will probably continue to perform well in 2003, especially corporate bonds. (We recently sold the US corporate bond fund we have held for some time, Dreyfus Short-Term Income Fund and purchased Pimco Total Return to replace it. The funds have similar objectives and risk levels; the Pimco fund has been producing better returns.)

Oil and gold prices will probably rise. Commercial real estate and REITs will benefit from moderate inflation.

The stock market is another story. Astonishingly, 2002 was a worse year for stocks than either 2000 or 2001. But, despite already large declines from the bull market highs in early 2000, many sectors of the stock market remain overvalued in historical terms. Couple this with expectations of a weak economy and considerable geopolitical risks, and one must conclude that risk remains high in stocks, higher than warranted by potential returns. Core's investments in stocks remain quite low and we are in no hurry to increase stock investments while bond investments generally and euro bond investments in particular are so attractive.

Interest rates on US bonds will remain low this year. Corporate bonds will probably do better than treasuries.

The US stock market remains risky. There is a reasonable chance that US stocks will decline again this year.

Conclusion. For two years, I have been writing of alternative investments and Core has been investing in them. These investments—in non-dollar bonds, REITs, and others—have been winners. Further gains lie ahead. Throughout this period, we have been sellers of stock investments, but, to the extent we have held any, these have been losers. Risk in stocks remains high; we will follow the Fed's guidance and invest in other and safer assets.

Your Financial Situation

We continually reassess client portfolios in light of ever-changing investment risks. We make our judgments based upon what we understand to be your situation. Although we meet and speak with many clients, I fear that we may be unaware of changed circumstances or changed plans for some clients.

Please contact us if there are changes to your personal financial position.

We will explain our various portfolios and will make recommendations to meet your goals with the minimum level of risk.

Please contact us if you wish to discuss how our portfolios and the complex investment environment can fit together to help you meet your goals with the minimum amount of risk. (You may reach us at 800 451 2240 or by email to me: JNMayberry@coreasset.com.) As I attempt to show in this letter, there are investments that offer low risk and good returns, even in this difficult period.

CORE Comments

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