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

November 22, 2005

Year-End Financial Planning

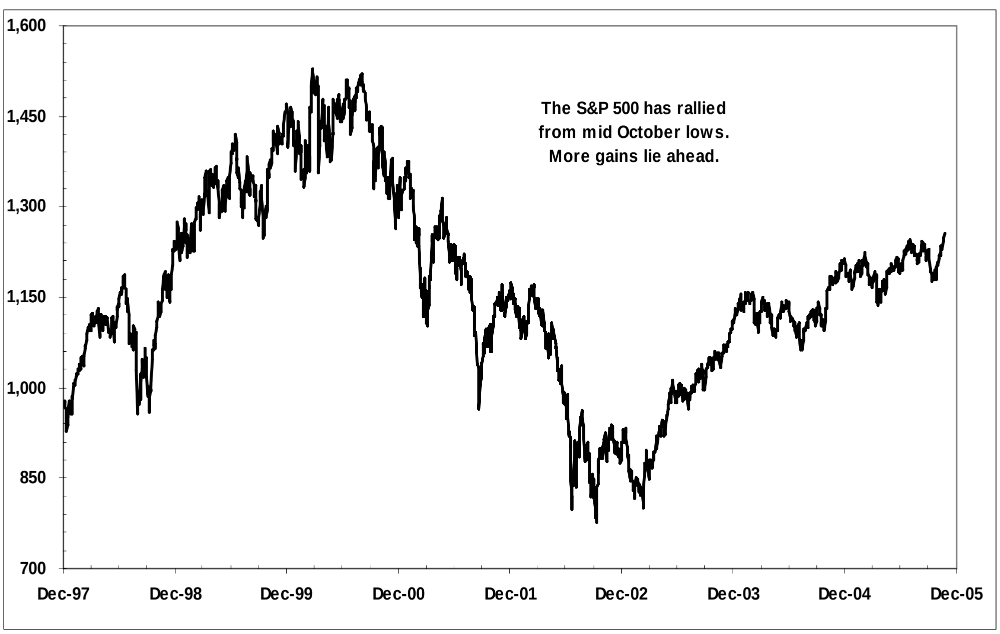
After several years in which small company stocks have outperformed large capitalization stocks, big stocks are beginning to do better, especially among growth stocks.

We are taking profits in small stocks and considering purchase of large-cap growth stocks.

We are at work on financial planning projects, as we often are, for a number of clients. As we bring analyses up to date that we prepared in earlier years for clients, we are reminded that some people's financial circumstances change markedly over time. It is almost always the case that one benefits from an analysis of one's financial position--with a plan, one can make informed decisions about savings for retirement, about reasonable levels of spending in relation to one's investment capital, and the like.

If one has sold real estate or other property that has appreciated in value, what should be done with the sale proceeds? How should one save for children's (or grandchildren's) education? How much can one afford to fund one's charitable or political interests? Our clients present these questions and others; we provide a reasoned basis to arrive at sensible answers.

Core has prepared financial plans for a large number of clients over the years and we are ready to work with you, either in updating work we did in the past for you, or in preparing a new analysis. The best starting point for us to develop the right investment strategy for a person is to understand that person's needs and goals. We suggest that you consider whether we should look with you again (or for a first time) at your overall financial situation. We would be happy to discuss with you how we can help. Please call (800 451 2240 or 415 332 2000) or send an email to me (JNMayberry@core-asset.com) if you wish to discuss this.



A New Fed Chairman

By:

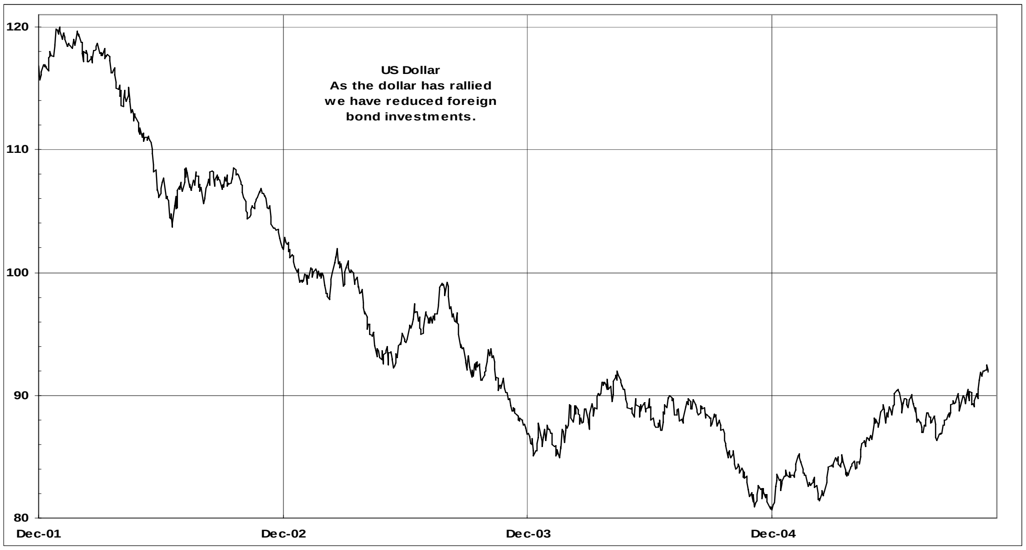
John N. Mayberry

Ben Bernanke's appointment to lead the Federal Reserve Board will likely be approved by the Senate soon. In January 2003, I wrote a report about a speech that Bernanke, then a recently-appointed Fed governor, gave about deflation and the actions the Fed would take to prevent its occurrence. (You

We have reduced positions in foreign bonds, and added to foreign stocks. Most foreign stock markets are cheaper than the US markets.

may see this letter on Core's website at http://www.coreasset.com/publications/archive/core-jan2003/index.html) Because of a light-hearted, figurative reference in that speech to the Fed's ability to print dollars and to drop them from airplanes to prevent deflation, some wags refer to Bernanke as "Helicopter Ben" and wonder whether he will be vigilant against inflation. Time will tell.

In the last eighteen months, the Fed has raised the Federal Funds rate by 0.25% at each of its meetings. Fed funds now stand at 4%, having been raised from 1% since June 2004. The Fed's announcements make it nearly certain that at least two more quarter-point increases lie ahead. Given the change in leadership and Bernanke's stated intent to show continuity with Greenspan's era, more increases may follow. It seems likely to me that the Fed will raise rates for another six months or more, barring a serious financial crisis or a marked slowing of economic growth.



The Financial Markets. Since my letter at the beginning of October, the markets have changed tone. Oil and gas prices have settled back from the somewhat hysterical levels reached after the hurricanes; the fear of further increases has subsided. Some of the stronger investment sectors in the summer turned weaker, including utilities, energy stocks, and commodities. The dollar has risen against other currencies. After a sharp sell off as October began, the broad stock market has rallied well in the last several weeks; further gains seem likely.

Please contact us if you wish to discuss your overall financial picture. Please call at 800 451 2240 or 415 332 2000. You may email me at JNMayberry@coreasset.com.

Energy stocks and oil and gasoline prices have fallen back to levels that prevailed before Katrina. Unusually warm weather in the northeast this autumn has helped keep prices below recent highs. Unfortunately, the underlying constraints on supply of oil and petroleum products give these markets a very narrow margin between demand and supply. Modest interruptions in supply and/or increases in demand will send prices higher once again. We have generally maintained our fairly large investments in the energy sector and commodities.

We have reduced our foreign bond positions markedly in recent weeks, as the dollar has continued to be strong against the euro and the yen. Currency markets have attended more closely to higher interest rates in America than to America's ever-rising debt with the rest of the world. We have generally invested the proceeds of our foreign bond sales in foreign stock markets, where prospects are favorable. We are beginning to make investments in an exchange-traded fund that holds biotech stocks. The more productive pharmaceutical research seems to be happening in these stocks, rather than the huge companies. They will probably grow rapidly in future years.

CORE Comments

CORE ASSET MANAGEMENT

108 Caledonia Street
Sausalito, California 94966
(415) 332-2000 • (800) 451-2240
fax (415) 332-2151
www.coreasset.com
info@coreasset.com

CORE Comments

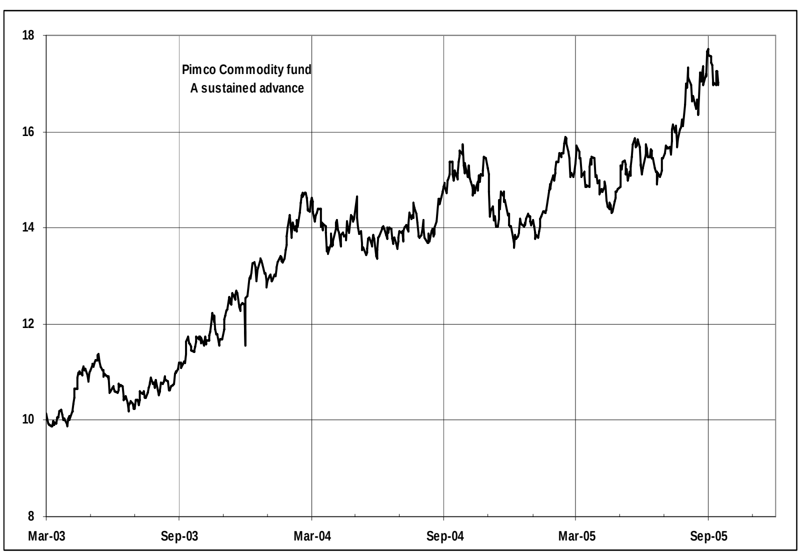
ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

October 3, 2005

Core's portfolios have good returns this year, while the US stock market is essentially unchanged.

John N. Mayberry

The Pimco Commodity fund, in which Core's clients have significant investments, is having another strong year, as shown in the chart below.



Strong Gains for Core's Portfolios in Third Quarter

Core's portfolios moved ahead smartly in the third quarter and show solid gains for 2005, well ahead of the broad stock and bond markets. Our investments in utilities stocks, oil-related stocks, and physical commodities have provided a real lift. Additionally, the investment positions we have been building in foreign stock markets have performed well and offer good prospects for further earnings. In the aggregate, Core's portfolios show gains of 7% for the year, compared to broad US stock market returns that range from down 2% for the Dow Industrials, to up 2% for the S&P 500.

The hurricanes. Hurricanes Katrina and Rita were devastating; their dire effects will last for some time. Terrible loss of life and displacement of hundreds of thousands from their homes along the Gulf Coast are tragedies of vast scale. Severe damage to oil platforms and refineries in the region has disrupted supply of crude oil, natural gas and refined oil products at a time when there is virtually no spare capacity. As a result, prices for gasoline, heating oil, natural gas, and jet fuel have risen. Higher prices for gasoline, heating oil and natural gas are certain to be a burden for many in the coming months. Slower economic growth may result.

Although one may take little pleasure in it, high prices and shortages in oil have helped our portfolios, because of our substantial investments in utilities, oil stocks and commodities. Core's principal energy-stocks investment is up by about 50% since the beginning of the year. The Pimco Commodity Real Return fund, through which we hold our commodity investments, is up about 25% this year, and our utilities positions are ahead by 20% in 2005.

Benefits of portfolio diversification. The positive action in these parts of Core's portfolios has more than offset weaker returns in other

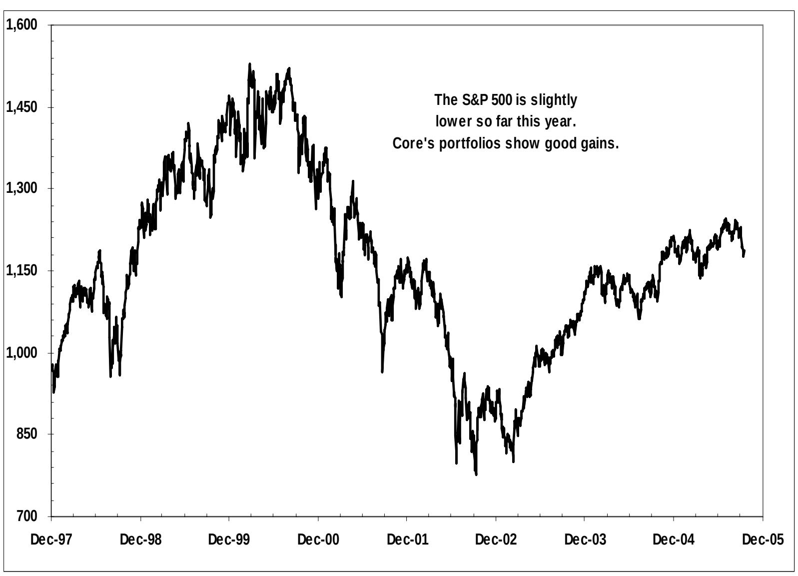
We suggest that you add to your investments with Core, to take advantage of opportunities on offer now.

aim in choosing the assets in which we invest is two-fold: First, we seek to invest in different assets that respond differently to events financial, economic, and political, so as to achieve relatively smooth returns and to lower the risk of loss. Second, we seek to invest greater amounts of capital in inexpensive assets that are likely to respond positively to the events we foresee. Commodities, energy stocks and utilities were all cheap and out of favor when we began to invest in them in 2003 and 2004. In the continuing flow of prices in investment assets, there are usually attractively-priced investments. At present, there are good investment opportunities, and I suggest you add to your portfolios with us to take advantage of these.

The hurricanes and the spending for rebuilding will increase inflation.

Some of Core's investments benefit directly from higher inflation. Others provide a hedge against it.

Future investment effects of the hurricanes. Inflation had been rising before Katrina, the effect of already high oil prices. Damage to oil facilities from the storms pushed up prices further. These higher prices may be temporary. Drilling platforms and refineries will be repaired; new ones may be built. However, the bigger push to inflation may result from the reconstruction activities in the aftermath of these hurricanes. The federal government has pledged "whatever it takes" to rebuild New Orleans and the rest of the Gulf Coast. Present estimates for whatever it takes are in the range of $200 billion. However, President Bush has declared that taxes will not be increased to pay the bill. Instead, the Treasury will borrow another $200 billion, adding to government borrowing that now exceeds $300 billion per year. Printing another $200 billion will certainly cause prices to rise further. Because of rising inflation, the Federal Reserve Board will continue to increase short-term interest rates. Increasing inflation, rising short-term rates, and vastly increased federal government borrowing will likely cause higher long-term interest rates (and higher mortgage rates) or slower economic activity. Or both.



Each year, Core Asset Management Company files with the SEC a Form ADV with information about our 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.

Because personal saving by individual Americans is now negative in the aggregate, the United States will borrow foreign capital. We will increase our indebtedness to and dependence upon foreign private investors, foreign central banks and foreign governments, including oil exporting nations. The interests of these foreign buyers of US Treasury bonds are certainly not congruent with America's. Higher US interest rates or a weaker dollar (or both) will follow. Foreign rebuilding may present problems different in kind but equally damaging.

If you have not responded to Schwab's offer of lower commissions, we will direct Schwab to email its offer to you again. We suggest that you accept the offer to receive your trade confirmations by email.

To protect our capital as all this unfolds--higher interest rates, weaker dollar, and higher inflation--we will keep our investments in TIPS (Treasury Inflation-Protected Securities), non-dollar bonds and stocks (European bonds and Asian and European equities), and commodities and oil-related stocks. We will maintain modest positions in the broad US stock market. Corporations have increased profits strongly in the last three years and strengthened balance sheets. Although stock prices have risen from the lows of 2002, some areas of the market are attractively priced and able to withstand higher interest rates and higher inflation.

Lower costs of investing . . . The last few years have seen welcome developments for individual investors. Costs of investing have fallen and the range of investment assets available to individuals has broadened. Costs have fallen for us in two ways: lower transaction costs by brokers (including Schwab with which many Core clients have accounts) and lower costs in the funds in which we invest.

First, the transaction costs: Commissions have fallen sharply year after year, a result of improving trading technologies and competition among brokers. In recent months, Schwab lowered commissions to $13 per trade for its customers with aggregate assets above $50,000 who elect to receive commissions by email. We recently contacted clients who can benefit from this offer, after which Schwab extended the offer by email. For those clients who did not take advantage of this, we urge you to contact us by telephone (800 451 2240) or email (JNMayberry@coreassset.com). We will arrange for Schwab to put its offer before you again.

Exchange Traded Funds, which we use increasingly, offer several advantages to mutual funds. Their internal costs are lower and they are more tax efficient.

As more ETFs are created, they provide an ever wider range of assets in which we can invest for you.

Second, lower costs in investment funds: The growth of Exchange Traded Funds is one of the most salutary developments for investors in a generation. Exchange traded funds are open-ended investment vehicles like mutual funds; they trade on the exchanges like stocks. They are passive (as opposed to actively managed) investment pools that replicate the investment returns of a given stock or bond index. Apart from their investment merits, they are very inexpensive securities in which to invest, far less costly than almost all mutual funds. They are also very tax-efficient and generate little taxable investment income, another significant advantage. Their tax advantages arise from somewhat complicated arbitrage that takes place as new investments are made in ETFs.

ETFs began in 1993, when Standard & Poor's, the American Stock Exchange, and State Street Bank and Trust launched an ETF based on the S&P 500 stock index, commonly called the Spider (for SPDR, Standard & Poor's Depositary Receipt). Subsequently, S&P licensed seven more ETFs to track the industry groups represented in the S&P 500. (Our prin

The ever-broadening range of investment assets available to us provides a great advantage to investors today.

principal utility stock investment is in the S&P Utilities Spider, symbolxlu, and our main energy investment is in the S&P Energy Spider, xle.) The success of these ETFs has stimulated the creation of well over a hundred other ETFs, for various stocks and bond investments. Another early set of ETFs are the various single country funds in which we have been investing recently to build positions in Asian and European stocks. The foreign stock market ETFs are far less expensive than similar international mutual funds. Many foreign equity funds have underlying costs of 2% per year; ETFs with similar investments have internal costs from one third to one tenth that amount.

. . . . and a broader range of investment assets. In the twenty years since I entered the investment management business, there has been a continual expansion in the types of investment assets available for investment by individual investors. A good example is the Pimco Commodity Real Return fund, in which Core has had investments since January 2004. (A chart of this fund is on the first page.) This fund replicates a broad-based index of physical commodities that includes agricultural and industrial commodities, precious and base metals, and crude oil and natural gas. Since Pimco launched this fund a few years ago, we have been able to invest in a broad range of physical commodities with as little as $1000. Prior to this, such exposure to commodities required at least $100,000 and the use of costly futures contracts.

The Pimco commodity fund, the Treasury's inflation-adjusted bonds, and REITs are examples of assets that have become available to individual investors over the last two decades.

Treasury Inflation-Protected Securities ("TIPS"), first issued by the US Treasury in the mid-nineties, offer the example of an entirely new class of assets that has become available to investors in recent years. The principal repayment amount of a TIPS bond increases each year by the rate of inflation. Thus, when these bonds are redeemed on their due date, the holder receives the initial face amount plus an additional sum equal to inflation since the bond's issuance. These bonds offer a complete hedge against inflation, a superb addition to portfolios in an inflationary environment. Core's clients have investments in TIPS via mutual funds and an ETF.

Real Estate Investment Trusts ("REITs"), in which we have had very successful investments, are another example of a recently-developed type of security that enables investors to invest in assets--commercial real estate and timberlands--previously open only to very large institutional investors.

With this ever broadening range of investable assets, we are able to reduce risk in portfolios by diversification away from US stocks and bonds and to increase returns by investing in inexpensive assets likely to appreciate. My expectation is that in the years ahead, these trends will continue. We will have more types of investment assets available to us at favorable prices. If we employ these investment tools with good judgment and in a rigorous and disciplined manner, we stand to earn good returns without taking undue risk.

CORE ASSET MANAGEMENT
108 Caledonia Street
Sausalito, California 94966
(415) 332-2000 • (800) 451-2240
fax (415) 332-2151
www.coreasset.com
info@coreasset.com

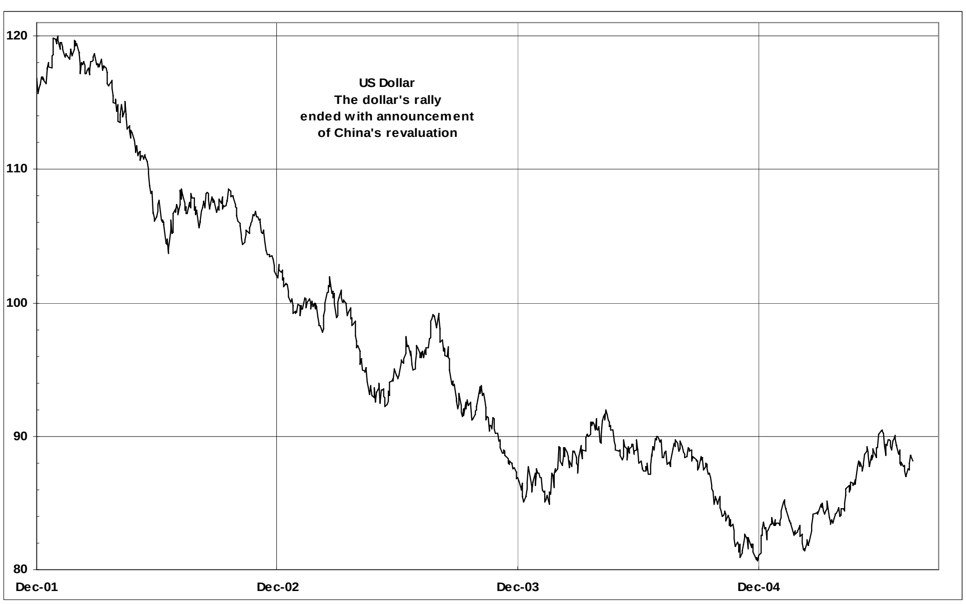
August 22, 2005

In Thrall to China and Saudi Arabia

As power and wealth shift from the United States to China and Middle Eastern oil producers, Core's foreign investments and investments in oil and other commodities permit us to profit from these changes.

Changing power relationships among different countries have been on display recently. China ended its decade-long peg of the yuan to the dollar; in its place is a new scheme, not yet fully defined. As crude oil prices continued their two-year long rise, King Fahd of Saudi Arabia died. Iran rejected years of European and American diplomacy and resumed its nuclear program.

These events illustrate the shift of political power and economic wealth away from the United States to China and the Arab oil producers. America is increasingly dependent on foreign capital to finance its spending and on foreign oil to provide its energy. The Bush administration's fiscal policy--huge increases in domestic spending, huge increases in military spending, and huge tax cuts--is mirrored by many individual Americans whose household spending exceeds household income. Government policies lavish tax breaks on the oil industry, minimize efforts to conserve oil, and ignore the development of non-oil energy sources. Private Americans echo public policy by rather extravagant use of energy in homes and vehicles.



As a result of this profligacy, decisions made in Beijing, Riyadh, and Teheran determine America's future to ever-greater degrees. From a political and social perspective, America's growing dependence on the good will of China and Saudi Arabia is distressing. As investors, we need not despair, but we must look abroad to invest our capital.

Because capital flows relatively freely around the world and because there is an ever-broadening array of investment securities, we can benefit from these changes. We have made investments for you that appreciate as oil prices rise--and as Saudis and Iranians gain wealth and influence. We invest your capital to profit from the growth in wealth and power in China and elsewhere in Asia. Core places your capital in front of these global changes of political and economic power.

China and the dollar. Because of its enormous trade surplus with the United States, China has accumulated hundreds of billions of dollars and made correspondingly large purchases of US treasury bonds. China announced in July that it would break its currency's tie to the dollar and link the yuan to an undefined basket of currencies. A few weeks later, it named those currencies--the dollar, the euro, the yen,

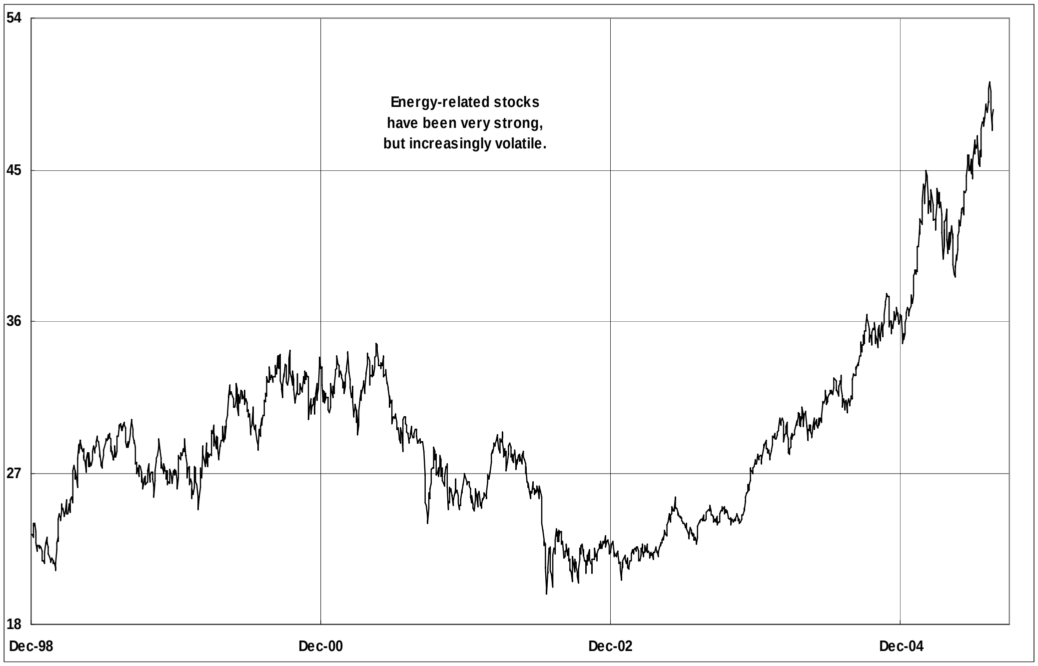
By:

John N. Mayberry

and several others--but did not disclose the weight accorded to each. China will allow the yuan to move in value against this basket by small, daily amounts. In time, China's re-valuation will increase the value of the yuan in dollar terms. And, because it will now be valued against other currencies, China will presumably buy fewer US bonds with its trade surplus and more euro and yen bonds. This will likely cause the dollar to fall in value against those currencies, and cause the yields on US bonds to rise.

If you hold other investments that concentrate in US stocks and bonds, we suggest you consider adding to your investments with Core. We look further afield to protect capital.

So far, the change in the yuan's value has been small. But, since China's announcement, the dollar' value has fallen in euro and yen terms. It appears that the dollar's rally since the beginning of the year is coming to an end; it has resumed its decline.



Since 2002, when the dollar began to fall, our primary dollar-depreciation investment has been the American Century International Bond fund, which holds foreign bonds denominated in foreign currencies. Most of the fund's holdings are euro-denominated bonds; about 15% are Asian. European bonds have been excellent investments for us: the euro rose sharply from 2002 through 2004 and European bond prices rose over that period.

We are in the process of reducing investments in foreign bonds and building positions in Asian stocks. These stock markets are cheaper than America's and they will benefit from further declines in the dollar.

I have begun to reduce investments in this foreign bond fund and to increase investments in Asian stocks. First, the long rally in European bonds is probably coming to an end. Second, Asian currencies are likely to be somewhat stronger than the euro in coming years. Third, stock markets in Japan and other Asian countries are cheap and likely to grow. These countries benefit from the growth of China. Via exchange-traded funds ("ETFs"), we are able to invest in the stock markets of individual countries, and we have begun to build positions in Japan, Malaysia and Singapore. (Although one can invest directly in Chinese stocks, I avoid them. The Chinese stock market is neither fair nor transparent, and the Chinese government holds controlling stakes in many Chinese companies. It is hard to feel comfortable as a minority shareholder in a company controlled by the Chinese government.) We are investing in Germany and in developing economies through ETFs, which trade at lower prices than American stocks. I am looking at a fund for stocks in India, but holding off for now, as its price is rather high.

Oil, energy stocks, utilities and commodities. This group of related investments has been very strong and it forms a large part of Core's portfolios. Ever-higher prices for crude oil, gasoline, and heating oil command growing attention in the press. Energy costs are an increasing burden on consumers; they portend higher inflation and lower economic growth. Growing demand from China and India for energy and other commodities and the constraints on oil production have caused prices to rise to eye-popping levels. Although I expect that hard assets, oil, and other commodities will be strong for several years, utilities and oil company stocks have become riskier as their prices have risen.

Consider adding to your Core investments. If you have capital on the sidelines or with managers who invest mostly in American securities, we encourage you to add to your investments with Core. Please call me at 800 451 2240, if you wish to discuss this.

CORE Comments

CORE ASSET MANAGEMENT

108 Caledonia Street
Sausalito, California 94966
(415) 332-2000 • (800) 451-2240
fax (415) 332-2151
www.coreasset.com
info@coreasset.com

July 11, 2005

CORE Comments

ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

The New World of Global Labor Pools and Low Wages

Low inflation and low interest rates are a result of the globalization of labor and capital.

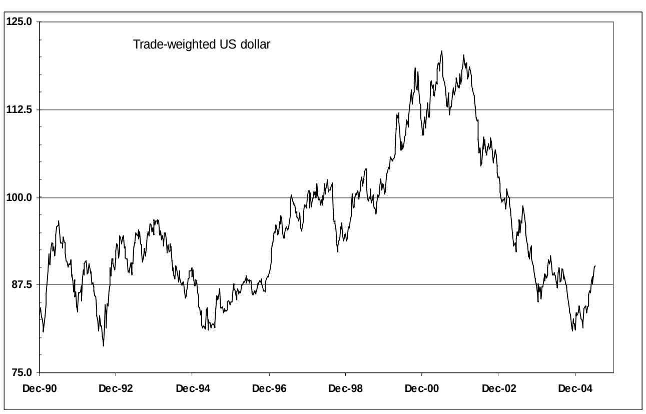
John N. Mayberry

The US Dollar has gained 11% this year. The markets have ignored the current account deficit and focused on rising US short-term rates

The world has shrunk and with the shrinking have come profound changes to economies and investment markets. This letter considers some of these changes and their investment implications.

Economies depend upon capital, labor, and natural resources. For much of human history, these three elements of economic growth were somewhat immobile. As a result, economies were rather local. Trade effected movements in natural resources, foods, and manufactured goods. As trade expanded, capital began to follow along the trade routes.

Over the last twenty years, a set of changes has accelerated the flows of capital and made labor a resource available globally, not just locally. Because foreign capital has flowed into the developing Asian countries, especially China, many manufacturing activities are now performed in regions with large, low-cost pools of labor. Because of the enormous investment in fiber optic networks and other infrastructure in the late 1990s, the cost of telecommunications and of data and voice transmission around the world has become extremely low, making it ever more feasible to employ Indians and Chinese for service activities that could only be performed locally in the past.



Low wages. As the pool of well-educated workers in China, India and other Asian countries has grown, more and more services, as well as manufacturing, are performed in those countries. I have read estimates that the entry of Chinese and Indian workers into the global labor pool has quadrupled the numbers of workers available for manufacturing and services that used to be performed in western Europe and in America. These new workers have put enormous pressure on wages. The result for American and European workers is fewer high-paying jobs. Growth of wages and salaries in America is low, recently about two percent greater than inflation.

Commodity inflation. As China and India have grown rapidly in recent years and with reasonable economic growth in the United States, there is rising demand for natural resources. For oil and natural gas, there have been constraints in the extraction of the resources, further constraints on refining of oil, and shortages in power generation facilities to meet demand for electricity. In similar ways, other industrial commodities and basic materials, like meeting growing demand. These factors have pushed up prices for natural resources and basic materials, a simple phenomenon of supply and demand.

Oil prices have risen sharply this year again, but inflation and interest rates have remained low.

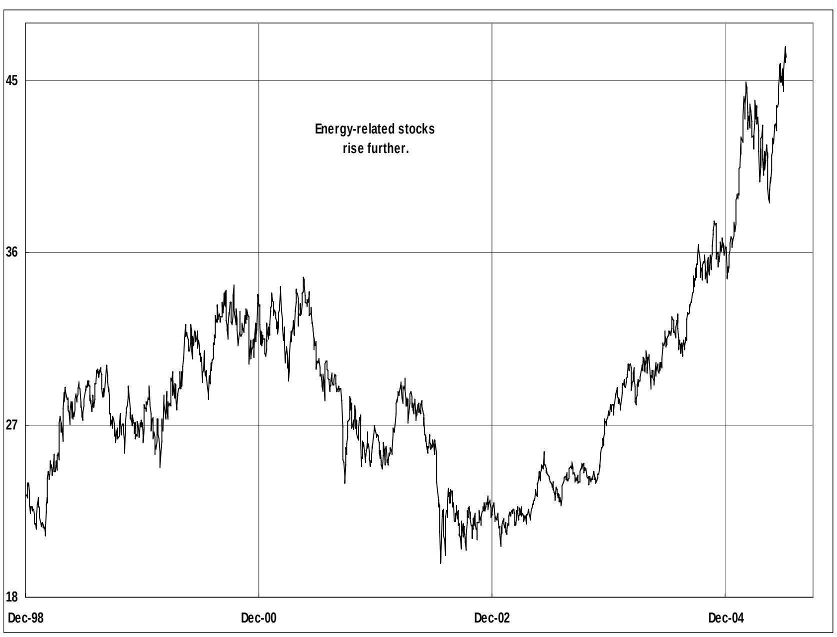
Low-cost labor in China and India have kept wages and inflation low.

Energy-related stocks have been quite strong again this year.

In addition to growing demand and constraints on supply, weakness in the US dollar also contributes to commodity inflation. Most physical commodities are priced in dollars. Although the dollar has risen in value this year, its general weakness, now in its third year, has contributed to rising commodity prices. The prospect for continued loss in the dollar's value, about which I have written extensively, makes it likely that commodity prices will continue to rise in dollar terms.

Overall US inflation. In previous decades, rising prices for oil and gasoline have triggered broad increases in the consumer price index ("CPI"). Now, however, despite oil and gas price increases, inflation has remained rather low. In the last twelve months, the CPI has increased by 2.8%, quite low by the standards of the last generation. The very low cost of imported goods from China and the absence of wage increases, discussed above, have kept inflation down.

Low interest rates: Greenspan's conundrum. In June last year, the Federal Reserve Board first raised the fed funds rate from the exceptionally low level of 1%. At each meeting of the Fed's Open Market Committee since then, the Fed has raised short-term rates by 0.25%. Fed funds now stand at 3.25%. To the surprise of most people, including myself, long-term interest rates are now lower than they were a year ago when the Fed began it series of rate hikes. The ten-year US treasury bond now yields 4.09%, compared to 4.61% a year ago. In February, Alan Greenspan referred to the persistence of low long-term rates while the Fed raised short-term rates as a "conundrum". Low long-term rates are generally viewed as the market's prediction of slower economic activity. Low rates here and abroad appear to portend economic weakness, but they also reflect the effects of low manufacturing costs and the abundance of cheap and productive labor. Long-term interest rates should be low if inflation will remain low for some time to come and if major economies will grow slowly. Perhaps Greenspan's conundrum is easily explained.



High Prices for Homes

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.

A letter that considers the world-wide economic puzzle but ignores the effect of extremely high prices for house leaves out a very big piece. It is hard to overstate the importance of this subject to the economy and to investment markets. The increase in home prices is not a phenomenon of just the San Francisco Bay Area, New York, and Florida. With the exceptions of Germany and Japan, house prices have reached astonishingly high levels in all developed countries in the world. The increase in home prices in developed countries in the last five years equals $30 trillion, equivalent to the combined annual economic output of these countries. The increases in housing prices are almost certainly unsustainable; it is increasingly likely that they will fall in the years ahead. Because of the importance of rising home prices to the American economy, the end to price increases will very probably have an adverse effect on our economy.

The Housing Price Boom has Sustained the US Economy

The increase in home prices has been stimulated by improvident mortgage lending practices and by risky mortgage products.

Continued rises in home prices are unsustainable.

The background. In America, a range of factors contributed to the rise in house prices. After the bursting of the dot.com stock bubble in 2000, 2001 and 2002, the Federal Reserve cut interest rates sharply and deeply in an attempt to counter the recessionary effects of the bear market in stocks. As interest rates fell, the cost of home mortgages fell, making homes affordable to an ever-larger group of people. Demand for homes rose as erstwhile (and disappointed) stock market investors decided to invest in residential real estate.

Equity extraction and consumer spending. As house prices rose and mortgage rates fell, owners refinanced their mortgages. In many cases, home owners increased the principal amounts of their mortgage borrowing and used the cash proceeds of these loans for other expenditures. "Equity extraction", as this is called, has sustained consumer spending in these years of low wage and salary increases. Because of the relatively low wage growth--a feature of the growing pool of labor from China and India--income has grown more slowly than spending. A good deal of the cash for consumer spending has come from the proceeds of newly-refinanced mortgages. If equity extraction should decrease, consumer spending will suffer. Will equity extraction decrease? Quite likely.

Novel and risky mortgage practices. Lower mortgage rates have made home buying affordable for more people. But new types of mortgages have become ever more popular, putting at risk home prices and consumer spending. Interest-only mortgages, adjustable-rate mortgages (ARMs) and "negative amortization loans" account for a large portion of new mortgages. (According to *The Economist*, 60% of all new mortgages in California this year are of these types, against only 8% in 2002.) Negative amortization loans, unimaginable in more sober times, allow the homeowner not only to postpone principal repayment on the mortgage but permit the payment of less than all the interest on the loan. Unpaid interest is tacked onto the principal. These types of mortgage loans amount to bets that interest rates will stay low and that home prices will rise.

The indebtedness of American households is higher than ever before in relation to incomes and to GDP.

Many ARMs and interest-only mortgages carry below-market interest rates in their first years. When the period of "teaser rates" ends, interest payments on these mortgages will increase, even if the general level of interest rates does not rise. And when principal repayment begins, families will be faced with much higher monthly mortgage costs. If interest rates rise, monthly payments will be higher still. The fiscal condition of American households is too weak to sustain higher mortgage payments. Household debt (including credit card debt as well as mortgages) as a percent of GDP is 90%, a record. Similarly, payments on household debt are at historic highs in relation to disposable income. This is remarkable--and worrisome--at this time when interest rates are at such low levels. As monthly mortgage payments rise, many families will find them unaffordable, causing at least some to seek to sell their homes. Those who make their higher mortgage payments and keep their homes are likely to reduce other personal expenditures, depressing consumer spending and the general economy.

House prices in relation to rents are far higher than normal.

Overvaluation of residential real estate. Housing prices in the United States (and in a number of other countries) are at higher levels in relation to rents than ever before. The ratio of house prices to rents is 35% higher than the average level from 1975 to 2000. At current levels of inflation and assuming no further appreciation in prices for homes, it would take twelve years for rents to rise enough to restore the normal relationship between rents and house prices. A careful study of house prices in America from 1890 to 2004 by Yale economist Robert J. Schiller suggests that, after adjustment for inflation, the prices of home has risen by just 66% in 114 years, or 0.4% per year. All of the increase in home prices comes in two periods, just after World War II and since 1997. In the current environment, of public fascination with residential real estate, widespread speculation in housing, and lax mortgage lending practices, the boom in home prices may continue. It is beyond doubt, however, that home prices are extremely overvalued by any measure and that the mortgage debt burden, which will necessarily rise, is unsustainable.

In Britain, Australia, Holland and Japan, the economies slumped when house price rises stopped.

What happens when the housing bubble bursts? In Australia, Britain, and the Netherlands, house prices began rising sharply before prices in America took off. In each country, house price inflation has slowed and the general economies have suffered. In Holland, house prices were flat in 2003 after growing sharply for several years. Consumer spending fell and the economy entered a recession from which it has not yet recovered. In Australia and Great Britain, slowing home price appreciation caused retail sales to slow significantly. Japan's situation is far more stark. Residential real estate prices doubled from 1980 to 1991. In the fourteen years since then, property prices have dropped each year and are now 40% below their peak. Nearly all the price appreciation in home prices has been reversed. Since the 1991 peak in home prices, Japan has suffered protracted recessions, periods of deflation, and the weakest growth in consumer spending among developed countries.

We reduce risk to your investment portfolios by keeping stock investments low and by investing in foreign bonds, commodities and other non-traditional assets.

Investment implications of the housing bubble. When house prices stop rising here, slowing consumer spending may lead to a recession. Given the high level of stock prices now, an economic slowdown could usher in another bear market. With such high indebtedness by American households and America's huge and rising debt to the rest of the world (the current account deficit), there is risk of financial shocks, including sharp declines in the dollar. Our approach has been to hold relatively small stock market positions and to invest in foreign bonds and other assets to offset weakness in the US dollar. We will continue this investment strategy.

The markets in 2005. So far this year, the dollar has strengthened against foreign currencies, depressing--for now--the value of our foreign bond holdings. Despite the still-widening US current account deficit, currency markets have been influenced more by rising US short-term interest rates and relatively strong growth here, in contrast to stable rates and very slow growth in Europe. Oil stocks and utilities, which form a large portion of our equity investments, have been quite strong. The broad US stock market, as measured by the S&P 500, the Dow, and the Nasdaq, was down by a small amount in the first half. Bonds have gained in value as interest rates have fallen. Commodity prices, including oil, have risen again this year

CORE Comments

CORE ASSET MANAGEMENT
108 Caledonia Street
Sausalito, California 94966
(415) 332-2000 • (800) 451-2240
fax (415) 332-2151
www.coreasset.com
info@coreasset.com

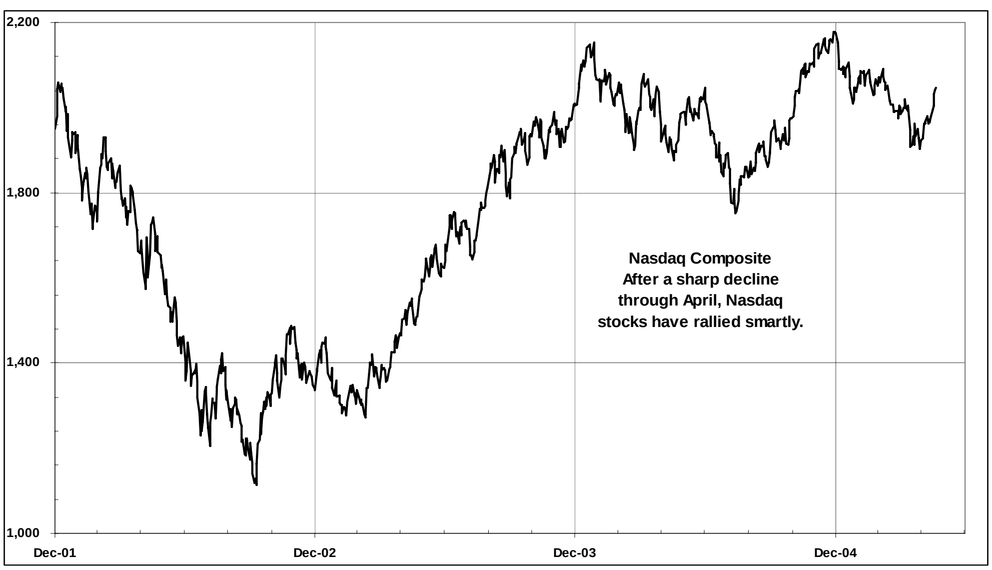
May 24, 2005

Holding Ground in Treacherous Markets

Unexpected moves in various markets have turned upside down the expectations of many investors. Our broad diversification among many asset classes has preserved our capital in these turbulent markets.

The year so far. 2005 has provided little joy for investors, no matter where they have invested. The US stock market is lower, with the S&P 500 off by 2% and the Nasdaq by 6%. Bond investors have a bad case of nerves following the downgrades of Ford and GM bonds to junk-bond status. And, those assets that are still up in price this year, including oil-related stocks and commodities, have fallen in price since early to mid-March. So, from the combination of lower prices in some markets and choppy trading in others, the year has provided scant reward so far. As of this writing, our accounts in the aggregate are down by less than one-half percent for the year.

Prospects for the months ahead. After falling sharply into the end of April, stocks rallied quite strongly in recent weeks. In particular, Nasdaq stocks have been very strong this month. Based on the internal dynamics of this rally, the prospects for stocks in coming months are favorable. It is certainly too early to celebrate a sustained rally in stocks, but let us be grateful for what is now on offer.



The dollar has rallied this year against the major currencies, especially in relation to the euro. It has risen by 8% against the euro and by a bit less against other major currencies. The dollar's advance since January is of similar magnitude to earlier rallies within its three-year downtrend. Those rallies, of course, proved to be brief interruptions in the dollar's bear market. I expect the dollar to be weaker in the next two years and have maintained foreign bond investments, which benefit from the strength in foreign currencies.

As discussed previously, buying of US Treasury bonds by foreign central banks has been enormous. In 2004, foreign central banks, notably those of China, Japan, and South Korea, purchased more than $300 billion of Treasuries. Following reports in recent months from various central banks about diversifying their holdings away from the US dollar in favor of a broader basket of currencies, foreign central banks were net *sellers* in March of Treasuries

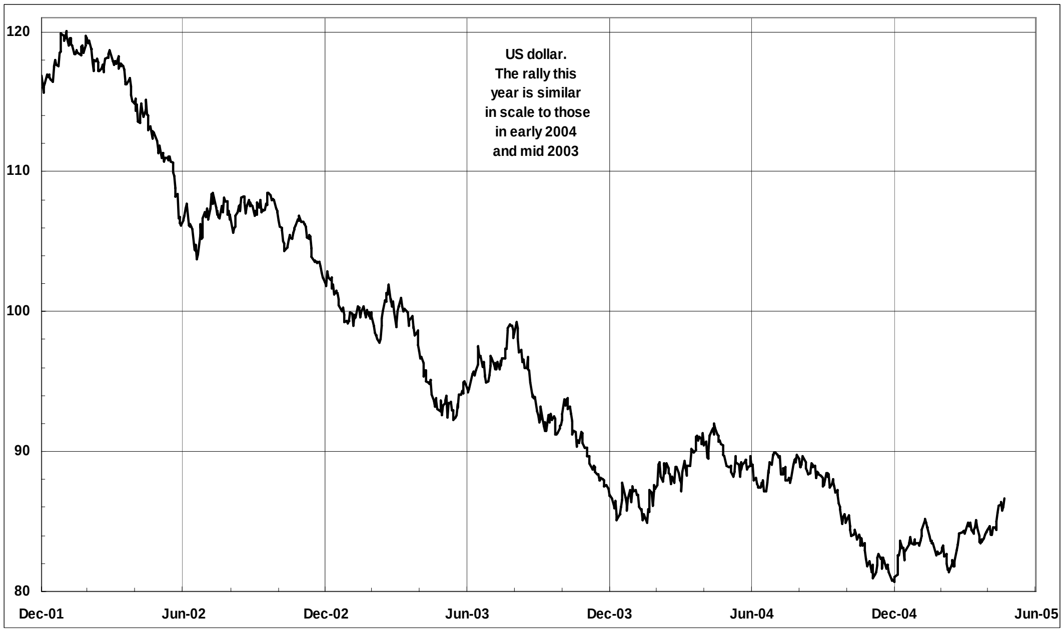
By:

John N. Mayberry

for the first time since the summer of 2003. One month does not a trend make, but this as an ominous sign of increasing US dependence on the currency allocation decisions of foreign central bankers. Although the market's short-term response to this news was muted, it cannot be taken as good news for the value of the dollar nor for the continuation of extremely low interest rates on Treasuries.

The dollar has been stronger this year, but declining purchases of US Treasury bonds by foreign central banks expose the dollar's vulnerability.

Crude oil prices, oil-related stocks, and commodities declined since early March, after very strong advances in the previous twenty-four months. Energy stocks remain somewhat undervalued; it appears likely that energy stocks will increase in price over the next twenty-four months, even if crude oil prices decline to $40 per barrel.



The bond market--at least in the high-credit quality arena in which Core invests--has confounded most observers by its remarkable strength. Yields on the benchmark, ten-year Treasury bond have again been hovering near 4% at a time when most observers expected yields on the ten-year to have risen to 5% or more. For most clients, we hold positions in the government's inflation-protected bonds, called TIPS. Prices for the Pimco Real Return fund, through which we make our TIPS investments, have recently traded at all-time highs. We'll take our investment gains where we can find them.

Core Asset Management annually amends its Form ADV, our filing with the SEC. If you wish to receive a copy of Part II of Form ADV, we will be pleased to mail it to you.

Rumors and Ructions. There are rumors of big losses in the hedge fund world resulting from a popular trade, selling short the stock of GM and Ford against long positions in their bonds. This trade was thought to have very little risk, until Kirk Kerkorian (always described in the press as an octogenarian billionaire) announced his intention to buy an additional 5% of GM's stock for a price several dollars above its then-market price. This caused GM stock to rally by more than 10%, putting one side of the trade into a big loss. On the next day, Standard & Poor's, which rates publicly-traded bonds, issued downgrades of GM's and Ford's bonds to below investment grade. GM and Ford bonds promptly fell in price, putting the other side of the trade into a loss.

As of this writing, no hedge fund bodies have floated to the surface, but there is, once again, a demonstration that risk for highly-leveraged and exotic trading strategies may lurk in previously unimagined places. The concern for investors like ourselves is that, with the interlinking of investors and the securities and derivatives in which they invest, a serious disruption in one arena could spread within the financial system to others. Recall that in 1998, the collapse of Long Term Capital Management, an enormous and highly leveraged hedge fund, was frightening enough to the Fed that it organized a rescue of the fund with large investment and commercial banks. The Fed, one expects, is watching closely.

CORE Comments

CORE ASSET MANAGEMENT
108 Caledonia Street
Sausalito, California 94966
(415) 332-2000 • (800) 451-2240
fax (415) 332-2151
www.coreasset.com
info@coreasset.com

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

April 5, 2005

Modest Gains in a Down Market

When interest rates and inflation rise, as is happening now, investment risk becomes clearer.

The winners of the last two or three years--REITs, junk bonds, emerging market debt--may be big losers.

After a very rocky quarter in most markets, Core's clients' accounts were little changed. Some accounts rose slightly, others fell slightly, depending on the mix of investments. US stocks were lower--down 2.5% for the S&P 500 and 8% for the Nasdaq--and the broadest measure of US bonds produced a loss. The dollar's rise caused a loss of about 2% on our foreign bond positions. Investments in utilities, physical commodities and oil-related stocks brought solid gains and tipped most accounts into the black for the quarter.

Mispricing Risk. In the very low interest rate environment of the last few years, when safe, short-term bonds yielded next to nothing, investors put their money in higher yielding, riskier investments to earn income. A good example--one from which Core's clients benefited--is REITs (Real Estate Investment Trusts). Because of their high dividends (generally 6% or more a couple of years ago), investors poured capital into the sector and prices rose above the value of the underlying real estate properties held by REITs. (We sold our REITs in January of this year, a very successful investment.)

Similarly, high-yield bonds ("junk bonds") and bonds issued by companies and governments in the developing world ("emerging market debt"), offered, as they should have, much higher yields than US treasury bonds. These risky investments likewise attracted the capital of investors hungry for yield; their prices rose to very high levels and their yields fell to levels unusually close to those of low-risk US treasury bonds.

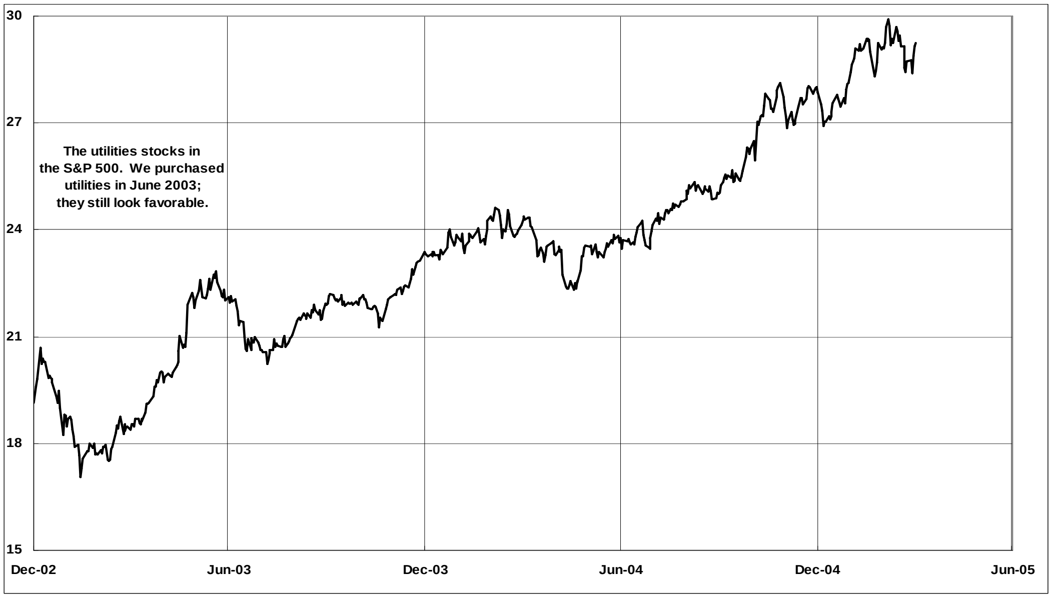
Now, however, the Federal Reserve Board is in the midst of a long-term process of raising short-term interest rates. Inflation is on the rise again, after falling to extremely low levels in the last few years. In this environment, investment risk becomes quite clear. Risky assets--which now include bank and insurance stocks, junk bonds, REITs, and emerging market debt, to name a few--are likely to demonstrate their true risk by falling in price.

By:

John N. Mayberry

Utilities stocks generally benefit from higher oil prices, because they can pass their higher fuel costs on to customers.

For these reasons, Core sold your REIT investments in January and cut overall stock investments by a recent sale of the Gateway fund, which had been held in most clients' accounts. (For the clients who held it, we sold positions in Weitz Value, a US stock fund, and replaced it with Oakmark Select, a really superb equity fund that had long been closed to new investors, but which recently opened.) In the first quarter, we purchased for various clients more foreign bonds, more commodities, and more oil-related stocks. Of course, these investments have their risks as well, but they are likely to be better investments as (and if) the dollar weakens further and inflation rises further. Because commodity inflation, rising oil prices and a declining dollar seem probable, I have put more of your investment capital in these, withdrawn some capital from the stock market, and sold REITs outright.



The dollar and rising interest rates. Since the beginning of the year, the dollar has risen in value against other major currencies by 3.8%. As mentioned, short-term interest rates are rising in the US and they are now higher than rates in Europe. There is an entirely reasonable view that, as US rates rise, foreign capital, seeking higher yields, will flow into dollar-based assets and strengthen the dollar's value against the euro and other currencies. This certainly may happen.

Core Asset Management annually amends its Form ADV, our filing with the SEC. If you wish to receive a copy of Part II of Form ADV, we will be pleased to mail it to you.

The other (and better) argument is that the dollar's value must fall further because the policies and practices of Americans have created a huge, ever-growing, and unsustainable indebtedness to the rest of the world. America spends far more than it earns--$666 billion in 2004 and growing fast. To pay for our purchases, we must borrow capital from abroad, in ever-greater amounts. The remedy is real change--of which there is now no sign--in America's trade, saving, and spending practices and policies, or a substantial further decline in the dollar's value. The dollar may appreciate in coming months, but the high probability of a longer-term and large decline argues strongly in favor of maintaining our foreign bond investments and avoiding the risk of having all our investment capital tied to the fate of the dollar. Warren Buffett, the chairman of Berkshire Hathaway, has written a very cogent (and clear) discussion of the decline of the dollar in Berkshire's annual report. It is very well worth reading and may be found at http://www.berkshirehathaway.com/letters/2004ltr.pdf at pages 18 to 20.

Oil and commodities. The strongest investments this year have been oil stocks and physical commodities. The Pimco Commodity fund, in which we invested in January 2004, has been outstanding, providing a real hedge for our stock and bond investments and producing strong gains, more than 11% this quarter. Many Core clients hold the oil-stocks fund. With the big rise in oil prices, this fund gained 18% in the quarter. Utilities were strong as well.

CORE Comments

CORE ASSET MANAGEMENT
108 Caledonia Street
Sausalito, California 94966
(415) 332-2000 • (800) 451-2240
fax (415) 332-2151
www.coreasset.com
info@coreasset.com

CORE Comments

ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

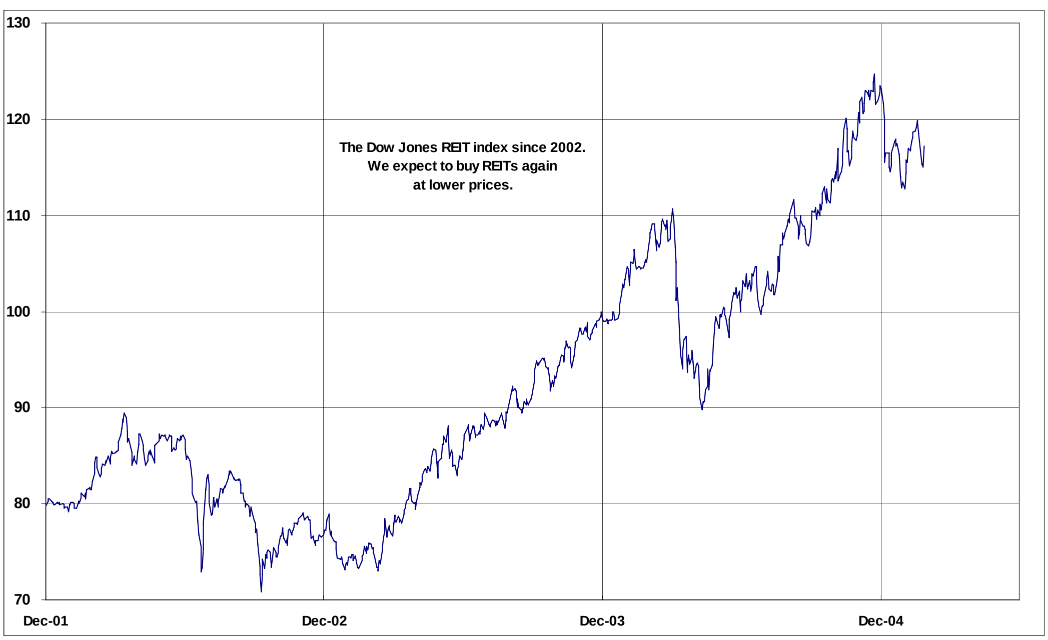
March 1, 2005

The New Year Begins; Oils, Utilities and Commodities are Quite Strong.

Strength in the stock market is mostly in oils and utilities; the general market is weak. The dollar gained a little in January, but it will fall further in coming months. Foreign bonds remain very attractive.

In the first two months of this new year, the various markets in which we invest are moving in different directions. The US stock market began with a sharp sell off in January. Since then, the Dow Industrials and the S&P 500 have recovered and stand now at levels that prevailed at the end of 2004. The Nasdaq remains down by about 5%. The US bond market has been a bit weak in these first two months.

The US dollar rallied by about 5% in the first weeks of the year, but has begun to fall again. Our foreign bond investments are very slightly lower as of this writing. Commodities generally have risen strongly in price and the rate of inflation picked up again in January. REITs fell by more than 10% in January, and have regained some ground since then.



As discussed in our last letter, REIT prices ended 2004 at extremely high levels, the highest ever, in fact, in relation to underlying earnings, dividends and property values. In the first days in January, we sold (with a few exceptions) all REIT positions held by Core clients. The decision to sell was based only on the exceptionally high prices. (The adjoining chart shows REIT prices since 2002, as measured by the Dow Jones REIT index.) I believe strongly that commercial real estate forms a valuable part of an investment portfolio, and I expect to reinvest in REITs when prices become more favorable. However, by the end of 2004, the risk in REITs seemed far too great. We sold.

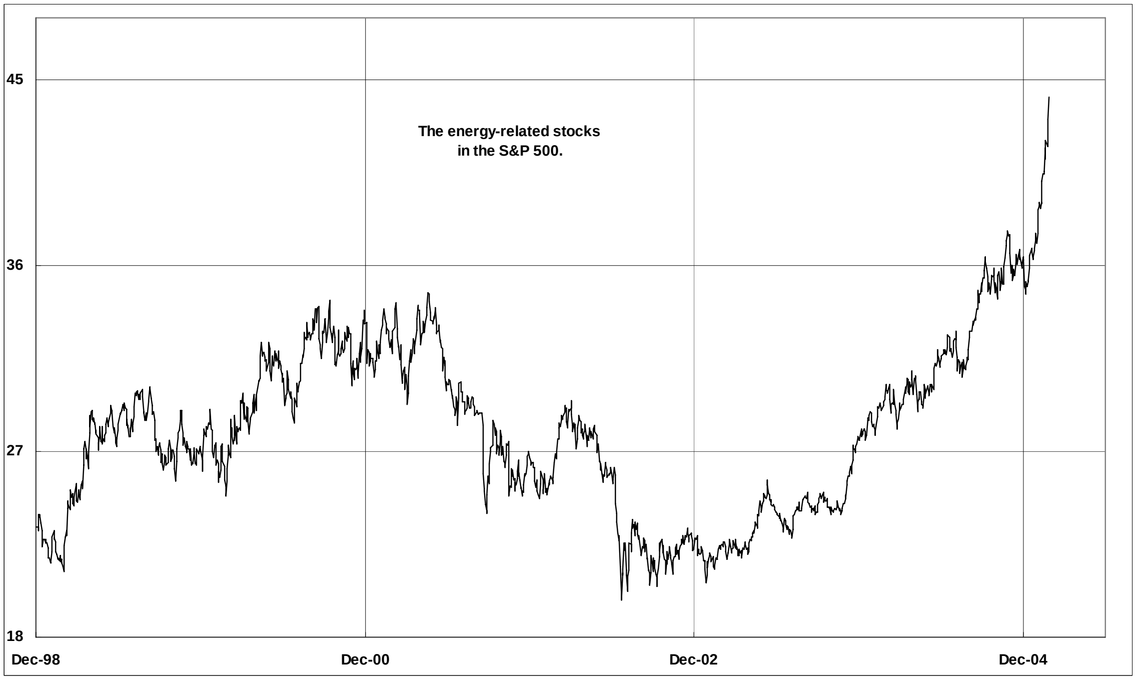
Utilities and energy stocks. Although the stock market as a whole has been somewhat weak so far this year, two related stock market sectors have been remarkably strong: utilities and oil-related stocks. In 2003 and 2004, although oil prices were generally high and oil company profits quite strong, the stocks of companies in the oil business remained quite inexpensive, per-

By:

John N. Mayberry

haps on the notion that high prices for crude oil were a temporary phenomenon. But in the opening weeks this year, oil stocks attracted widespread buying and moved sharply higher. Core has had positions for many clients in the energy sector of the S&P 500, through an exchange-traded fund with the symbol xle, shown in the chart below. Although oil stocks are no longer as cheap as last year, we have continued to make purchases in this sector, in the expectation that oil stocks will rise substantially from present levels over the next two years.

Although oil stocks have risen sharply this year, they are not overvalued. We expect to add to energy-related investments.



Similarly, utilities stocks, in which we have had investments for almost all accounts since the middle of 2003, have been very strong this year, as they were last autumn. In general, utility companies can pass on to their customers their own higher fuel costs and increase their profits. (We can see this in the bills our utilities render to us for electricity in our homes and businesses.) Thus, although these two sectors in which we invest, oils and utilities, have risen rapidly in price, they are not, in my judgment, overvalued as REITs have been. For now, we are continuing to buy in these areas.

Alan Greenspan's conundrum. In recent Congressional testimony, the Federal Reserve Board chairman remarked on the "conundrum" that long-term interest rates had fallen in the nine month period since the Fed began its increases in short-term rates. Greenspan is not alone in his surprise; the prevailing view--which I have shared--is that long-term US interest rates would rise. The ten-year bond, which many have expected to be yielding 5% by now, has traded at yields between 4% and 4.35% for several months. Still low long-term rates probably reflect Chinese and Japanese central bank purchases of US treasuries and an expectation among bond investors that economic growth will slow, cutting demand for borrowing. As an investment matter, it is still better to expect Greenspan's conundrum to be resolved by higher bond yields and lower bond prices. Our primary goal in US bond investments in these years is to preserve capital. We will remain very cautious in our bond investments and stay away from bonds with long maturities and poor credit ratings.

Core Asset Management annually amends its Form ADV, our filing with the SEC. If you wish to receive a copy of Part II of Form ADV,

Commodities and the dollar. I expect the dollar to continue its decline that began three years ago. If President Bush and Congressional Republicans are willing to restrain federal spending--a big "if", indeed--then US deficits with the rest of the world may grow less rapidly and the dollar may find some support. For now, however, widening deficits and policymaker's apparent acquiescence in dollar depreciation suggest lower values for the dollar. This will continue to benefit our investments in foreign bonds and in commodities.

CORE Comments

CORE ASSET MANAGEMENT
108 Caledonia Street
Sausalito, California 94966
(415) 332-2000 • (800) 451-2240
fax (415) 332-2151
www.coreasset.com
info@coreasset.com

CORE Comments

ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

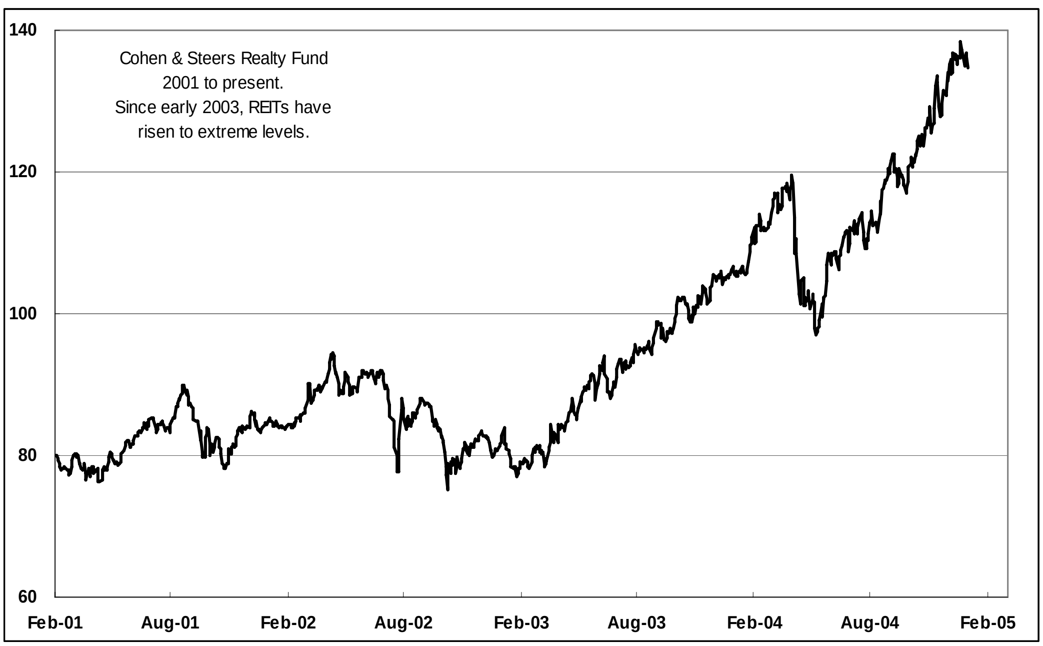
January 5, 2005

2004 Ends on a Strong Note . . .
. . . Prospects for 2005

We earned very good returns in 2004. All assets within your portfolios gained in value.

Strong gains in the fourth quarter lead to a fine year for your investments. All of Core's investments performed well in 2004, and we earned gains of 10 percent to 15 percent for the full year, depending on the composition of individual portfolios. The level of returns was particularly gratifying in light of the relative weakness in the stock market, where returns ranged from 3 percent for the Dow to 9 percent for the S&P 500.

The overall investment situation as 2005 begins is best characterized as one in which nothing is cheap. In the beginning of 2001, the Fed began to cut interest rates and to provide extra liquidity to the financial system, in response to the bear market in stocks that began in 2000. Although the Fed has now begun to raise rates from historically low levels, rates remain very low. The Fed's policies encouraged investors to take investment risk and investors responded as directed. It is fair to say that at present no significant asset class is starved for investment capital. The most striking example of risk taking can be seen in the REIT market.



REITs are extremely overpriced. Publicly-traded real estate investment trusts ("REITs") are diversified pools of commercial real estate. REITs are required to pay out essentially all their earnings in the form of dividends. As a consequence REIT investments typically have rich payouts, often greater than 7 percent. In the last two years, investors seeking these rich yields and relative stability have poured money into the sector, with the result that REITs as a class have gained 50 percent to 60 percent in the last two years. The result of this unrestrained buying has been wonderful for Core's clients: we have had 10 percent to 15 percent of your capital invested in REITs since 2002. The problem is that REITs are now wildly overpriced and risky. I have begun to sell your REIT investments and intend to reduce them to very low levels this month.

By:

John N. Mayberry

REITs trade at a premium to the value of their underlying real estate assets. They have set all-time highs in relation to stocks and bonds. They have become too expensive for comfort.

REITs now trade at their highest levels ever in relation to underlying earnings, in relation to interest rates, and in relation to stock market price/earnings ratios. In the present environment, when interest rates are very likely to rise, the odds of a significant decline in REIT prices are high. We cannot know when REITs will fall back to normal levels. It is possible that investors will continue to pour new money into this sector and that prices will continue to climb. My judgment is that it is better to forego future speculative gains and to protect the gains we have already. We have already seen this movie; we know how it ends. If I am correct in my assessment, we will be able to invest again in REITs sometime later this year or next when prices and investment risk are lower.

We warmly welcome referrals from our clients. If you know of anyone who could benefit by our work, we would be very grateful to hear from you.

The dollar's decline continues. The euro resumed its relentless advance in recent months. Early in September, the euro was worth $1.20. When 2005 ended, its value had risen to $1.36. Our investments in foreign bonds appreciated in line with this and added significantly to our overall portfolio gains. As I have written, I think it is very likely that the dollar will fall further against major foreign currencies, perhaps by 20 percent or more. However, it is well to remember that in each of the last three years as the dollar has fallen, there have been counter-trend rallies in which the dollar climbed by more than 5 percent. Indeed, in 2004, after falling in January, the dollar recovered and stood higher in September than it had at the end of 2003. It is easy to envision a dollar rally of 10% to 15% at any time. Such a rally will depress--temporarily--the value of our foreign bond investments.

However, unlike the situation with REITs, which I consider to be outrageously expensive, the major foreign currencies are not overvalued in relation to the dollar. Indeed, my view is that the dollar has further still to fall. My plan at present is to hold your foreign bond positions, even in the face of a dollar rally.

Core Asset Management extends to clients and friends the hope that the new year brings health, peace and prosperity to all.

The stock market. The fourth quarter began with stock prices generally down on the year, but a strong rally unfolded, particularly after the election and all market indices ended in the black for the year. Small company stocks made a series of all-time highs in November and December. Utilities stocks, in which we have had a large investment, also rallied sharply in the second half of the year. These are areas of the market that appear vulnerable; I may reduce your positions in these sectors in favor of cheaper areas.

Inflation, the bond market and commodities. Many observers believe that the Consumer Price Index understates inflation. That is a question for another day. For now, let us note that even as measured by the CPI, inflation is on the way up. The CPI rose by 3.5 percent in the twelve months to November, nearly twice the level that prevailed in much of 2002 and 2003. Inflation erodes the value of regular bonds; Core's bond investments are mostly in the treasury "inflation-protected" securities, called TIPS. We cannot expect to earn much money from bonds in 2005. Bond investing these days is a game of preserving capital.

On the other hand, inflation and the weak dollar are tonics for our investments in physical commodities. We had modest profits from these investments in 2004 and I believe the outlook is favorable for commodities, perhaps for several years. After a twenty-year bear market in the prices of many commodities, we may now be in the early stages of a multi-year rally in this sector. I feel quite comfortable with this investment; it provides real diversification in your portfolios and offers decent prospective gains.

CORE Comments

CORE ASSET MANAGEMENT
108 Caledonia Street
Sausalito, California 94966
(415) 332-2000 • (800) 451-2240
fax (415) 332-2151
www.coreasset.com
info@coreasset.com