Brick Financial Management LLC

Benjamin B. Taylor
Investment Manager

phone: 973-313-1220
toll free: 888-BRICK-10
http://www.brickfinancial.com

August 1, 2005

Re: July 2005 Client Letter

Dear Partners, Clients and Friends,

Our model portfolios both performed strongly in July. The Relative Value model portfolio advanced 6.1% while the Choice model portfolio gained 8.3%, besting their respective indices this month. The returns for both model portfolios versus relevant stock market indices (including reinvested dividends) as of July 31, 2005 follow[1]:

	July	YTD 2005	2004	2003	2002	Since Inception
Relative Value[2]	**6.14%**	**8.26%**	**33.54%**	**44.09%**	**-2.09%**	**103.95%**
Wilshire 4500	5.63%	7.56%	18.10%	43.84%	-4.21%	75.02%
Mid Cap Equity Funds	5.34%	7.57%	15.52%	36.11%	-4.32%	61.83%
Choice[3]	**8.30%**	**-4.89%**	**15.31%**	**22.31%**		**34.16%**
S&P 500	3.72%	2.88%	10.88%	32.87%		51.57%
Large Cap Equity Funds	4.50%	3.26%	7.79%	25.59%		39.79%
Portfolio Average[4]	**6.72%**	**4.32%**	**28.07%**	**37.31%**	**-2.09%**	**79.62%**
Wilshire 5000	4.14%	4.18%	12.48%	31.64%	-5.54%	45.72%
All U.S. Equity Funds	5.05%	4.78%	11.96%	32.44%	-5.46%	46.88%

[1] The returns of the Relative Value and Choice model portfolios and the Portfolio Average are determined using a technique known as "time-weighted return on investment" and include all capital gains and reinvested dividends. They do not represent actual trades or returns of client portfolios although client portfolios are based on the model portfolios. Client portfolio returns may be higher or lower than the model portfolios' returns. The model portfolios are presented here for informational purposes only. Although Brick Financial believes the information and data in this report were obtained from sources considered reliable and correct, we cannot guarantee their accuracy or completeness. Neither this commentary, nor any opinions expressed herein, should be construed as an offer to sell or a solicitation of an offer to acquire any securities or other investments mentioned herein. Persons associated with this firm may own or have an interest in securities or investments mentioned in this presentation. Their positions may change from time to time and they may buy or sell such securities or investments. Past returns are no guarantee of future performance. The Relative Value and Choice model portfolio data is maintained at Foliofn.com. The index and mutual fund data comes from several sources including Wilshire, Standard and Poor's and The Wall Street Journal (Lipper Mutual Fund Averages).

[2] The inception date for the Relative Value model portfolio is 12/6/2002.

[3] The inception date for the Choice model portfolio is 4/4/2003.

[4] The Portfolio Average is meant to represent the weighted average of the Relative Value and Choice model portfolios. Returns for the Average are determined as follows: A split investment (70% in the Relative Value, 30% in the Choice) is assumed to be made at the beginning of each calendar year and rebalanced every subsequent calendar year. Inception date for the Average is 12/6/2002.

Copyright © 2005 Brick Financial Management, LLC, PhatKnot Media, LLC, Benjamin B. Taylor, all rights reserved. Readers may freely quote this document in part or in its entirety with the contingency that material is attributed to "Benjamin B. Taylor, President of Brick Financial Management, LLC, www.brickfinancial.com." Otherwise written permission is required.

Millionaire status in a decade
July was a solid month for the equity investors and a better month for us. The since inception return of the Relative Value model portfolio stands at 104% (30.8% annualized) marking the official <u>doubling</u> of our money in just over 2½ years.

> Investing $1,000 per month at an annualized rate of 30.8% would result in a $1 million dollar portfolio in about 10 years and $5 million in 15 years.

Although we are happy with our absolute results in this port, we are just as happy that we have been able to outpace the Wilshire 4500 Index over the life of the port. Alas, it will be difficult, if not impossible, to sustain 30% returns over the lung run. However, we expect to be able to continue to beat the market indices over time.

The younger Choice model portfolio has been less generous in its returns since inception, but the port has still done well. Money invested in this portfolio has increased by about a third since inception resulting in an annualized return of 13.5% over 2⅓ years.

> Investing $1,000 per month at an annualized rate of 13.5% would result in a $1 million dollar portfolio in about 18 years and $5 million in 30 years.

Our portfolios are well positioned
Although the Choice model portfolio trails the S&P 500 Index, we are confident that this condition is unlikely to continue. This confidence is borne from two broad circumstances:

1. The Choice model portfolio is made up of companies whose respective intrinsic values have yet to be realized in their market prices. When compared to the market, the companies in the portfolio produce higher returns on equity, generate higher degrees of free cash flow, have less debt and have the potential to grow at a faster rate. Yet, we purchased these companies at price ratios that were lower than average stock in the marketplace. Consequently we see our future annualized returns exceeding the 13.5% that we have benefited from thus far.
2. The S&P 500 has enjoyed outsized annualized returns of 19.6% over the last 2⅓ years. But all indicators (growth of economy, inflation, market price levels, and corporate earnings) point to a market that can not continue to sustain such heady returns. We estimate future long run returns more in the neighborhood of 7½-9%[5].

Market returns have been "inflated"
In other words, it is our view that we are experiencing a period of *inflated* market returns and *deflated* returns in the Choice portfolio. Although we have confidence that we will eventually be rewarded with relative returns greater than the market's, we can not say *when* this will

[5] In a Fortune (Nov. 22, 1999 issue) magazine article titled, "Mr. Buffett on the Stock Market", Warren Buffett estimated the long-run gross returns of the stock market would come in around 6-7%. This was when the S&P 500 index was priced at about 1360. Since then the index has come down in price to about 1230 at the end of July 2005. Using Buffett's forecast of stock market returns as a proxy, we can assume that market returns will likely come in above 7%, given that its price levels are much lower than in 1999 and the earnings of companies much higher.

BRICK FINANCIAL MANAGEMENT, LLC
BUILDING WEALTH ONE BRICK AT A TIME

Copyright © 2005 Brick Financial Management, LLC, PhatKnot Media, LLC, Benjamin B. Taylor, all rights reserved. Readers may freely quote this document in part or in its entirety with the contingency that material is attributed to "Benjamin B. Taylor, President of Brick Financial Management, LLC, www.brickfinancial.com." Otherwise written permission is required.

occur. All we can say is that it is likely to happen sometime in the future. As we have stated previously, stock prices are subject to unpredictable and unexplainable price movements in the short-term. But over longer periods, price and value usually merge. (http://www.brickfinancial.com/letters/200506clientletter.html#shortterm)

Staying fully invested is critical to our success

We have addressed this inability to time the market in a previous Client Letter (http://www.brickfinancial.com/letters/200505clientletter.html#bunk). However, it is instructive to re-examine this point using the action in a few of our positions and our portfolios over the past few months.

Choice model port positions	Return in June	News events during June	Return in July	News events during July
eBay	-13.13%	Google's announcement that it would introduce a competing online payment service which would rival eBay's PayPal	26.57%	eBay pulled in an excellent quarter with quarter-to-quarter free cash flow rising 106%. It also raised earnings estimates for the rest of the year.
Amazon	-6.81%	no significant news	36.45%	Quarter to quarter revenues jumped 26% on higher margin sales. Profits beat estimates for the qtr.
Accenture	-2.62%	IT spending on consulting services remains low and company's margins remain depressed.	12.04%	The company beat analyst estimates for the qtr and margins begin to rebound.
InterActive	-1.97%	Sold its remaining interest in Vivendi Universal Entertainment for $3.4 billion.	11.16%	Favorable reaction to pending Expedia spin off and its share buyback program.
Radian	2.92%	no significant news	9.45%	Posted a 16% rise in net income for the qtr.

Fred Flintstone or the Great Gazoo?

Using the June price movements of our positions as your only gauge, you might have tagged us stock market dumb-dumbs. Had you the July returns at your disposal, you might instead have made a different determination. So are we Fred Flintstone or the Great Gazoo? Well, in this case we would rather be a little green alien genius than a barefoot caveman dumb-dumb. If we demonstrate any genius at all however, it is not in predicting whether prices will be up

BRICK FINANCIAL MANAGEMENT, LLC
BUILDING WEALTH ONE BRICK AT A TIME

Copyright © 2005 Brick Financial Management, LLC, PhatKnot Media, LLC, Benjamin B. Taylor, all rights reserved. Readers may freely quote this document in part or in its entirety with the contingency that material is attributed to "Benjamin B. Taylor, President of Brick Financial Management, LLC, www.brickfinancial.com." Otherwise written permission is required.

or down. It is instead in rigorously adhering to a value-oriented approach to investing and "staying put" in the face of price declines like the ones we saw last month.

The downs and ups of 2005

Staying put has been critical throughout 2005. Our portfolios suffered severe price declines during the first four months of the year, only to experience a substantial reversal for the last three. There is no one event we can point to that may have caused this about face. We will blame the natural volatility of the market for the turnaround. The following table illustrates the up-down (actually the down-up) action in each of our portfolios so far in 2005.

	January – April	May – July
Choice	**- 15.98%**	**13.20%**
S&P 500	- 4.00%	7.17%
Relative Value	**- 9.42%**	**19.52%**
Wilshire 4500	- 6.94%	15.58%

Our returns in a historical perspective

Allow us to revisit our assessment of the Choice portfolios since inception performance. It is important to have some perspective here. Although the Choice model portfolio currently trails its respective indices, its annualized return of 13.5% should be viewed as "acceptable" by most prudent investors. Consider that the annualized return of the S&P 500 over the last 30 years is, coincidentally, 13.5%. Even these 30 year returns are slightly inflated given that since its inception[6], 48½ years ago, the S&P 500's annualized return is a less atmospheric 10.7%. This is generally considered the "normal" return of the stock market[7]. It is highly probable that the stock market is likely to revert these normal levels or below (7½-9%) over the next five to ten years.

In this context, we are quite comfortable with the Choice model portfolio's performance to date. And while we prefer to never lose to the stock market indices, a perfect record is neither possible nor necessary to achieve acceptable returns *or* to achieve our two investment objectives which are to,

- Increase your (and our) invested capital, consistent with reasonable risk, <u>and</u>
- Outperform the market indices over long periods of time.

What do "acceptable" returns look like?

You may be wondering what we mean by acceptable returns. In the interest of clarity, we will take this opportunity to convey to you what such returns should look like over the coming years. Think of the following as our *unstated* third and fourth investment objectives. We will consider our returns to be acceptable if we achieve the following in each of our portfolios,

[6] Standard & Poor's first developed industry wide stock prices indices in 1923 and three years later formulated the Composite Index, containing 90 stocks. As the economy grew, S&P felt the need to expand the index to 500 stocks and renamed it the S&P 500 Index on March 1, 1957.
[7] "Normal" should not be confused with "guaranteed".

BRICK FINANCIAL MANAGEMENT, LLC
BUILDING WEALTH ONE BRICK AT A TIME

Copyright © 2005 Brick Financial Management, LLC, PhatKnot Media, LLC, Benjamin B. Taylor, all rights reserved. Readers may freely quote this document in part or in its entirety with the contingency that material is attributed to "Benjamin B. Taylor, President of Brick Financial Management, LLC, www.brickfinancial.com." Otherwise written permission is required.

- An average annual return of 12-15% over rolling 5-year periods, and/or
- Annual average outperformance of the stock market (as measured by the Wilshire 5000) by 4-7% per year.

Since our portfolios inception, we have averaged annualized returns of 24.7% while the Wilshire 5000's annualized return has been 15.2%. We bested the index by a margin of 9.5%.

We are playing with a loaded deck
Let's take a look at each of these unstated objectives more closely. The unstated third objective is our expectation of what an intelligently approached course of value-oriented investing in a small number of positions should be able to accomplish over an extended period of time. Consider that,

- In several empirical tests it has been found that that value-oriented stock investments (represented by low price multiple stocks) produce a performance margin advantage over the general stock market of about 2-3%.[8]
- Concentrated portfolios increase the odds of beating the market. An investor is nearly 13 times more likely to outperform the stock market with a concentrated portfolio of 15 stocks than with a diversified portfolio of 250 stocks.[9]

At Brick Financial, we employ the use of both value investing and concentrated portfolios. Thus we should receive the advantage of both. It's as if we are playing poker with a loaded deck. We are bound to win. In an environment where average annual stock market returns of 7½-9% are likely, our "loaded deck" should make 12-15% returns an achievable mark for us.

The unstated fourth objective reflects our recognition that there will undoubtedly be stretches when the stock market's return stinks and other times when it will be outstanding. Since, it is our policy that we keep the majority of your (and our) money invested in stocks at all times our portfolios will be vulnerable to the direction of the stock market. In times when the market is down, our portfolios are likely to feel this pain as well. However, it is our intent that over longer periods of time we will produce returns that outperform the stock market by a margin of 3-7% per year whether or not the market is in bull or bear[10] mode.

Note: Although we see the third and fourth objectives as important, they remain unstated *as the simultaneous achievement of investment objectives one and two make objectives three and four inevitable.*

[8] Source: *The Future for Investors*, Jeremy Siegel, (Random House, Inc; New York; 2005), p. 43; *Stock for the Long Run*, 3rd ed., Jeremy Siegel, (McGraw-Hill, Inc; New York; 2002), p. 138.
[9] Source: *The Essential Buffett*, Robert Hagstrom, (John Wiley & Sons, Inc; New York; 2001), p. 176
[10] Bull market: A prolonged period in which investment prices rise faster than their historical average. Bull markets can happen as a result of an economic recovery, an economic boom, or investor psychology.
Bear market: A prolonged period in which investment prices fall, accompanied by widespread pessimism. If the period of falling stock prices is short and immediately follows a period of rising stock prices, it is instead called a correction. Bear markets usually occur when the economy is in a recession and unemployment is high, or when inflation is rising quickly.

Copyright © 2005 Brick Financial Management, LLC, PhatKnot Media, LLC, Benjamin B. Taylor, all rights reserved. Readers may freely quote this document in part or in its entirety with the contingency that material is attributed to "Benjamin B. Taylor, President of Brick Financial Management, LLC, www.brickfinancial.com." Otherwise written permission is required.

Of course the preceding treatise is a long way of saying that the Choice model portfolio's performance to date is right in line with our expectation of acceptable returns, despite its slight relative underperformance. Should we be able to continue to produce returns at this level or slightly higher, which we believe we can, it is highly probable that we will find ourselves *ahead* of the market in due time.

Benchmarking our performance

In a future letter we will address why we choose to benchmark our performance against the S&P 500 and the Wilshire 5000. But we will tell you that we think benchmarking is important. Any investment program must be benchmarked. Too many investors have no idea of the actual progress of their investments. They do not really know how well they are doing against the major market indices or if they are making money at all. Computing returns *properly* takes a small amount of diligence yet very few investors partake in the endeavor.

An intelligent investor who does not measure his own progress against some standard is doing himself a disservice. He must go through this exercise if he is to ascertain if he is making the most of his effort. If he is not adding value, then why bother. Brick Financial seeks to provide investment returns net of costs superior to returns that might be achieved in an index mutual fund of similar characteristics as our portfolios. By doing this, you will know if we are adding value over the long term to your investment program.

Investing, though not easy, is simple

In our Client Letters we try to inform as well as educate you on your investments and investing in general. Some of the topics we cover may be unfamiliar to you. Further, this unfamiliarity may cause a general feeling of anxiety in you as you find yourself in the peculiar position of being totally aware of what you do *not* know. Such a sentiment has the unfortunate consequence of inducing you into thinking that this material is somehow beyond your comprehension. Let us assure you that this simply is not the case. In fact, we often say that investing, though not easy, is simple.

However, it is not our intent to trivialize the very real anxious feelings you may be experiencing. We merely mean to state that you (yes, you) can learn anything. We realize however that for some of you, if not most of you, there exists a gap in what you currently know and what you *should* know about your investments and wealth building principles. As your wealth building concierge it is our duty to assist you in closing that gap.

The Third Pig

To that end, we are in the process of developing and finalizing a personal finance and investment newsletter tentatively titled *The Third Pig*. Development of this newsletter is in line with two of our principles (http://brickfinancial.com/about_us/mission.pdf), which are:

- We will make extensive efforts to demystify the investment process.
- We will be forthright in all our communications (and)…we welcome an open dialogue with each of (you).

The newsletter will be delivered via email with an intended frequency of about once every week and a half. In addition to articles written in house, we will point you to other sources of

Copyright © 2005 Brick Financial Management, LLC, PhatKnot Media, LLC, Benjamin B. Taylor, all rights reserved. Readers may freely quote this document in part or in its entirety with the contingency that material is attributed to "Benjamin B. Taylor, President of Brick Financial Management, LLC, www.brickfinancial.com." Otherwise written permission is required.

information that might help you in your quest to become a better educated and informed investor. We will cover subjects like:

- What is value investing and how can it help you get richer sooner
- How to benchmark your personal quest toward becoming a millionaire
- How to overcome cultural biases that keep us perpetually un-wealthy
- What does P/E ratio mean, what is a cash flow statement
- How to read and understand the financial stock and bond tables
- How to determine the value of a company (or car, or house, or tropical vacation)
- What books we should be reading and which ones shouldn't we be reading

Of course we can not possibly tell you everything we will cover now but this should give you some idea of what to look for. We are excited about *The Third Pig* and look forward to sharing it with you in the coming weeks.

Your seal of approval
And lastly, we would like to ask for your referral. We would like you to be aware that (http://www.brickfinancial.com/letters/200505clientletter.html#refer) nothing has as much cache or is as important to Brick Financial Management's business success as your seal of approval. As always, thanks for your confidence in us. Please don't hesitate to call us at (973) 313-1220 or 1-888-BRICK-10 or email us at info@brickfinancial.com.

Sincerely,

Benjamin B. Taylor

Brick Financial Management, LLC
51 JFK Parkway
First Floor West
Short Hills, NJ 07078

Copyright © 2005 Brick Financial Management, LLC, PhatKnot Media, LLC, Benjamin B. Taylor, all rights reserved. Readers may freely quote this document in part or in its entirety with the contingency that material is attributed to "Benjamin B. Taylor, President of Brick Financial Management, LLC, www.brickfinancial.com." Otherwise written permission is required.