

Brick Financial Management LLC

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August 10, 2006

Re: June 2006 Client Letter

Dear Partners, Clients and Friends,

Our Core Model Portfolio ended the quarter with a return of -3.0% versus a -1.4% return in the S&P 500. Year-to-date, our portfolio trails the S&P 500 with a return of 1.0% versus 2.7% for the market. The following are returns for the Core portfolio versus relevant stock market indices (including reinvested dividends) as of June 30, 2006:

1:

	2 nd Qtr 2006	YTD 2006	2005	2004	2003	2002	Since Inception
Core Portfolio²	-2.97%	1.03%	-1.61%	28.07%	37.31%	-2.09%	71.16%
Wilshire 5000	-1.96%	3.37%	6.38%	12.48%	31.64%	-5.54%	53.82%
S&P 500	-1.44%	2.71%	4.91%	10.88%	28.68%	-5.88%	44.70%
Wilshire 4500	-3.65%	5.54%	10.03%	18.10%	43.84%	-4.21%	88.93%
U.S. Equity Mutual Funds	-3.57%	3.04%	6.65%	11.96%	32.44%	-5.46%	53.59%

Prices fell but values are rising

Markets were very volatile this quarter. A slight bump in inflation is fueling fears the Federal Reserve will raise interest rates. Economics 101 tells us if interest rates rise it makes bonds more attractive relative to stocks, thereby depressing stock prices. Should this happen this would actually be good for us, being value investors. We always like it when prices fall but values are rising. It means we can buy stocks when they are cheap.

We think the long term holds some promise. A few things occurred in the quarter and year-to-date that gives us some optimism. As we just alluded, stock prices and business values of companies began to diverge in a favorable way. The companies we hold and the companies we have our eye on became cheaper and healthier at the same time. A double bonus. We were also able to buy more of the stocks we already own at cheaper prices this quarter. Thus our average costs declined slightly. All in all, we feel we have reduced our risk in our portfolios by increasing the margin-of-safety in each of our holdings.

Risk and your investment program

We talk about risk a lot in these letters. We do this for a couple of reasons. One is our commitment to sharing with you the information we think you need to know which will



be most important to your investment success. Understanding risk in the context of a long term savings strategy is paramount in this regard. We think this understanding will allow you to stick with a program when investment fears arise, and they will, at the most inopportune times.

Our contrarian view of risk

We believe that risk should be measured as the probability of permanent loss of capital. Too many novice and professional investors alike measure risk in terms of price fluctuations. An unfortunate byproduct of this view is the related view that the more risk one takes on, the higher one's potential returns. In other words, high beta or "risky" stocks should garner high returns. As it turns out this is not really true. We pointed to Robert Haugen's book, *The New Finance*, in our [February Client Letter](#) as providing evidence that low beta or "low risk" stocks actually perform better in the long term than do high beta stocks.

In fact, we would argue that when a stock's beta increases, the stock actually becomes less risky. By way of example, let's say we buy the stock of a company for \$50 per share. In our analysis we have estimated the intrinsic value of this company in the range of \$90 to \$110 per share. In this example, we have very little risk as we wait for the market to recognize what we have and close the price to value gap by purchasing the stock at ever increasing prices. But if the stock suddenly falls in price to let's say \$30, the beta of the stock actually increases. The stock has become more volatile thus conventional wisdom says it has also become more risky. If the value of the company has remained unchanged (\$90 to \$100 per share), then the reality is the stock has become *less* risky as its price to value ratio has widened – the proverbial margin-of-safety has increased. In this example an investor would have the opportunity to buy an asset worth a \$1 for just 30¢. Prior to the price decline that investor would have only been able to buy that \$1 for 50¢ although a fifty cent dollar is nothing to sneeze at.

The above scenario is exactly what happened in our portfolio over the last quarter. As we said, we *lowered* our risk profile by buying more of the stocks we own whose prices have declined but values remained stable or increased. This action had the added benefit of increasing our potential future returns. Going forward, we believe there are bargains to be had in the investment market and we feel comfortable with our position.

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As always, thanks for your confidence in us. If you are not already, find out how to [become a client](#). Please don't hesitate to call us at (973) 486-9860 or email us at info@brickfinancial.com.



Sincerely,



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Endnotes

¹ The gross returns of the Core Model 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 model portfolio data is maintained at Foliofn.com. Inception date for the Core Portfolio Average is 12/6/2002 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).