The Lam Group
Investment Management

<u>The Lam Group Newsletter Vol. 4, No. 1</u>
First Quarter 2004

- The Big Picture: Too (large) plus Too (narrow) equals…
- Investment Concept: 14 Clubs
- The Lam Group
- Asset Class Investment Results

The Big Picture: …Fore!
In 2003, the domestic large cap equity asset class (as defined by the S&P 500) was the worst performing asset class in the broad-market equity category. The domestic large cap equity asset class also underperformed these broad-market equity asset classes on an annualized basis for the 3-year and 5-year return periods as well.

Broad Market Equity Indices	2003	3 Year Annualized	5 Year Annualized
S&P 500 Index – Domestic Large Cap Equity	*+ 28.69%*	*- 4.05%*	*- 0.57%*
Russell 2000 Index – Domestic Small Cap Equity	+ 47.25%	+ 6.27%	+ 7.13%
CRSP 6-10 Index – Domestic Small Cap Equity	+ 58.46%	+ 14.30%	+ 11.99%
MSCI EAFE Index – International Large Cap Equity	+ 38.60%	- 2.91%	- 0.06%
MSCI EAFE Small Cap Index – International Sm. Cap Eq.	+ 57.79%	+ 6.93%	+ 5.48%
MSCI EMF Index – Emerging Markets Equity	+ 56.26%	+ 12.77%	+ 10.62%
Wilshire REIT Index	+ 36.18%	+ 16.62%	+ 15.15%

Source: Morningstar

The global underperformance of the domestic large cap asset class is unsettling, particularly if it is the only equity asset class you own. Ironically, many individual investors hold more of the domestic large cap equity asset class than any other. Indeed, many individual investors own the domestic large cap equity asset class in lieu of anything and everything else in the equity sector.

This narrow investment focus, however inadvertent, can be problematic from an overall portfolio risk perspective due to the inherent lack of diversification in the context of increasingly global economies and markets.

A lack of portfolio balance can usually be attributed to a lack of awareness of investment asset class allocation and its importance in the context of portfolio diversification and risk management.

Investment Concept: 14 Clubs
A simple golf equipment analogy can be an effective way of illustrating an asset allocation-based investment approach and an overall philosophy for managing portfolios. The Rules of Golf stipulate that a player can carry a maximum of 14 clubs during a round of golf.

Imagine an investment portfolio as a golf bag.

Think of each of the 14 golf clubs as a separate investment asset class and the golf bag as an investment portfolio.

Would anyone consider carrying 14 of the same club when playing a round of golf?

On the golf course, it is rare to see a player (of any skill level) with a golf bag that contains only one kind of club (i.e., 14 drivers or 14 putters). However, it is quite common to see improperly-allocated investment portfolios (both professionally and unprofessionally managed) with all the holdings concentrated in a single asset class (i.e., all domestic large cap stocks, all technology stocks, or, in the other extreme, all cash). Having a severely lopsided portfolio has resulted in questionable results for many investors (particularly over the last few years) in the same way a having a golf bag with an improper configuration of clubs may have resulted in higher scores than a golfer deserves.

To manage an investment portfolio that maximizes return and minimizes risk over a range of market environments, an investment manager must choose the mix of asset classes to be included in an aggregate portfolio with the same care and self-knowledge a skilled golfer must choose the appropriate mix of woods, irons, wedges and putter to carry in order to be adequately prepared for the treachery, disappointment and unexpected circumstances a round of golf can bring.

A specific golf club's capacity for distance and accuracy can be seen as an analogy for a specific investment asset class's capacity for return and risk.

In the same way every golfer has to make the decision of how much distance must be given up for the sake of accuracy, every investor must decide how much risk is tolerable for an expected return. When contemplating these issues, it is extremely important to be introspective and realistic. Every asset class/golf club decision involves a tradeoff that is highly personal and subjective; what works for someone else may not work for you.

Obviously, some clubs/asset classes may contribute more to the final results than others; however, this does not mean that small contributions are less important or meaningful. For example, a golfer who doesn't carry a sand wedge may get in deeper trouble when the unexpected or unintended strikes than a golfer who carries one. Similarly, over a range of circumstances, an investor who only owns stocks with no bond or real estate positions may get in deeper trouble than an investor who owned an appropriate mix of stocks, bonds and REITs.

Golf and portfolio management are similar in that real improvement is rarely achieved with the purchase of a new highly-marketed club or mutual fund. True long-term improvement in either discipline comes from gaining a greater awareness of the contributing factors that affect performance (via golf lessons or unconflicted investment advice) and the discipline and time to implement these factors optimally and effectively.

A golfer must choose the 14 different clubs to carry to play 18 holes that suit his approach to the game, physical abilities, temperament, and the course/weather conditions. Similarly, an investor must chose suitable investment asset classes to be included in an aggregate portfolio that take into consideration that investor's tolerance for risk, return expectations and investment horizon. For both the golfer and the investor, these choices must be made with market/course awareness, and both require a high degree of self knowledge.

Fore!

The Lam Group
The Lam Group offers both investment management and portfolio consulting services for taxable investors, family offices, foundations, endowments, and select institutions.

Our asset allocation approach utilizes a highly analytical process to determine the appropriate combination of asset classes to build investment portfolios and strategies that realistically and optimally reflect the needs, risk tolerances, and investment horizons of our clients.

For those readers who would like to know us better, our website (www.thelamgroup.com) has added several new features, including a Frequently Asked Questions section to address questions prospective clients may have about our firm.

Nelson J. Lam
The Lam Group, Inc.
P.O. Box 850
Lake Oswego, OR 97034
April 19, 2004

Archives for The Lam Group Newsletter are available at our website: www.thelamgroup.com

Disclaimer:
Opinions and views expressed in this newsletter and on the www.thelamgroup.com website are solely those of the author and are subject to change based on market and other conditions. These materials, including the mention of individual securities and mutual funds, are provided for informational purposes only and should not be used or construed as a recommendation or solicitation to buy or sell any security, fund or sector. Neither The Lam Group, Inc. nor any of its data or content providers (such as Morningstar and Dimensional Fund Advisors) shall be liable for any errors in the content, or for any actions taken in reliance thereon. All data provided by The Lam Group, Inc. is based solely upon research information provided by third parties. The Lam Group, Inc. has not reviewed, and in no way endorses the validity of such data. The Lam Group, Inc. shall not be liable for any actions taken in reliance thereon.

Past Performance is no guarantee of future results.

Asset Class Investment Results:
All portfolios constructed and managed by The Lam Group are designed for an individual client's specific risk tolerances, income requirements and investment horizon. Our investment management approach includes the design of a customized asset allocation plan, the research and selection of the most appropriate and cost-effective asset class investments for the client's specific investment policy, and the on-going monitoring and disciplined rebalancing of the aggregate portfolio to optimize return, manage risk and minimize taxes.

As different clients have different goals, risk profiles and investment horizons, it is not useful to publish a track record of specifically-managed portfolios. The investment performance data below illustrate the returns of some of the actual mutual funds utilized by The Lam Group for specific asset class allocations in the construction of investment portfolios we manage.

Equity Asset Class Category	**1Q2004**	**12 Mo.**	**3 Year Annualized**	**Correlation w/ S&P 500***
Domestic Total Equity Market				
-Wilshire 5000 Index (Total Dom. Eq. Market)	+ 2.61%	+39.36%	+ 2.79%	+ 0.99
US Total Market Fund	+ 2.58%	+39.12%	+ 2.62%	+ 0.99
Domestic Large Cap Stocks				
-S&P 500 Index	+ 1.69%	+35.10%	+ 0.63%	+ 1.00
Domestic Large Cap Value Fund	+ 3.89%	+47.98%	+ 6.69%	+ 0.93
Domestic Small Cap Stocks				
-CRSP 6 -10 Index	N/A	N/A	N/A	N/A
-Russell 2000 Index	+ 6.09%	+63.56%	+10.84%	+ 0.83
Domestic Small Cap Value Fund	+ 7.38%	+85.26%	+21.75%	+ 0.77
Real Estate Investment Trusts (REITs)				
-Wilshire REIT Index	+12.07%	+50.65%	+21.49%	+ 0.37
REIT Fund	+12.02%	+49.48%	+21.61%	+ 0.35
Real Estate Fund	+ 8.23%	+48.84%	+20.16%	+ 0.53
International Large Cap Stocks				
-MSCI EAFE Index	+ 4.34%	+ 57.54%	+ 3.43%	+ 0.88
International Large Cap Value Fund	+ 7.24%	+ 73.38%	+10.83%	+ 0.80
International Small Cap Stocks				
-MSCI Small Cap EAFE Index (in US $, px only)	+11.83%	+82.93%	+13.81%	+ 0.71
International Small Cap Value Fund	+13.95%	+89.97%	+24.83%	+ 0.61
Emerging Markets Equity				
-MSCI Emerging Markets Free Index	+ 8.87%	+77.05%	+15.47%	+ 0.84
Emerging Markets Value Fund	+10.77%	+98.42%	+27.81%	+ 0.80

* 3 yr correlation using monthly data

Fixed Income Asset Class Category	1Q2004	12 Mo.	3 Year Annualized	Correlation w/ S&P 500*
Domestic Investment Grade Bonds				
-Lehman 1-3 year Govt Bond Index	+ 1.09%	+ 2.44%	+ 4.90%	- 0.63
Short Duration Domestic Inv. Gr. Bond Fund	+ 1.16%	+ 2.74%	+ 5.55%	- 0.37
Short Duration Domestic Muni Bond Fund	+ 0.72%	+ 2.32%	N/A	N/A
-Lehman Aggregate Bond Index	+ 2.65%	+ 5.40%	+ 7.44%	- 0.45
Domestic Investment Grade Bond Fund	+ 2.70%	+ 6.20%	+ 8.34%	- 0.37
Domestic High Yield Bonds				
-CSFB High Yield Index	+ 2.67%	+22.86%	+10.93%	+ 0.55
High Yield Fund	+ 1.76%	+18.56%	+ 9.30%	+ 0.65
Inflation-Linked Bonds				
-Lehman TIPS Index	+ 5.14%	+10.83%	+11.00%	N/A
TIPS Fund	+ 5.25%	+11.75%	+11.34%	- 0.41
Commodities-Linked Fund	+16.77%	+45.67%	N/A	N/A
International (non-US $) Bonds				
-Salomon Brothers Non-$ World Govt Index	+ 1.57%	+16.05%	+14.21%	- 0.28
Non-$ Bond Fund	+ 1.71%	+17.28%	+14.81%	- 0.19
Emerging Markets Debt				
-JP Morgan EMBI+ Index	+ 3.38%	+21.85%	+13.35%	N/A
Emerging Markets Debt Fund	+ 3.23%	+23.86%	+23.65%	+ 0.52

* 3 yr correlation using monthly data