

E-Memo

TO: INVESTOR/MEMBERS, CLIENTS AND FRIENDS
FROM: Jon Bruss and Bob Ollech
Date: January 11, 2005
Subject: *What's It All About, Alfie?* - The Search of Alfie and the Search for *Alpha*

Last year's film remake, *Alfie*, came and went without a lot of fanfare. It got pretty good reviews but didn't cause anywhere near the stir that the original film caused when it hit the silver screen in 1966. Perhaps it was the star; Jude Law is not Michael Caine, or perhaps the music. Burt Bacharach wrote the song, "What's it all about, Alfie?" and his co-collaborator, Dionne Warwick, performed it with him to popularize both the film and the song. We don't intend to get into the film or music reviewing business on these pages, nor do we intend to engage in any moralizing, though it may seem that way as we engage in a discussion of the film's character, Alfie, and his search for happiness and satisfaction and the investor's search for *Alpha* - the achievement of which should bring happiness and satisfaction to investors. Yes, and along the way we are engaging in a bit of playing on words. And why not? We work hard here at Fortress Partners, but we also like to have fun.

We didn't see the 2004 version of Alfie but we do recall the 1966 original with Michael Caine. In the 1966 version, Alfie desperately wants to keep smiling and have a great time. He has established criteria for women whose lover he wishes to become but alas, such a woman doesn't exist and if she did (though he doesn't realize it) she wouldn't be worth having.

So what does that have to do with investing and investors? A lot, actually. Alfie is looking for something or someone to add value to his life. Investors look for investments or investment managers that can add something to their investment portfolio - something greater than what is offered, for example, by merely investing in a market index or an index fund. And there certainly are lots of those available to investors; many of the most popular are behemoths which mimic the S&P 500. Names like Vanguard and Eaton Vance come immediately to mind as two of the largest and most popular examples. Everyone knows about the S&P 500—for most folks it represents "the market." It contains energy stocks and tech stocks, financial stocks and consumer stocks and the list goes on. It is however, *unmanaged* in the sense that while the members of the index are changed from time to time through a committee process that requires some exogenous input, the index basically runs itself - it is "THE MARKET."

Let's take a look at "THE MARKET" to see how it has performed over the past years. I think you would agree that thirty years (but we'll look at 10 years as well) would be a fair period during which to observe market ups and downs, economic cycles and trends as well as industrial shifts - the change from the dominance of the "Big Three" auto makers to the dominance of technology. It is what the broad market is.

If you were able to own the S&P 500 Index for the last 30 years and you invested \$10,000 in that index on December 31, 1974, you would have enjoyed a 10.04% annual return (before any fees and commissions) for that period and your original **\$10,000 investment would be worth \$176,408 today**. Now let's speculate for a moment about what might have been or could have been had you been able to generate a return of 11.04% - just one percentage point more - **your investment of \$10,000 would be worth \$231,411!** Wow! Just one percentage point more in annual performance would have gained you another \$55,000. Such is the power of compounding. (Albert Einstein remarked that compound interest was the greatest wonder of the universe.) That added one percentage point is what the investment management world calls *Alpha*. So what is Alpha? Simply put, it is value added above and beyond a benchmark. Value added, in the case in this paragraph, by a fictitious "active" manager who invests not in a passive portfolio designed to mimic the market benchmark, but only in his best picks.

So as Alfie searched and searched for someone or something to add value to his life, investors search for someone or something to add value to their portfolios and thereby beat the market. And that's where Alpha comes into play. In the example cited above, that additional one percentage point of annual return, which brought you \$55,000 in incremental gain, was brought to you by *Alpha*, the value added.

We said that we'd try to refrain from moralizing, but we may begin to sound like we are preaching and I guess we are. The E-Memo goes out to about 300 individuals and yet only 10% of you are members/investors in Foundation Financial Partners, LLC. All we can conclude is that we have not done a good enough job of helping you to understand what we are doing here at Fortress Partners.

Our job is sort of like Alfie's life. We are seeking opportunities which we can turn into value added for you. While we can't show you 30 years of *Alpha* history, we can show you what the NASDAQ Bank Index has done in the last 30 years. It has provided an annual return of 14.09% over that period compared to 10.04% of the S&P 500. That looks to us like a 40% difference - a lot of

Alpha without having to pay a manager, you are thinking to yourself. That 14.09% compounded on a **\$10,000 investment made 30 years ago would make your investment worth \$521,708 today**. Now that is rather astounding, isn't it?

But guess what? Try as you might, you can't invest in a NASDAQ Bank Index "fund." It doesn't exist. And for lots of good reasons. Those may be fodder for another E-Memo so suffice it to say that such a fund would not work well because of the small market capitalizations of the banks in the index versus what might be expected to be the demand for such a fund. Most index funds are hundreds of millions if not billions in size. It would be impossible to have the kind of liquidity expected by investors in a huge NASDAQ Bank Index fund.

We believe that we can show that there is no other index (save for the new America's Community Bank Index which has only a 12 month history) that can even come close to acting as a benchmark for what we do. Why? The NASDAQ Bank Index contains only banks and thrifts. Only. No finance companies, no credit card companies, REITs. Just banks and thrifts. And those are what we invest in. Those are what we know best. Those are what we have started, managed, regulated and researched for all of our business careers - over 100 years, combined. And that is what should provide you with *Alpha*.

So how does one go about this kind of investment with any assurance that one could meet or exceed the performance of the index? (I think you'd agree that just meeting that goal of 14.09% annualized return would be quite satisfying.) Well it's not easy. Investment managers don't go around discussing their *Alpha*. Why? Many don't have *Alpha*, they have not added value over and above the benchmarks to which they compare themselves or don't have *Alpha* in any material manner. You should ask your investment manager whether they are adding value by the measurement of *Alpha*. They should be willing to show you the calculation and if they are not, perhaps you should move your portfolio.

Now let's talk about our *Alpha* versus the S&P 500 and versus the NASDAQ Bank Index. If you have been a reader of our E-Memos over the past couple of years, you've seen it but we haven't so identified it. We have regularly compared our performance against the S&P 500, the Dow Jones Industrial Average, the S&P 600 Small Cap Index, the NASDAQ Composite and the NASDAQ Bank Index. Over longer periods of time, we have beaten these indices (and if years were made up of 13 months, our guess is that we would have beaten the Bank Index in that imaginary 13 month year ending with January 31, 2005. As of January 7, 2005 we tied the NASDAQ Bank Index for the period 12/31/03 - 1/7/05). We are investors - we have a long term point of view and over that longer period, now over 4 ³/₄ years, **our Alpha is 23.99% (annualized) vs. the S&P 500 and 11.73% (annualized) vs. the NASDAQ Bank Index**.

Since we started in 2000:

- A \$10,000 investment in Foundation Financial Partners, LLC would have become \$25,774.50,
- A \$10,000 investment in the NASDAQ Bank Index would be valued at \$21,070.03, while
- A \$10,000 investment in the S&P 500 would have declined and be worth only \$7,832.90.

Our guess is that deficit between our performance (or for that matter the performance of the NASDAQ Bank Index) will not be made up any time soon by sticking with the S&P 500. Remember that 21.7% decline will require a 27.7% improvement just to get your investment back and will need to increase by 229% to catch up with Foundation Financial Partners' performance in the last four years.

Alfie may never find what he is looking for but you can find *Alpha* if you look and ask for it. We have prepared for you a PerTrac Profile Report for your review and attached it to this month's e-mail. We've also attached several pages of definitions of the terms used on the Profile Report. In the future it will accompany each regular monthly edition E-Memo. We hope that this discussion will help you to find *Alpha* for your investment portfolio.

We can help and would like to have the opportunity to do so.

For your consideration, our results since March 2000:

December 2004
PERFORMANCE HISTORY (1) (2)

	Inception to Date (57 Months) 3/29/00-12/31/04	Four Year Return Annualized 12/31/00-12/31/04	Three Year Return Annualized 12/31/04	12 Months Ending 12/31/04
FOUNDATION	+ 157.72%	+ 25.44%	+ 24.37%	+ 11.21%
Dow Jones Industrial Average	+ 8.49%	+ 2.07%	+ 4.07%	+ 5.30%
NASDAQ	- 51.51%	- 2.70%	+ 4.20%	+ 9.15%
S&P 500	- 12.97%	- 0.52%	+ 3.58%	+ 10.87%
S&P 600 (Small Cap Index)	+ 63.61%	+ 11.52%	+ 13.26%	+ 22.66%
NASDAQ Bank Index	+ 135.32%	+ 16.14%	+ 17.35%	+ 13.64%

(1) **After** management and other expenses but **before** charges for Performance Allocation; indices and Fund performance include the reinvestment of dividends.
 (2) The performance information has been prepared and presented in compliance with the Performance Presentation Standards of the Association for Investment Management and Research (AIMR-PPS®), the U.S. and Canadian version of the Global Investment Performance Standards (GIPS®). AIMR has not been involved in the preparation or review of this information.

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 PERFORMANCE INFORMATION IS HISTORICAL, AND PAST PERFORMANCE IS NOT INDICATIVE OF,
 NOR DOES IT GUARANTEE FUTURE RESULTS. INVESTING IN SECURITIES MAY RESULT IN A LOSS OF PRINCIPAL.**

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