

E-Memo

TO: INVESTORS/MEMBERS AND FRIENDS
FROM: Jon Bruss and Bob Ollech
Date: October 8, 2004
Subject: Myths about Banks and Thrifts

Misinformation, ignorance, and personal biases are not in short supply in this world. And that certainly carries over into the investment arena where people, including some “professional investors” invest (perhaps gamble is a better word) serious money based on preconceived notions and limited information. It has been a fascination of ours to observe that many people will forgo buying an item that costs a few dollars because it “wasn’t on sale” or they didn’t have a “25-cents off coupon”, yet apparently think nothing of buying or selling thousands of dollars worth of stock based on a dubious “hot tip” from a friend-of-a-friend, or because some wonk on CNBC recommended doing so. There is no free lunch in the investment world. Thorough research and experience can improve results, especially in our chosen universe of small and micro-cap banks and thrifts where the markets are less efficient.

In talking with prospective investors, we encounter numerous misconceptions about investing in banks and thrifts. Some of these misconceptions stem, we suspect, from not having taken the time to study the information we provide. In other cases, people cling to long-held perceptions and “don’t want to be confused by the facts.” Whatever the case, the mainstream financial press has generally done a relatively poor job of analyzing and highlighting some of the investment merits of banks and thrifts. Not intentionally, perhaps – we know that time constraints and deadlines put practical limits on reporters’ research efforts – but there has been a tendency to stick with the consensus view and the well-trodden path, rather than striking out to do some meaningful, original research that can help investors profit.

We have a running collection of these misconceptions - ten at last count – and the list keeps growing. We thought it would be worthwhile to our readers and investors to spend some time discussing these myths. So over the next several issues we’ll tackle one or more myth share with you our views. So here goes....

The “I-have-too-many-bank-stocks-in-my-portfolio-now” Myth.

Based on our observations, in most cases, the opposite is true. Bank and thrift stocks are generally underweighted in individual and institutional portfolios. Banks and thrifts actually represent the largest segment, by number, of publicly traded companies in the country. As you may know, there are over 5,000 publicly traded companies in the U. S. Banks and thrifts represent 1,200 of those companies, or nearly 25%. Measured by market capitalization, this group represents just over 12% of the total value of the stock market. We seldom see a common equity portfolio with even 10% allocated to banks and thrifts (aside from our own!).

Why? Well we think that banks are sometimes sacrificed on the altar of diversification. Your adviser will tell you that you need to have a little bit of this and a little bit of that; you know, some energy stocks, a few conglomerates, some consumer cyclicals, a few tech stocks, some healthcare issues and, while you’re at it, toss in some utilities, some natural resources, a bank or two, and the list goes on. Sound like your portfolio?

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If it does, you are not alone. Why so few banks? Are banks too stodgy and slow growing (another myth)? Are they too difficult to analyze? Perhaps you or your advisers think that dividends don't have much of an impact on the total return of your portfolio (yet another myth). The fact of the matter is that adequate portfolio diversification can be accomplished with a dozen stocks. Beyond that, the incremental reduction in risk provided by adding another stock is relatively small. We contend that most investors' portfolios would benefit from at least a market weighting in banks and thrifts. Why? Over time, bank and thrifts, as a group, have exhibited lower volatility, paid higher dividends and provided a higher total return than most other segments of the stock market.

And diversification? We surely have it in banking. For example, in the Monday, October 4, 2004 issue of Investors' Business Daily a full page discussion focused on banking in the fast growing economies of the Southwest and the West. It also contained an article discussing the strategy of one California bank and its approach to the growth in the market it serves. This particular bank deals up a hand of widely diversified services ranging from loans to churches, loans to residential developers and loans to small businesses, in addition to a wide variety of services to those market segments, all provided by highly experienced and competent specialists. While this bank is addressing its market's needs with loan services focused on housing and construction, other banks specialize in agricultural loans, some focus on trust and asset management, and still others are experts in serving retail consumers with products like mortgages, home equity loans, credit cards, investment brokerage and property and casualty insurance. There are big banks, little banks, banks in the Southeast, the Mid-Atlantic, New England, Mid-South, the Midwest, and the Northwest. In short, an experienced manager should be able to construct a diversified portfolio of banks that performs well through nearly any market cycle.

Rapid change and obsolescence are common dangers in some market sectors such as technology and consumer cyclicals, but changes in banking usually evolve more slowly. Strong federal and state regulation, in part, causes that. As a result, there is seldom reason to engage in a lot of trading in a portfolio of carefully selected banks. (Frequent trading is expensive and tax-inefficient.) Furthermore, bank and thrift stocks, especially micro and small cap institutions have very low volatility when compared to the S & P 500. In our view, bank and thrift stocks should be the bedrock, the foundation, of most investors' equity portfolios.

Last November, we shared an excerpt from the July 15, 2003 edition of the Consilient Observer, a publication of Credit Suisse First Boston. The article written by firm's market strategist, Michael Mauboussin, presented the results of extensive research he'd done on investment managers' performance. His research found that 70% of all active managers underperformed the market (defined as the S & P 500) over the prior 5 years and 75% underperformed for the past 10 years! Furthermore, Mauboussin found only 31 general equity funds had managed to outperform the market for the 10 years ended December 31, 2002. He found these funds shared four common characteristics which set them apart from other funds [our comments in brackets]:

- 1) They had relatively concentrated portfolios. [We say that you can have satisfactory diversification with 12 stocks]
- 2) They had low turnover within the portfolio. [We said that low turnover means more tax efficiency and lower cost]
- 3) They had a value, rather than a growth, bias. [Banks are a value play]
- 4) Their headquarters were far from Boston or New York [Hartland, Wisconsin is 1,096 miles from Boston and 901 miles from New York].

No, we didn't twist Mr. Mauboussin's arm to help him reach those conclusions (we've never even met him), but it so happens that the four traits of successful investment managers correlate nicely with the way we manage the Foundation Financial Partners, LLC. portfolio.

This year has been a tough year for stocks with many of the averages down for the year. Our well chosen portfolio of banks performed well last month, last year, last three years and since inception.

September 2004
PERFORMANCE HISTORY (1) (2)

	Inception to Date (54 Months) 3/29/00-9/30/04	Three Year Return Annualized 9/30/01-9/30/04	Twelve Months Ending 9/30/04	Year to Date As of 9/30/04
FOUNDATION	+ 134.50%	+ 23.03%	+ 12.83%	+ 1.19%
Dow Jones Industrial Average	- 0.84%	+ 6.67%	+10.99%	- 2.12%
NASDAQ	- 57.78%	+ 8.64%	+ 6.70%	- 4.98%
S & P 500	- 20.32%	+ 4.03%	+13.85%	+ 1.50%
S & P 600 (Small Cap Index)	+ 44.79%	+ 15.73%	+24.59%	+ 8.55%
NASDAQ Bank Index	+ 116.23%	+ 15.66%	+17.46%	+ 4.42%

(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.**