

E-MEMO

TO: INVESTOR/MEMBERS AND FRIENDS
FROM: Jon Bruss
DATE: January 12, 2004
SUBJECT: 2004— Year of Dividends and M & A?

If you are like me, you have been searching for the truth about the stock market for 2004. Truth is in the eye of the beholder, especially when it concerns market truth. On one hand we hear that the market will be up 10% to 15% for the year. Others, looking at from whence we came in 2003 express dire predictions using catch words and phrases like "bubble," "jobless recovery" and "rate hikes" just to name a few. The truth could be all, some or none of the above. Take your choice. I've made mine, at least as far as banks and thrifts are concerned.

2003 was a great year for investors. Small cap value stocks really outperformed. The NASDAQ was up 50% and the S & P 600 Small Cap index was up over 37%. Those of you who were involved in Foundation Financial Partners, LLC from the beginning of 2003 saw their results improve by over 32%, after fees and expenses but *before* performance allocation. That was last year, this is 2004. What about 2004?

I believe that we may be entering a phase in the market in which stock pickers will really earn their keep. We could well see, as many predict, years ahead in this decade of single digit year over year performance for stocks. If that's the case how can one outperform the market? First of all, I continue to believe that investments in banks and thrifts will, over the long run, perform well. Second, I believe that the bank and thrift stock selection process used by Fortress Partners to select stocks for investment by Foundation Financial Partners helps assure that it performs well and even better.

Dividends are an important part of our selection criteria. Why? Simply this: Dividends count as part of a portfolio's total return. To illustrate this point, the Statement of Operations of Foundation Financial Partners, LLC for 2003 (unaudited) is helpful: Dividends and realized and unrealized gains and losses constitute the *gross* change (increase or decrease) in net assets due to operations but before expenses. The gross change was roughly \$5.3 million of which just under \$500,000 consisted of dividends and the balance was realized and unrealized gains and losses. Dividends from our portfolio represented a whopping 9.3% of the gross change from operations.

For the year ending December 31, 2003, Foundation Financial Partners, LLC owned 16 stocks. Here's the dividend record as of that date:

• Average common yield at year-end 2003:	2.11%
• <i>Percent of 16 stocks paying dividends in 2003:</i>	<i>93.75%</i>
• Percent of dividend payers increasing dividend in 2003:	80.00%
• <i>Average percent increase in dividend in 2003:</i>	<i>11.39%</i>
• Percent of dividend payers increasing dividend 2X in 2003:	20.00%

How does this compare to the universe of all stocks? According to Shirley Lazo in *Speaking of Dividends* in the January 12, 2004 issue of *Barron's* magazine, of the 7,000 companies reporting dividends to Standard & Poor's, "1,630 dividends were boosted." By my calculations, that represents just over 23% of all 7,000 companies compared to 93.75% in the Foundation portfolio. Where do you want to be?

I expect that the ratio of dividends to total gross change in operations will increase as banks continue to increase dividends. If we are to see a reversion to single digit market growth over the next several years, an important part of outperforming the averages will be investment in stocks paying dividends, and if investors want to outperform the

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market, investing in dividend paying bank and thrift stocks may just be the way to do it!

Last month we obliquely referred to the other half of the subject of this E-Memo: M & A. You'll recall last month's interview with Jeff Gendell of Tontine Associates. That article was widely quoted during the month of December. Gendell said, "A lot of the thrifts and banks we own are going to start seeing deposits flood in. When loan demand goes up, it attracts other banks to the area. That is happening right now in the banking industry, and we are seeing a total grab for deposits. The next 12 months will be the most active for bank acquisitions in the last 10 years." And it is happening. Unofficially, the record over the past two months ending December 31, the number of mergers announced has been running about four per week. Prior to that we were seeing an average of two to three per week for the previous six months and one to two per week in the first third of 2003. By any measurement, that's a sharp increase. It was bound to happen. As bank and thrifts see the value of their currency (stock) rising, it becomes easier and easier to pull off an acquisition. Some of these acquisitions like the announced B of A acquisition of Fleet have been soundly criticized by analysts. I have seen stinging criticism and stirring defense of that transaction. We'll have to wait perhaps as long as 5 years to learn who is right. Many if not most analysts look at the year in which the merger was announced and the year in which it will close to determine the impact of the deal. The B of A-Fleet deal doesn't look good near term. The apologists are looking at the longer term and seeing that B of A will have important market share from New England through the Southeast and, when all is said and done, looking at its franchise nationally, B of A is only missing a good sized piece of the Midwest.

I can't predict which of our banks and thrifts will be a target in 2004. We are positioned geographically as I indicated last month to participate in the Midwest where 40% + of our holdings are located and are positioned to benefit as that economy continues to recover. We are also in New England, the Mid-Atlantic and Florida where we expect a continued strengthening M & A activity of 2004. Many of our banks will benefit however as neighboring institutions are merged from existence. They will participate in picking up the pieces from poorly executed mergers, the take out multiples of their neighbors will, rightly or wrongly drive their stocks and finally, scarcity value of being one of the remaining independents in an attractive market will tend to drive up prices.

Our stock selection process focuses on good management, good markets and clean loan portfolios all of which acquirers find to be very attractive. We're ready.

Last but not least, our results for the past month and other periods:

DECEMBER 2003
PERFORMANCE HISTORY(1)(2)

	Inception to date (45 Months) <u>3/29/00-12/31/03</u>	Three Year Return Annualized <u>12/31/00- 12/31/03</u>	Twelve Months Ending <u>12/31/03</u>	Quarter Ending <u>12/31/03</u>
FOUNDATION	+131.75%	+30.58%	+32.64%	+11.51%
Dow Jones Industrial Average	-4.28%	-1.04%	+25.32%	+12.71%
NASDAQ	-56.19%	-6.75%	+50.01%	+12.11%
S & P 500	-25.80%	-5.56%	+26.38%	+11.64%
S & P 600 (Small Cap Index)	+29.42%	+7.19%	+37.53%	+14.54%
NASDAQ Bank Index	+89.42%	+14.34%	+29.93%	+11.85%

- (1) After management and other expenses but before charges for Performance Allocation.
- (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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