

E-Memo

TO: INVESTORS/MEMBERS AND FRIENDS
FROM: Jon Bruss and Bob Ollech
Date: November 10, 2004
Subject: ELECTION FLASH—Dividends and Capital Gains Win!

Last Friday we wrapped up a day and one-half banking conference in Philadelphia which focused on banks in the Mid-Atlantic States. After visiting one of the banks we own in New Jersey, just outside of New York City, we stopped on the Jersey Turnpike to fill the rental car with gas and got out to stretch. The mini-van behind us had New Hampshire license plates which read "Live Free or Die!" the New Hampshire slogan. On Election Day 2004 New Hampshire became a "blue state", carried by Senator Kerry. We asked the driver about the significance of that change, especially considering the state's motto.

He responded: "Those [expletive deleted] tree-huggers, they did it! They think that the only voters that count live in the Northeast. As for me, I voted with my wallet. They don't really understand." That was not exactly what we expected to hear. By now, most of us heard and read that this election was about moral issues. According to a tabulation done by CNN (www.cnn.com/ELECTION/2004) moral values trumped the economy/jobs vote 22% to 20%. Taxes were the most important issue for only about 5% of all voters, but apparently for our new found friend from New Hampshire, it was the #1 issue. Of those who thought taxes were the most important issue, 57% voted for President Bush while those who thought the economy and jobs were the most important issue, 80% for Senator Kerry. Voters who said the President's tax cuts were good for the economy represented 41% of those voting and 92% of them voted for the President. So while the economy, jobs and taxes may have taken a back seat to moral values, they were part of the consideration when the levers were pulled or the ballots were marked.

The *Wall Street Journal* (WSJ), in its lead editorial on November 3 entitled "Many Happy Returns," pointed out that the title of the editorial referred to increases in corporate dividends payouts since the Bush tax cuts of 2003. The election returns came in well after the November 3 edition's deadline. According to the piece, everybody won - shareholders, taxpayers and politicians looking for ways increase tax revenues. The editorial cites data compiled by the Cato Institute which compared dividend payouts for all S&P 500 companies before and after the tax cut. The data showed (drum roll, please) that the lower tax rate on dividends led to . . . more dividends." The Cato Institute said that the overall payout increase was 18%, 23% if special dividends were included, *AND* that 22 companies began paying dividends for the first time. The National Bureau of Economic Research (NBER), according to the WSJ, compiled some additional information which tracked dividend payments from 1980 through the first quarter of 2004 and found "a sharp and widespread surge in dividend distributions following the tax cut . . ." Apparently, a larger proportion of public companies increased dividends in 2003 when the cut was first announced, but 150 firms began paying dividends for the first time after the tax cut was passed. For those of you who have read these pages over the past year or so, this should come as no surprise. We wholeheartedly agreed with those who forecast this result. The NBER further pointed out that "the surge in regular dividend payments after the 2003 reform [was] unprecedented in recent years." Here's what we can learn from this according to the WSJ:

- If you tax something less, you get more of it; the most basic of economic supply-side lessons;
- And a point we have made repeatedly regarding dividends is "dividends represent all cash that has flowed to shareholders from the control of corporate managers." Giving back to shareholders cash which can't be reasonably used in a business in the foreseeable future is a good thing as far as we are concerned.
- Moreover we have repeatedly quoted Henry Paulsen, CEO of Goldman Sachs when he said that he learned in graduate school that "dividends are real and earnings are an opinion" - a lesson from the Enron debacle of 2002.

The WSJ didn't know who would win the election, but they pointed out that President Bush proposed to make the dividend (and capital gains tax) cut permanent so they don't expire in 2008. The voters spoke loudly on November 2, 52% to 47% that among other things, they want the dividend tax cut made permanent.

And that brings us to a promise we made that we'd talk about some of the **myths we've heard about banks and banking**. As you might have expected, there is a myth floating around about dividends. It goes something like this: **Dividends are not a significant consideration when selecting stocks for the portfolio**. We argue, NOT TRUE! Our research on this myth follows:

Dividends can have significant impact, and **banks pay higher dividends and have increased dividends at a faster pace than the S&P 500**.

The following table shows the dramatic differences between the dividend growth of the stocks S&P 500 Index and all Financial Services Sector dividend paying stocks with market caps >\$1 billion. **Note: While the Financial Services Sector soundly topped the S&P 500 companies as a whole, the bank and thrifts sub-sectors did even better.**

Industry Sub-sector/ Index	Number in Sample	5-Year Average Dividend CAGR %	Number in Sample	10-Year Average Dividend CAGR %
Banks	118	11.99	91	14.40
Thrifts	22	19.94	10	18.20
Total Financial Sample	248	11.49	177	12.71
S&P 500 Index	500	1.43	500	3.29

Source: SNL Financial, LC Database 7-21-04

- **Bank dividends are real; earnings are an opinion.** Dividends provide a level of assurance that the earnings of the payer are for real.
- **Bank dividends** tend to remove the temptation of management to spend shareholder capital foolishly, especially on acquisitions.
- **Bank dividends** generally exceed dividends of non-bank companies (NASDAQ Bank Index yield is 2.1% vs. the S&P at 1.7% and the Dow at 2.1% as of 11/8/04). We would be remiss if we didn't point out that our portfolio of banks and thrifts as represented in Foundation Financial Partners, LLC (common equity only) carries an average dividend yield as of 10/31/04 of 2.8%

Dividends or not, the **total return of the NASDAQ Bank Index beats the S&P and the Dow**.

ANNUAL RETURNS (1)	NASDAQ Bank Index	S & P 500	Dow Jones Industrials
Without Dividends	13.80%	7.66%	8.64%
With Dividends	16.38%	9.41%	10.76%

(1) For the 9 year period 10/31/95-10/31/04. Total return figures for the three indices are not available for the 10 year period.

And that is the whole point of this exercise. Dividends do count - in fact they count a great deal. They improve the total return of the Bank Index by 18.7%, the S & P by 22.8% and the Dow by 24.5%. But, **the Bank Index without dividends beats the S & P and the Dow by a whopping 80% and 60% respectively for the period.**

Dividends do make a difference. Dividends *ARE* a significant consideration when selecting stocks for your portfolio!

As we approach the end of 2004 we hope you will consider Foundation Financial Partners, LLC an important part of your investment strategy by adding to your investment or becoming a member of our Fund for the first time. Dividends do count and the best way to make them count is to be a part of Foundation's portfolio of banks and thrifts.

For your consideration, our results since March 2000:

**October 2004
PERFORMANCE HISTORY (1) (2)**

	Inception to Date (55 Months) 3/29/00-10/31/04	Three Year Return Annualized 10/31/01-10/31/04	Twelve Months Ending 10/31/04	Year to Date As of 10/31/04
FOUNDATION	+ 142.21%	+ 24.61%	+ 8.19%	+ 4.51%
Dow Jones Industrial Average	+ 0.48%	+ 5.63%	+ 4.45%	- 2.48%
NASDAQ	- 56.04%	+ 5.81%	+ 2.68%	- 1.05%
S & P 500	- 19.10%	+ 3.92%	+ 9.41%	+ 3.05%
S & P 600 (Small Cap Index)	+ 47.49%	+ 14.51%	+ 16.79%	+ 10.58%
NASDAQ Bank Index	+ 123.31%	+ 18.40%	+ 12.78%	+ 7.85%

(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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