



Prudent Wealth Management LLC

Common Sense Value Investing

To Our Fellow Shareholders,

March 31, 2005

	<u>YTD</u> <u>2005</u>	<u>1YR</u>	<u>Annualized</u>	
			<u>3YR</u>	<u>5YR</u>
PWM Equity Composite	-0.8%	+10.1%	+5.9%	+12.9%
PWM Equity Comp. Net of Typical Fee	-1.1%	+9.0%	+4.9%	+11.6%
S&P 500 Total Return	-2.2%	+6.7%	+2.8%	-3.2%
Lipper MultiCap Value*	-0.8%	+10.0%	+5.7%	+5.2%

*Lipper Multicap Index is after Management Fees. For Additional Performance Data See Page 4.

The Portfolio

There were a couple of changes to the portfolio this quarter. We initiated a position in **Unilever** (UL) at \$39.06. UL is a global food and household products maker. They have struggled with a ponderous corporate structure which was the result of many acquisitions over the years. They even have two corporate headquarters and, until last month, two CEO's! They have constantly underperformed their peer group and disappointed investors. The company does appear to be taking action to correct the long standing problems. A cost cutting program in recent years has helped but investors are unimpressed as there is so much more that needs to be done. In February, UL restructured the management team and now has a single CEO. This is another step forward. We think the company is moving in the right direction, but progress may continue to be slow. The stock seems modestly undervalued and appears to have low risk. We think a conservative fair value estimate is at least \$45. If UL fixes their problems and is valued by the market as highly as its overvalued peer Procter & Gamble, the stock could trade as high as \$66. In the meantime we collect a 3.3% yield. This stock may not offer huge upside, but the modest upside, the current yield, and the apparently low risk ought to provide us a return that beats the cash alternative.

We sold the last of our **Burlington Resources** at \$42.93 in January. As usual, we sold too early. It has continued to climb and now trades at \$50. As we have often said, we have no particular skill at guessing the timing of stock price movements. This is largely driven by investor psychology which can be volatile and impossible to predict. Instead, what we attempt to do is to estimate the 'fair value' of an investment as well as making a judgment about the risk level. In the case of Burlington the valuation was high enough at \$43 that it appeared to be discounting very high natural gas prices for many years into the future. While this may indeed happen, it appears to already be priced into the stock. At this point, everyone is aware of the relative scarcity of natural gas and oil and the projections for industry profitability are moving from 'too pessimistic' toward 'too optimistic'. (We see one analyst at a major brokerage now suggesting \$105 per barrel oil is a possibility.) The valuation is looking pretty high, and consequently the risk of disappointment also appears to be high and rising. Our judgments about valuation and risk can often lead us to buy too early (before a stock quits falling) and to sell too early (before a stock quits rising). Nonetheless, we believe that using valuation and risk to guide our decisions is a proven, prudent method of investing.

We trimmed our position in **Norfolk Southern** (railroad) again. We cut our position in half (to 1.8%) in January at a price of \$34.34. True to form, NSC now trades at \$37.2! While the P/E is only 16x, we think that is approximately a fair multiple for a mature, cyclical business such as a railroad. Furthermore, business has been quite good and the current earnings level may turn out to be at or near the peak for this cycle. Only time will tell. There is as much judgment involved here as there is math. However, in our view, as the P/E and earnings per share rise, the risk also rises.

Thinking About Risk

We believe that avoiding large losses is at least as important as achieving large gains. Risk management is at least as important as finding cheap stocks – arguably more so. A key to our historical outperformance has been that we didn't incur big losses in the 2000-2002 period. *(Sidebar: We cannot guarantee that we can avoid such losses in the future. The performance of this period was extraordinary and may be difficult or impossible to duplicate. What we can say is that we will continue to emphasize risk management in an attempt to avoid large losses in the future.)* We believe that our traditional value investing discipline, with its emphasis on a 'margin of safety', allowed us to identify and avoid the outsized risks in the market at that time. It is often hard to communicate an assessment of high risk when the daily market action appears to suggest otherwise. (How can the market be risky when it seems to rise nearly every day?) Benoit Mandelbrot, in his recent book The Misbehavior of Markets, argues that markets are riskier than standard economic theory (and most investors) assumes. Prices tend to move in somewhat stable trends, but are constantly assaulted by sharp, dramatic swings.

The extreme highs and lows of a price series are more important to an investor than are the averages. This is likely due to the ever present psychology component of investing (fear and greed). Investors are disproportionately impacted by extreme price highs and lows. At extremes, they overpay for good news and excessively discount bad news. Furthermore, investors may expect stable trends to persist, positioning their investments for same, and assigning no probability to extreme price movements. When such extreme price moves occur, the results can be devastating. It is our understanding that Long Term Capital Management collapsed, in part, due to this lack of preparing for extreme price movements. They apparently were betting on bond spreads, using historical averages as their guide. They did not prepare for the rare occurrences when normal bond spreads became extremely abnormal (the 100 year flood). Mandelbrot quotes John Meriwether, founder of LTCM, as saying: "Our whole approach was fundamentally flawed. With globalization increasing, you'll see more crises. Our whole focus is on the extremes now – what's the worst that can happen to you in any situation – because we never want to go through that again." Extremes do occur. And when they do, they often damage your portfolio all out of proportion to their frequency. Just because they are infrequent, that doesn't mean they can be ignored. Risk must be measured even when everything seems rosy. Risk doesn't erode your performance a little bit each day. When the loss comes, it comes all at once.

If you need further evidence of the perils of ignoring risk, consider this. The USA Today reports that the 50 hottest-selling mutual funds at the market peak in March 2000 are now down an average of 42%, five years later. Conversely, the 50 funds with the largest cash *outflows* at the market peak have gained an average of 21.4% in the last five years. The best sellers typically had the best trailing performance and thus attracted the most inflows. Investors saw large historical gains in certain funds, bought in with little regard for risk, and then suffered significant losses.

How This Relates to Return Expectations

This pattern of stability followed by dramatic instability is also closely related to how we expect our performance to look. We do not expect to outperform the market or peer group every day, week, month or year. It is more likely that there will be periods where we produce average/typical returns. Then the market will offer up a good opportunity. As value investors, we typically buy when the stock price is falling. And we typically buy too early. This may actually cause us to underperform in the short run! Then there may be an extended period when the stock muddles along with all the other average stocks and does nothing distinguished. Eventually, if our analysis proves correct, the problems, which caused the stock to be undervalued, will be fixed, investor expectations will rise, and the stock will likely move to fair value or above. This is the point where we begin to outperform. *Therefore, our ability to add value, to outperform, traces an irregular pattern through time. We don't expect to outperform by .01% each day. Whatever amount of outperformance we may achieve will most likely come in lumps. We believe that this is an important issue for you to understand. As we have said before, occasional short term underperformance may be a pre-requisite to achieving our stated goal of long term outperformance.*

Back to Risk

The Battle for Investment Survival is the title of another very interesting book written by Gerald Loeb. It has gone through at least 10 printings with the first being 1935. It is an intriguing title the likes of which you are not likely to find on many books published in recent years. Surviving in the investment world implies a landscape full of danger – a battle with an uncertain outcome. It implies that stocks aren't sure things that always go up. It is no coincidence that such a view was common in 1935, well into the Great Depression. We are all, to a great degree, a product of our own experiences. In the 1930's, most investors learned that investing in stocks can be very dangerous and should not be undertaken haphazardly. In the 1990's, many investors learned that stocks offered a sure path to easy riches. While stocks have come down from their peak in 2000, there still appears to be a tremendous amount of speculation with very little concern for risk. To repeat, continuous risk management is critical to long term investment 'survival'. We intend to continue our efforts at limiting our risk of permanent capital loss, even when it seems that others are more concerned with the risk of missing the next move up in prices.

We greatly appreciate your business. Please let us know if there is any way we can better serve you.

Sincerely,



Clayton Bryan, CFA
Principal



Doug Manz, CFA
Principal

**This letter is for informational purposes only. Nothing contained herein shall be construed as an offer or recommendation to buy or sell individual securities. Data has been obtained from sources believed to be reliable but there can be no guarantees concerning errors or omissions.*

Performance

Year	PWM				Total	Percentage	Percentage	Total
	Total Return	S&P 500 Return	Number of Portfolios	Composite Dispersion	Composite Assets	of Firm Assets	of Non-Fee Paying Assets	Firm Assets
7/31/97- 12/31/97	+3.5%	+2.4%	1	0	\$ 70,119	100%	100%	\$70,119
1998	+3.5%	+28.6%	1	0	\$93,063	100%	100%	\$93,063
1999	+15.8%	+21.0%	1	0	\$141,482	100%	100%	\$141,482
2000	+16.1%	-9.1%	1	0	\$199,036	100%	100%	\$199,036
2001	+23.5%	-11.9%	1	0	\$198,956	100%	100%	\$198,956
2002	-0.45%	-22.1%	21	.018	\$2,440,046	55%	13%	\$4,409,101
2003	+13.6%	+28.7%	23	2.74	\$2,809,827	47%	19%	\$6,005,821
2004	+14.8%	+10.9%	26	2.7	\$3,643,085	32%	10%	\$11,405,558
YTD 2005	-.8%	-2.2%	24	.85	\$3,239,039	28%	11%	\$11,616,225

Prudent Wealth Management LLC has prepared and presented this report in compliance with the Performance Presentation Standards of the CFA Institute (formerly known as the Association for Investment Management and Research (AIMR-PPS®)), the U.S. and Canadian version of the Global Investment Performance Standards (GIPS®). The CFA Institute has not been involved in the preparation or review of this report.

Notes

1. Past performance is no guarantee of future results. Data has been obtained from sources believed to be reliable but there are no guarantees concerning errors or omissions.
2. The Firm is defined as Prudent Wealth Management LLC, a Registered Investment Advisor established in 2001. PWM specializes in managing separate, equity based portfolios for individuals. Prior to the creation of Prudent Wealth Management LLC, the Firm is defined as Mr. Bryan's sole account covering the period 7/31/97-09/30/01.
3. Performance has been calculated using time weighted rates of return adjusted for cash flows. Returns are calculated monthly and are linked geometrically. Trade date accounting is used.
4. Capital gains in the amount of \$20,649.54 are included in the performance for the year 2001. These gains resulted from investments in a mutual fund designed to profit from a decline in the NASDAQ 100 index. Investments designed to benefit from stock or index declines are not expected to be used in the future.
5. The composite was created on 12/31/02. A complete list and description of all of the Firm's composites is available upon request.
6. The dispersion of returns is measured by the standard deviation across equal weighted portfolio returns represented within the composite for the full year.
7. Portfolios in the composite range in size from \$29,924 to \$277,873.
8. Performance is reported before management fees but after all commissions. Fees are described in Form ADV Part II. The Client's return will be reduced by the management fee. A representative example of the impact of the standard 1% management fee is as follows:

Period	Annualized Total Return	
	Gross of Fees	Net of Fees
1 YR	+10.1%	+9.0%
3YR	+5.9%	+4.9%
5YR	+12.9%	+11.6%
ITD	+10.5%	+9.4%