



Prudent Wealth Management LLC

Investment Management and Financial Counseling for Individuals

To Our Fellow Shareholders,

September 30, 2004

	<u>YTD</u> <u>2004</u>	<u>1YR</u>	<u>Annualized</u> <u>3YR</u>	<u>5YR</u>
PWM Equity Composite	+9.5%	+18.2%	+8.2%	+11.2%
PWM Equity Composite Net of Fee	+8.7%	+17.0%	+7.1%	+10.1%
S&P 500 Total Return	+1.5%	+13.9%	+4.1%	-1.3%
Lipper MultiCap Value*	+4.0%	+17.7%	+7.0%	+4.8%

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

If you have been reading our newsletter for any length of time you know that we have been somewhat bearish. We are not top-down investors who look at the economy or charts or some other macro data and conclude that we should be in or out of stocks. We are concerned about stocks in general because we have a difficult time finding any individual stocks that look attractive to us. The main problem we find is high valuation. In our view, most of the stocks we look at are simply too expensive. Let's look at a recent example. The Coca-Cola (KO) company has been in the news recently. It has delivered bad news to investors and the stock price has fallen significantly. We like to see the price of a 'good company' get cheaper because that may offer us an opportunity. However, KO is still not cheap even though the price of the stock is down 27% from its recent high. At a recent \$41, the stock is trading for a heady 20.5x its estimated earnings for 2004. Longtime readers will also remember that we hold financial history in high regard. And by historical standards, we consider 20.5 times earnings pretty darn high. That tells us that, even with bad news and a lower stock price, investors likely have some pretty high expectations of KO. The future performance of the business, and growth in earnings, had better be good or investors will be disappointed and the stock could lose a material chunk of its value. To us, a higher valuation means higher risk. And we don't like excessive risk. We prefer the opposite scenario where investors have become completely discouraged about the future prospects of a particular company and have sold the stock down to the point it becomes undervalued. This gives us some protection, albeit not total, from future disappointments and, should business improve, investors will be likely to pay more for the stock in the future. So we propose KO as a good example of how hard it is to find attractive investment opportunities. Even companies that encounter trouble and find their stock price under pressure, often still sell at too-high valuations.

KO is a good example in another respect. A 'great company' does not always make a 'great investment'. KO has long been considered a 'great company'. Warren Buffet is a big fan, and long time shareholder, because of KO's competitive advantages. However, the stock has been a poor investment for quite a long time. Today it sells for less than

half of its all-time peak price of \$89 reached in 1998. The stock has been falling for 6 years! A disappointing stock performance for a company that was once considered one of the best out there. There are at least two lessons here. First, a great company can change. Management can make mistakes. Prices can be raised too high. Competitors can take market share. Consumer trends can change. There are a million things that can negatively impact a company's financial performance. Therefore it is risky to project current trends too far into the future. There are many companies that were great in their day but are no longer in business. A great company does not automatically equate to a great investment. The second lesson is that you can overpay for anything. There is a price that is too high for even the best company in the world. At the peak in 1998, KO was selling for 54 times previous twelve months earnings! That is very high by nearly anyone's standard. But investors felt that it was worth the premium because it was such a great company with the best management and the finest future prospects. 'Sure it's expensive, but you get what you pay for' the buyers might have said to justify their purchase at the time. However, when everybody recognizes the special nature of the firm it is likely to be fully reflected in the price. At this point, investors expect great things. If the future is less than great, the stock will be punished, as it has been. If the future is just as great as it was expected to be, the stock will likely not do much because such performance was calculated into the price when making the decision to buy the stock. Consider that during the period from 1994-1997, when the company was highly regarded, earnings per share rose 66% while the price rose 274%. During the period 1997-2003, as the company fell from favor, earnings grew 19% but the price fell 51%. The important point here is that the fantastic investment returns are made when the company reputation is morphing from 'just average' to 'great'. Those who bought the stock *before* the company was considered great made all the money. Those who bought *after* the company was widely recognized as great took all the pain.

Even in a market where most stocks seem too expensive, we continue searching for bargains. Occasionally we find attractive investment opportunities. During the quarter we initiated a position in **Interpublic Group (IPG)**. This is an advertising company that was once viewed much more positively by investors. After lots of problems in the last couple of years it has become a good bargain. Investors have been disappointed so often that their expectations are now very low. And yet things are improving. There is a new management team. They have scaled back their rapid acquisition approach, shed non-core businesses, and re-focused the company on growing revenues internally. The balance sheet has been dramatically improved. Debt, net of cash on hand, has been brought down to a very conservative level. We think the new management team is on the right track. In fact, they have shown some modest improvement in internal revenue growth already. When the restructuring is finished and the economy has stabilized, the stock ought to be worth at least \$18-\$20 but can be purchased today for \$10.90.

Miscellaneous Quotes

The Wall Street Journal published a story on Jean-Marie Evillard in its 10-4-04 edition. He is an excellent mutual fund manager with a value style. After giving him a lifetime achievement award, Morningstar's Don Phillips said "*He's focused on not losing money and building gains over time...It's a wonderful way to manage money but not a common*

one, unfortunately.” With condemnation for the current state of the investment industry, Evillard states “some gave in to the temptation to stop being a fiduciary of customers’ assets and started becoming asset-gathering machines.”

Which takes us to this piece from the Wall Street Journal of 8-2-04:

Headline- SEC is flooded with mail on scandal and proposals to clean up the fund industry. “Some in the industry are discussing whether funds should require their managers to own shares in their own funds on the theory that it is a good thing for managers to eat their own cooking.” Long time readers will know that we agree wholeheartedly. We have always believed that investing alongside our clients helps to align our goals and our clients’ goals.

Since real estate continues to be everybody’s favorite subject...

From Bloomberg 8-2-04: “Japanese land prices decline for 12th year in 2003”...

“Tokyo’s condominium prices, down one-third since 1990....” *What’s this? Real estate can fall?*

From the Wall Street Journal 9-14-04:

“Bonds backed by America’s shoppers now represent about 32% of the U.S. bond market, if the vast mortgage-backed securities market is included. That compares with 29% for U.S. government and agency debt and 20% for corporate debt...” It seems there really is a large amount of consumer debt out there. At some point, consumers will have to stop spending more than they earn.

We want to thank you for your business and assure you that we will continue to watch over your money as carefully as we watch our own.

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	S&P 500	Number of	Composite	Composite	of Firm	of Non-Fee	Firm
	Return	Return	Portfolios	Dispersion	Assets	Assets	Assets	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
YTD 2004	+9.5%	+1.5 %	26	1.3	\$3,454,795	44%	16%	\$7,793,308

Prudent Wealth Management LLC has prepared and presented this report 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 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 \$29,544 to \$268,414.
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	+18.2%	+17.0%
3YR	+8.2%	+7.1%
5YR	+11.2%	+10.1%
ITD	+10.6%	+9.6%