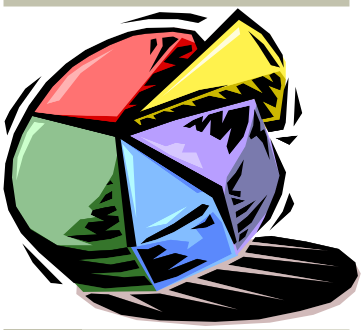
November 2005



“...EFFICIENT PORTFOLIOS FOR RATIONAL INVESTORS.”

TD Capital Management LLC

The Leaky Valve

Dear Clients and Friends:

It’s a great life. I was between a couple of things last Friday (28 October) and had a few minutes for a non-fat latte at a local Starbucks. The stock market had “stunk” for the month-to-date, and I felt compelled to write you a comforting reminder that long-term investors expect interim bumps along the road and that October 2005 was indeed one of those bumps. After scribbling a few paragraphs, I looked at my new handy-dandy cell-phone / Internet access device and noted that the cantankerous equity market was in the middle of a very significant increase. The increase continued for the rest of the day on Friday and seems to be continuing through the last day of the month – All Hallows Eve.

The reason for the angst about last Friday and Halloween Day is not that I think October or July or any other month, week, day or even year is significant for long-term investors. It’s rather that at the end of every month the custodian of your money (Fidelity in most cases) stops for a few minutes and prepares statements for your information and review. On the months when the markets have been up, everybody feels good. On the months when the markets have been down, everybody feels a little knot in their stomachs. Thanks to the little run-up on Friday and Monday, the October statements will look a little better (and the stomach knots will be a little smaller) than it seemed when I sat down for my latte last Friday.

That knot (small or large) is a very human, appropriate, internal (or gut) response to an extremely important concept - risk. In this case, the response is related to the risk that negative returns or market valuations may not be temporary and that the investment component will not provide the funds necessary for us to meet our financial objectives.

So, what about this whole idea of risk? I’ve been doing a lot of my 4 a.m. reading about risk and its history and the related arithmetic, and that’s what I wanted to write to you about anyway. The big Halloween fright that turned into a hiccup isn’t really the subject of the message that I was hoping to send you.

To a great extent, what I (and the smart folks I work with) do around here is help you manage your risk:

- We remind you that diversification is, on a risk-adjusted basis, preferable to putting all your eggs in one basket (exposure to non-systematic risk).
- We construct and manage your portfolios in such a way that your scheduled or anticipated cash needs (and an appropriate “fudge”) are not exposed to normal but uncomfortable downside equity volatility (liquidity risk).
- We keep a very close eye on your macro and micro tax situations in order to integrate your portfolios, plans and tax pictures to avoid unnecessary tax costs.
- We pay constant attention to the costs associated with construction, management and maintenance of your portfolios in order to avoid what we like to call “silly” taxes or costs.

Interestingly, I think, the essence of efficient and appropriate portfolio management is the manipulation of various and sundry risk elements. We seek to enhance the expected or potential returns of the portfolios under our care while recognizing the potentially harmful downside of not recognizing certain risks. We can control for those risks that can be mitigated or used to advantage by paying attention to detail, integrating the total financial picture, diversification, and long-term investing. We must also be aware of risks that cannot be put under control—these must be considered and accounted for with controlled spending, appropriate expectations, and a few little “fudges” inside the portfolios.

The scientist who developed the Saturn 5 rocket that launched the first Apollo mission to the moon put it this way: “You want a valve that doesn’t leak and you try everything possible to develop one. But the real world provides you with a leaky valve. You have to determine how much leaking you can tolerate.” (Obituary of Arthur Rudolph in the NY Times, 3 January 1996). *A little leak is significantly less important and costly if we recognize its potential existence and plan accordingly. Remember, no valve (leaky or not), no trip to the moon.*

We’ll be studying and writing you more about this whole concept of risk and management over the next few months – meanwhile we’ll stay focused on you and your portfolios and your needs and the risks associated with your financial lives. You – keep us informed.

May God Bless,

Doug

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