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TO: All clients and interested parties

FROM: Bob Kargenian

This quarter, we're touching on what it means to be a fiduciary (and examples to the contrary), another example on investor behavior, perceptions and change and adaptation, long-term returns and retirement planning, performance, and an update on some administrative matters (the mail and our website).

**What Exactly is a Fiduciary? (and why it's important you know)**

The Webster's Dictionary defines the term "fiduciary" as "of a confidence; holding in trust." A Financial Advisor held to a Fiduciary Standard occupies a position of special trust and confidence when working with a client. As a fiduciary, the Financial Advisor is required to act with undivided loyalty to the client. This includes disclosure of how the Financial Advisor is to be compensated and any corresponding conflicts of interest.

TABR acts as a fiduciary for its clients, in its role as a fee-only registered investment advisory firm, and I was in that same role at Prudential Securities/Wachovia from late 1991 to the time I left in February 2004.

I bring this up in light of a recent court ruling against the SEC, and to educate you. I can assure you, most investors do not know this information, and unless informed, would not know to ask.

The recent court ruling struck down what is known as the "Merrill Lynch Rule," a rule under the 1940 Investment Advisers Act ("the 1940 Act"), the federal law created to regulate the actions of investment advisers. Financial advisers employed in retail brokerage firms (Merrill, Smith Barney, Morgan Stanley, Wachovia, Fidelity, Schwab, etc) are **NOT** considered fiduciaries. Many of Wall Street's biggest firms have decided not to register as advisers under the 1940 Act, and under the Merrill Rule, the SEC has allowed such firms to provide investment advice without having to comply with fiduciary standards—until now.

Would it surprise you to learn that these financial advisors (and therefore his/her brokerage firm), puts their bottom line ahead of the interests of their customers? Whether it is disclosed or not, that is what an investor gets from retail brokerage. I should add that insurance agents and representatives from banks are also rarely held to a fiduciary standard. There is a lack of transparency from this area of the financial services industry, especially connected with the sale of annuity contracts and 403(b) plans to the elderly and educators. Have you ever purchased a life insurance contract, or an annuity, and had the

representative disclose to you in writing how much they were making in commissions?  
Good luck.

Let me give you an example of how a fiduciary is **Not** supposed to act. At Wachovia, my former firm, I still maintain a couple of Education IRA accounts for my kids. Back in 2003, during the merger, management eliminated the Prudential moneymarket funds as the core cash component in client accounts, and made the default a bank deposit sweep option. For an analogy, all brokerage accounts have a core cash fund—this is what is used to pay checks, debits and purchases. For our clients, we use Fidelity Cash Reserves in retirement accounts and Fidelity Municipal Money Market in taxable accounts. The 7-day current yield on these two funds, as of August 1 was 4.99% and 3.27%(federal tax-free), respectively.

In comparison, the rate on the bank sweep account at Wachovia was 1.13% as of June 30. Another “option” available to Wachovia clients is the Evergreen Money Market Class A, which had a yield of 4.51% as of July 27. Unfortunately, it is not so easy to make this the default option. If you want your deposit to go into the higher yielding fund, the advisor must write a ticket each time, and the client is charged \$7 to buy and another \$7 to sell. That is not practical, nor is it cost effective. The firms knew this, when they set things up this way. So, guess what? Most accounts, by default, stay in the bank sweep, earning about 3% less than they should be. Where does that money go? Right to the bottom line of Wachovia. If there is \$4 billion in their bank sweep accounts, that is \$120 million of profit annually, and that doesn’t even count how much they can make from lending the money(which they cannot do with a moneymarket fund).

Please note I’m not picking on Wachovia. They were actually about the last major firm to implement this type of program. Merrill Lynch was the first many years ago, and all the rest have followed. This is just one example of how major Wall Street firms put their interests ahead of their clients. We are the exact opposite.

That is not to say that all financial advisors at retail broker/dealers are untrustworthy. Many of them, in fact, are very competent. But they are not held to the **fiduciary** standards that govern RIA’s(registered investment advisers), and I would estimate that out of the approximate 60,000 financial consultants at the biggest five retail firms, fewer than 5% of them are capable of managing money. That is why you see very few discretionary accounts in the hands of these financial advisors. How do I know this? Because I worked on that side of the industry for 22 years, seeing it in person every day. Please remember the following about our firm.

All of our compensation is fee-only and disclosed in writing, and we receive no commissions or transaction fees for the sale of any investment products(mutual funds, securities transactions, life insurance, etc). We also receive no referral fees of any kind for sending you to a qualified estate attorney or CPA. All of the mutual funds we invest in for clients, and the securities we purchase in Wrap accounts are done so with the best interests of our clients in mind, and to back it up, all of our personal money is invested in the exact same manner. We have **Significant** skin in the game.

So, when one of your friends starts bragging to you about how their advisor did for them last year(**like that is really meaningful**), you'll now be educated to ask them back things like "how have you actually done over the last 8 years, in a full market cycle, and how much risk did you take and what was your allocation, and by the way, is your advisor a fiduciary?" The chances are, you won't get many answers, because the truth is, your friends really won't know. Too bad for them.

### **Investor Behavior(Again)**

As I have pointed out many times in these pages, one of the most important determinants of investor performance(some would argue it is the SOLE determinant) is investor behavior. So, take a look at the little quiz I've developed below, and then ask yourself which of the three money managers you would have liked to have your hard-earned cash invested with.

#### **Time Period                    12/31/99 to 12/31/02**

Manager A	15.0%	compound annual return
S&P 500 Index*	-14.6%	

#### **Time Period                    12/31/02 to 12/31/06**

Manager B	8.6%	compound annual return
S&P 500 Index*	14.7%	

#### **Time Period                    12/31/99 to 12/31/06**

Manager C	12.38%	compound annual return
S&P 500 Index*	1.18%	

\*includes reinvested dividends

Most investors would look at the above and say, "I want Manager A and Manager C, but I'd probably fire Manager B." Mind you, that is just in looking at the returns—I haven't even touched on the risk part yet.

Well, guess what? These are not only REAL numbers, but Managers A, B and C are actually the SAME manager, none other than John Hussman of the Hussman Strategic Growth Fund\*. As a matter of disclosure, we own this fund in virtually all actively managed accounts, totaling some \$4.3 million in market value.

The lesson here is that you must evaluate a manager or strategy over a FULL market cycle(bull and bear market), and you must take into account how much RISK is being taken. There are lots of money managers who post impressive numbers when the market is going up, but what good is that approach if most or all of the gains are given back in a bear market?

I should add that Hussman has achieved the above with less than an -8% drawdown, while the S&P 500 was down nearly -40% at its worst level. If an investor is only looking at returns, without the consideration of risk, they are missing half of the equation. And sadly, most with that attitude will likely never get it, at least not until they've lost their collective shirt(or another description which rhymes with MASS).

### **Perceptions, Change and Adaptation**

In the 1990's, as word spread of our expertise in trading mutual funds, our practice grew quite steadily, and the primary focus was that of investment management. Fortunately, during the bear market, our risk management models and allocations performed well. For the time period 2003 to 2006, we've lagged appropriate benchmarks (much like Hussman, above), but that is not at all unusual since the stock market has not experienced a 10% or greater decline in nearly five years.

For the entire cycle of 2000 to 2006 or even 1999 to 2006, looking back we believe that our recommendations have performed well, especially when risk is taken into account. My point is not to talk about our performance, which we believe speaks for itself, but rather to emphasize some of the changes we have made in our practice. Not only have we adapted to a major change in the mutual fund industry, but we've become extremely knowledgeable in the area of IRA distribution planning as many of our clients are transitioning from the accumulation phase of their lives into the withdrawal stage. As a natural process of all of us getting older (I turn the magic 50 in November), we've had the unfortunate experience of seeing 15 of our clients pass away in the past 24 months or so. These are people we care about and in many cases have become close to.

The upside of that experience is that we've become experienced at advising and organizing all of the financial affairs for surviving spouses and their families, and making sure that distributions and transfers and trust administration are all done properly. Just last week we spent over 3 hours with a client whose husband had recently passed away. During our meeting, we made phone calls to the Social Security Administration to clarify her benefits, to her husband's employer to verify pension benefits and COBRA medical coverage and to an insurance company to get the proper forms to file a death claim.

We are in the process of putting this all together and working with the estate attorney on trust assets and administration, and in the end we'll be able to show our client a plan with various components that will generate adequate income for her to live comfortably the rest of her life, not to mention properly passing remaining assets to her children when she is gone.

We do not charge fees for any of this. It does not mean that we do it for free. Eventually, this work leads to investment management, which we think we're pretty good at as well, and we've made a business decision that the fees we charge for assets under management also cover work such as this, and other retirement planning work that we do.

So, if your perception is still that "the guys at TABR manage my IRA or my trust," you're only partially correct. And you would be missing out on some of the most important services we provide.

With every new relationship and most existing ones, we cover estate planning, life insurance, retirement planning AND investment management. They all go together. Don't think I'm trying to de-emphasize the investment management slice. I'm not. It is the most enjoyable part of the business for us. But, if the rest of the pieces are not in place, good or even great investment management will not matter.

You would be shocked at how many people who have significant net worth (in the multi-millions) have no estate plan, or how many spouses who have children and significant incomes have little or very inadequate life insurance coverage. Unfortunately, some of those people are our very own clients. However, we learned a long time ago you can only help people who want to be helped. And that is who we concentrate on.

Now, you should know even more about what we do here at TABR. If you're not utilizing our expertise in these other areas, perhaps you should consider doing so. Believe me, it is nice to show a client that their money with us beat their benchmark by 200 basis points a year for the last 8 years (with less risk). But it is even nicer to know that all of that clients' plans are in order in case the unexpected happens, and that if they just follow the plan of saving and letting our disciplined risk management work, they'll have a very comfortable retirement. That's what it's all about, isn't it?

### **Long Term Equity Returns(in Retirement Planning Today)**

Since November of last year, we have produced long-term retirement planning projections for 41 of our client households. Even from our clients who are already retired, we are receiving great feedback from this process. It is our goal to get through our entire client list within the next year, as we hold annual meetings/reviews with various clients.

Within this process, one must make certain assumptions about the future in regards to inflation expectations and investment returns. In our opinion, it is more prudent to be conservative about future returns than not, since if we can show a client that they can meet their goals for retirement income by achieving those returns, it allows them to be more comfortable from a risk standpoint. For instance, wouldn't you feel better if you knew you only needed to earn 5% a year over the next 25 years, instead of HAVING to earn 8% a year, in order to live comfortably and not run out of money?

In most plans, we are using 5.5% investment returns and 3.5% for inflation. For the purposes of this illustration, we're assuming a moderate risk account that has allocated 60% to equities, and 40% to fixed income. PLEASE NOTE—this is not a forecast of how we think we are going to do. It is pretty much impossible for anyone to accurately project how equity and fixed income returns will turn out for the next 25 to 30 years.

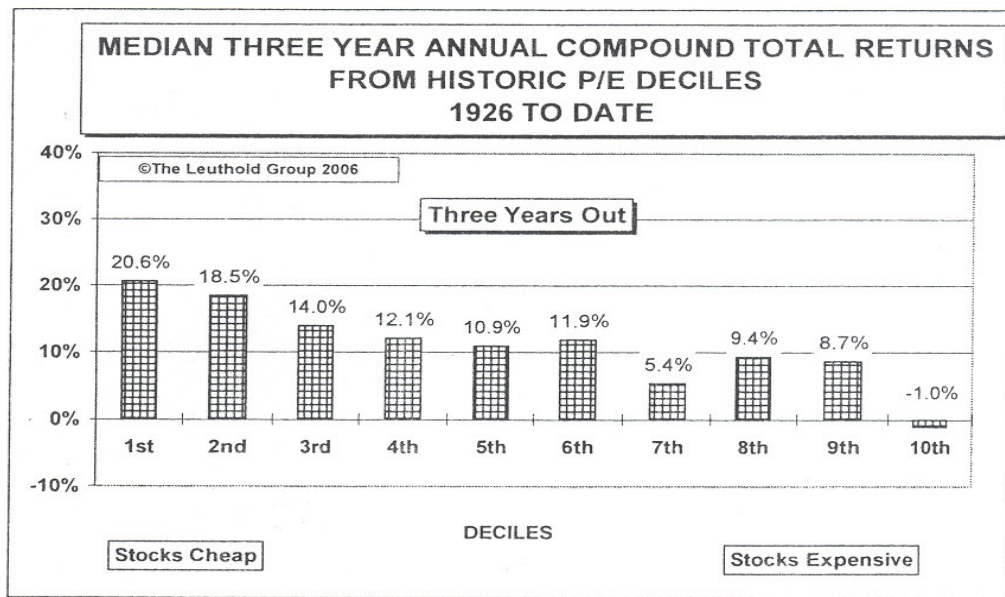
However, when you narrow the time period down to 5 to 10 years, there are certain valuation techniques that can produce a range of likely returns, and that is what I'd like to share with you.

First, on the fixed income side, the 10-year Treasury Note currently stands at about 4.8%. So, you can't exactly assume you are going to earn 8% from your bond allocation. Yes, with the recent selloff, yields on junk bonds have increased to about 8% after expenses, but that would still be an aggressive assumption, and one we're not comfortable making.

On the equity side, the equivalent of yields for bonds are price/earnings ratios for stocks. Both Steve Leuthold of the Leuthold Group and John Hussman of the Hussman Strategic Growth Fund have done extensive research on stock valuations. In the chart below from

Leuthold, you see the three-year compound returns, based on the starting point of normalized P/E valuations.

For instance, if P/E's are in the 6<sup>th</sup> decile, the past has shown (going back to 1926) that future 3-year compound returns have averaged 11.9% (that is pretty good). The current picture is mixed, as the S&P 500 is in the 9<sup>th</sup> decile, where returns have averaged 8.7%, including reinvested dividends.



The bad news is that when Leuthold extended their study to include 3000 stocks, which is most of the U.S. market, valuations are currently in the 98<sup>th</sup> percentile, implying a negative return going out three years. This is backed up by current data, which show that small and mid-sized companies are much more over-valued than large companies.

Rather than bore you with the details of Hussman's work, I'm simply going to summarize his findings. He is extremely thorough, so if you are really interested in the details, simply go to his website at [www.hussmanfunds.com](http://www.hussmanfunds.com) and read the July 16, 2007 weekly comment.

According to Hussman, "the probable total return on the S&P 500 over the coming decade ranges between -4% and 5% annually, with the most likely outcome in the low single digits. The current implied value of 0.14 for the log gross total return still converts to an expected 7-year total return of **4.71% annually.**" He goes on to add that "it's not useful to attempt to forecast specific **short-term** market outcomes, but valuations have an enormous and reliable impact on **long-term** outcomes. Investors ignore evidence like this at their peril."

As always, I am not trying to be gloomy here, but rather prudent and truthful. The crap you see on CNBC is mostly useless—financial cheerleading if you will. Remember my comments last quarter about patience. Many people remember the 80's and 90's when

stocks compounded at 16%, and they may long for that. But how many of you realize that in the 60's and 70's, stocks compounded at between 4% and 6%, and a good portion of that was dividends? For the past 8 years, the Vanguard Total Stock Market Fund has compounded at 4.38%. Who knows—we may be in for 12 more years of that.

The numbers I'm quoting, by the way, are passive, buy and hold numbers. There are no guarantees, but with our equity allocations, we know that if we can beat buy and hold returns by 200 basis points annually over time, **with less risk**, we'll be doing a pretty good job.

By the way, I recognize that a handful of clients are predisposed to seeking aggressive returns. We do have methods that will cater to that, but realize that with greater returns comes greater risk, or drawdown. Not many people have the stomach for that, but know that it is available.

### **Performance**

Below is the performance, net of management fees, of five real-time portfolios we are tracking. These represent a majority of the strategies we are using in client accounts, but not all. The differences are mainly attributed to risk(example—moderate allocation versus conservative allocation or aggressive) and account size. The numbers are for the first six months of 2007, through June 30.

<b>Type of Account/Strategy</b>	<b>YTD</b>	<b>Benchmark</b>
TABR IRA(Moderate Risk)	+4.97%	+5.48%*
TABR Stock Wrap Account	+9.50%	+7.50%**
TABR OEX Relative Strength	+10.43%	+ 5.90%(S&P 100)
TABR D.A.L.I. Account	+5.79%	+5.48%*
TABR Passive Allocation	+7.44%	+5.48%*
Vanguard Total Stock Index		+ 7.50%
Vanguard Total International Stock Index		+ 11.9%
Vanguard Total Bond Index		+ 0.8%

\*consists of 45% Vanguard Total Stock Index, 15% Vanguard Total International Stock Index and 40% Vanguard Total Bond Index

\*\*Vanguard Total Stock Index

### **Returns shown are net of management fees, and include reinvested dividends**

As you can see, we are beating the appropriate benchmark in every category, with the exception of the IRA (Moderate Risk) account, which is very close. What you do not see in the above, nor do you see it in your personal performance summaries which are mailed each quarter, is our average equity exposure. Benchmarks assume a fully invested position at all times—you get all the upside, and all the downside. Our average exposure for equity allocations during the first seven months was 80%, meaning we took about 20% less risk, yet did pretty well.

I'd also like to mention that we are introducing a Managed Bond portfolio, and you'll begin to see its results posted above beginning next quarter. This will be a pure bond account, with a combination of a core bond fund and our tactical active approach which combines high yield corporate funds with short to intermediate term government funds.

This portfolio is designed for taxable money with a short term time horizon(1 to 5 years), where the investor wants to do better than cash equivalents, but with very limited downside risk. It will not be used with retirement accounts, where the time horizon is much longer and where, in my opinion, some equity exposure is mandatory. Basically, this is for “bank” money that won’t be touched for awhile. The management fee for this account will be discounted to 0.50% annually.

### Administrative News

The additional features we are adding to our website at [www.tabr.net](http://www.tabr.net) are almost ready to go live, and should be available by the end of August. We’ll make a short announcement via email to everyone on our email list.

Second, we are making some progress on the mail front with Fidelity, but have discovered there are problems with their email notification service. For instance, after signing clients up through Fidelity.com, you would expect to stop getting prospectuses in the mail from Fidelity mutual funds. That has not been the case.

After pressing further with management, we found that if Fidelity cannot send an email notice for whatever reason(technical difficulties, etc.), to cover their backside, they will have a prospectus mailed. **The problem is, this is happening 60% of the time.** We have told management this is unacceptable, and they agree, and have escalated the issue, but they cannot tell us when it will get better.

Finally, when we printed our business cards back in 2004 when forming TABR, we forgot to put our cell phone numbers on the cards. Some of you have our numbers, but I know many do not, so if you need to reach us during off hours or on a weekend, they are listed below.

Bob Kargenian	714-307-7946
Steve Medland	949-689-6201

Just so all of you know, about once per month, all four of us leave for a staff lunch around 1 pm, and are typically gone for an hour and a half. So, don’t panic if you get voice mail for all of us. We’ll call you back as soon as we return. As a matter of habit, my cell phone stays in my car unless I am traveling, and sometimes on the weekend, I may not check it for a day. During the week, I’m either at my desk, out locally seeing clients or traveling.

As always, thank you for your trust and confidence in our team.

Best regards,



Bob Kargenian, CMT  
President/Principal

TABR Capital Management, LLC("TABR") is an SEC registered investment advisor with its principal place of business in the state of California. TABR and its representatives are in compliance with the current registration requirements imposed upon registered investment advisors by those states in which TABR maintains clients. TABR may only transact business in those states in which it is registered, or qualifies for an exemption or exclusion from notice filing requirements.

This newsletter is limited to the dissemination of general information pertaining to our investment advisory/management services. Any subsequent, direct communication by TABR with a prospective client shall be conducted by a representative that is either registered or qualifies for an exemption or exclusion from registration in the state where the prospective client resides. For information pertaining to the registration status of TABR, please contact TABR or refer to the Investment Advisor Disclosure web site([www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov)).

The TABR Model Portfolios are allocated in a range of investments according to TABR's proprietary investment strategies. TABR's proprietary investment strategies are allocated amongst individual stocks, bonds, mutual funds, gold and other instruments with a view towards income and/or capital appreciation depending on the specific allocation employed by each Model Portfolio. TABR tracks the performance of each Model Portfolio in an actual account that is charged TABR's investment management fees in the exact manner as would an actual client account. Therefore the performance show is net of TABR's investment management fees.

Comparison of the TABR Model Portfolios to the Vanguard Total Stock Index Fund, the Vanguard Total International Stock Fund and the Vanguard Total Bond Index Fund is for illustrative purposes only and the volatility of the indices used for comparison may be materially different from the volatility of the TABR Model Portfolios due to varying degrees of diversification and/or other factors.

Past performance of the TABR Model Portfolios may not be indicative of future results and the performance of a specific individual client account may vary substantially from the composite results above in part because client accounts may be allocated among several portfolios. Different types of investments involve varying degrees of risk, and there can be no assurance that any specific investment will be profitable.

For additional information about TABR, including fees and services, send for our disclosure statement as set forth on Form ADV from us using the contact information herein. Please read the disclosure statement carefully before you invest or send money.

\*The selection of the Hussman Strategic Growth Fund is not an endorsement or solicitation to sell this security. Nor is it being listed as the favorite of TABR. The purpose is to inform and educate the reader as to important characteristics that TABR uses in selecting a manager or strategy.