

Dear

Money is important. Economists and psychologists still fight about whether money makes us happy, but having it is clearly better than the alternative. Next to your health and family, paying attention to money in this life is a high priority.

How is money accumulated? Lots of ways, but for most of us the vehicle is saving part of what we earn. Make yourself live below your means and set up a systematic savings plan. Pay attention to the “latte” factor – eliminate those unnecessary daily expenditures that add up over time. Bank the savings. Be smart about the big expenditures like the type of car you drive. Use higher deductibles with lower premiums on insurance for cars, home, or health, etc. Stay out of credit card debt. Be a smart consumer. Don’t waste your money – save it.

Compounding is the royal road to riches. It takes time and requires perseverance, but it works and anybody can play. Compounding works with money market funds, bonds, real estate, stocks, or preferably, balanced portfolios with a combination of these asset classes. The attached chart shows two examples of how saving and compounding can add up over time at a theoretical 10% per year growth rate. Notice that the examples stress the truth that the early bird gets the big nest egg. All this may sound boring and may curtail some retail therapy, but compounding over time will build a nice pool of investment funds. Start early, and let the magic of time and compounding do the heavy lifting. You need to depend on yourself rather than Social Security or a company pension plan for financial security.

Investment markets have few set rules, but here are some common sense guidelines that we believe in:

- There is a high correlation between good long-term performance and error avoidance.
- There will always be bull and bear markets. Capital protection on the downside is more important than top upside performance.
- Have a plan and stick to it. Avoid market timing.
- Have a bias towards equity investments, but be psychologically prepared for the inherent volatility. It is better to be an owner than a renter.
- Diversify, diversify, and diversify. Spread out by asset classes, within asset classes, and by sectors and themes. Watch out for large concentrations of capital. Diversification is the primary tool for risk control.
- A major part of diversification is asset allocation – the mix of cash, bonds, stocks, and real estate in a portfolio. The mix that has worked over time that many recommend is two-thirds in equity assets (real estate and stocks) and one-third in cash and bonds. Balanced portfolios reduce volatility to levels most investors can tolerate while still allowing significant participation in the equity markets.
- Mistakes are part of investing. Be mechanical, strict, and non-judgmental about cutting losses.

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- Focus on the long-term. Short-term trading is a loser's game. Don't chase fads. When America is talking stocks, buy real estate. When America is talking real estate, buy stocks.
- Invest tax-efficiently. Minimize payments to the government.
- Make decisions and act on them. Investing is never all green lights. Uncertainty is normal.
- Wait for a fat pitch and pay attention to price. Be a bargain hunter. Buy in worried times. Buy when you are terrified, sell when you are satisfied.
- The Chinese have a proverb – "out of chaos comes opportunity." When your emotions say sell, sell, sell, consider buying.
- Don't overreach for yield. More money has been lost reaching for yield than at the point of a gun.
- When managing your "mother lode," stay away from leverage.
- Today a peacock, tomorrow a feather duster. Emotions are your enemy in investing – control yourself. Overconfidence, pride, envy, and the emotional reassurance of being with the herd all lead to investment errors. Investors overpay for comfort, excitement, and sex appeal.
- Don't put trust in the opinions of others or the last person you talked to. Do your own analysis and follow your own intuitions. Be patient and do not demand too much too soon.
- There is no free lunch. Risk and return are correlated. Surprise is endemic to the financial system. Investors should place risk management as the dominant tool for success in investing.
- Nothing is forever – fewer than 10% of the companies included in the Standard & Poor's 500 in 1957 are in the index today. Change happens so be prepared for shifts in the relative fortunes of even America's leading companies.
- Spend income, never principal.

This is all you really need to know. Money is a perishable commodity, it is important, so pay attention. Floss, use sunscreen, be positive, and be nice to investment managers in down markets.

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Love,

THE MAGIC OF COMPOUNDING

One of the easiest and surest ways to get rich is to utilize compounding. The table below shows two investors. The first investor invests \$2,000 in an IRA for just eight years for a total investment of \$16,000. The portfolio compounds at an assumed 10% per year over the next 39 years. The second investor starts later and contributes \$2,000 per year for 39 years for a total investment of \$78,000 with the same assumed 10% per year return. Due to the power of compounding, Investor A's total profit exceeds \$1,000,000 compared to \$805,000 for Investor B.

<u>Investor A</u>			<u>Investor B</u>		
	Tax			Tax	
<u>Age</u>	<u>Deferred Contribution</u>	<u>Year End Value</u>	<u>Age</u>	<u>Deferred Contribution</u>	<u>Year End Value</u>
19	\$2,000	\$2,200	19	\$0	\$0
20	\$2,000	\$4,620	20	\$0	\$0
21	\$2,000	\$7,282	21	\$0	\$0
22	\$2,000	\$10,210	22	\$0	\$0
23	\$2,000	\$13,431	23	\$0	\$0
24	\$2,000	\$16,974	24	\$0	\$0
25	\$2,000	\$20,872	25	\$0	\$0
26	\$2,000	\$25,159	26	\$0	\$0
27	\$0	\$27,675	27	\$2,000	\$2,200
28	\$0	\$30,442	28	\$2,000	\$4,620
29	\$0	\$33,487	29	\$2,000	\$7,282
30	\$0	\$36,835	30	\$2,000	\$10,210
31	\$0	\$40,519	31	\$2,000	\$13,431
32	\$0	\$44,571	32	\$2,000	\$16,974
33	\$0	\$49,028	33	\$2,000	\$20,872
34	\$0	\$53,930	34	\$2,000	\$25,159
35	\$0	\$59,323	35	\$2,000	\$29,875
36	\$0	\$65,256	36	\$2,000	\$35,062
37	\$0	\$71,781	37	\$2,000	\$40,769
38	\$0	\$78,960	38	\$2,000	\$47,045
39	\$0	\$86,856	39	\$2,000	\$53,950
40	\$0	\$95,541	40	\$2,000	\$61,545
41	\$0	\$105,095	41	\$2,000	\$69,899
42	\$0	\$115,605	42	\$2,000	\$79,089
43	\$0	\$127,165	43	\$2,000	\$89,198
44	\$0	\$139,882	44	\$2,000	\$100,318
45	\$0	\$153,870	45	\$2,000	\$112,550
46	\$0	\$169,257	46	\$2,000	\$126,005
47	\$0	\$186,183	47	\$2,000	\$140,805
48	\$0	\$204,801	48	\$2,000	\$157,086
49	\$0	\$225,281	49	\$2,000	\$174,995
50	\$0	\$247,809	50	\$2,000	\$194,694
51	\$0	\$272,590	51	\$2,000	\$216,364
52	\$0	\$299,849	52	\$2,000	\$240,200
53	\$0	\$329,834	53	\$2,000	\$266,420
54	\$0	\$362,817	54	\$2,000	\$295,262
55	\$0	\$399,099	55	\$2,000	\$326,988
56	\$0	\$439,009	56	\$2,000	\$361,887
57	\$0	\$482,910	57	\$2,000	\$400,276
58	\$0	\$531,201	58	\$2,000	\$442,503
59	\$0	\$584,321	59	\$2,000	\$488,953
60	\$0	\$642,753	60	\$2,000	\$540,049
61	\$0	\$707,028	61	\$2,000	\$596,254
62	\$0	\$777,731	62	\$2,000	\$658,079
63	\$0	\$855,504	63	\$2,000	\$726,087
64	\$0	\$941,054	64	\$2,000	\$800,896
65	\$0	\$1,035,160	65	\$2,000	\$883,185
	Less Total Invested	-\$16,000		Less Total Invested	-\$78,000
	Net Earnings	\$1,019,160		Net Earnings	\$805,185