

SECOND QUARTER REPORT 2004



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A MESSAGE FROM THE PRESIDENT

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Early this month, we hosted our quarterly wine and cheese get-together for clients and friends. During our discussion, we talked about the concept of

“Wealth Management”, and introduced the idea that to be truly successful, such a process must include much more than simply a focus on investments, taxes, trusts, insurance, and retirement plans. To illustrate, we asked our guests to consider the question: “What is wealth?”

The discussion that followed was warm, insightful, and very revealing, because for the first five minutes, absolutely no one mentioned anything to do with money. “Good Health”, “Great Friends”, and “A Call From My Son” were the first responses we got. As we continued, we touched on much deeper issues such as family relationships, what it means to leave a legacy, what it means to be the steward of one, and how it is that we each want to be valued and remembered. These issues illustrate that most of us understand “wealth” to be so much more than simply what we possess in physical terms, or what we accumulate in financial terms. Equally, if not more important to most of us is who we are, how we are connected to others around

us, how we honor those who have come before us, and how we will be remembered when we are gone.

Wealth management, therefore, should be multi-generational in scope. It should integrate the intentional life-long process of building, enjoying, and transferring financial wealth, with purposeful attention paid to doing the same with both social wealth and personal wealth.

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Social wealth is the way in which we interact with the community around us, and the value of the relationships that we build in a lifetime. It includes our sense of responsibility to our community, and the investments we have made in it; our friends and associates, our professional and social network, the institutions we value and support, and the causes that we hold dear. A great lifetime wealth management plan should acknowledge and address these unique and important aspects of our lives, and seek to reflect them accurately in the total process.

Personal wealth is who we are, and what we hold most precious. It is the sum of our personal experiences: the lessons we’ve learned, the mistakes we’ve made, the things we’ve seen, and the stories we can tell. It is the investments we have made in living, and what we have come to stand for personally in that process. It includes whom we love, and who loves us. Personal wealth is the most challenging to define, and hardest to discuss of all forms of wealth, but a great lifetime wealth management plan will pay particular attention to reflecting these deeply held personal values in the total process. It is only in this context that the technical tools of insurance, investing, tax planning, estate planning, and retirement planning begin to make sense, take form, and become truly inspirational.

I encourage you to contemplate these ideas, and to discuss them with us individually. Because it is only through mutual understanding of the complex and unique nature of *your* wealth, and an open, long-term planning process, that we can be most helpful in helping you to achieve what is most important and valuable to you. That is what inspires us.

Thank you again for your continued trust and confidence.

Thomas G. Twombly
President

MARKET COMMENTARY

Robert S. Phipps, III

The second quarter was very interesting in many regards. It produced the first of the much anticipated interest rate increases by the Federal Reserve, and marked what we perceive to be the end of a greater than twenty-year bull market in domestic bonds. It also produced a number of very interesting changes in market leadership and, perhaps most importantly, it was a period over which the price action in the domestic equity markets seems to have transitioned from the strongly trending, single-direction markets (either all up or all down) that we have seen since 1998 to a market that is trading in a well-defined trading range.



Only time will tell which of these second quarter changes will prove sustainable into the future. However, there are lessons from history that we believe offer some insight into these questions. First of all, we do believe that the long-range bull market in bonds has come to a close and that bond allocations should feature the types of bonds that are historically less susceptible to Federal Reserve tightening. We also believe that we are likely to see the equity markets not only remain in a trading range over the short term, but also to eventually return to a more traditional meandering pattern with a gradual upslope, rather than the strongly trending markets that we have seen over recent years.

Perhaps the most interesting questions deal with the change in leadership that we have seen over the quarter, with large cap stocks out-performing small cap stocks, domestic markets generally out-pacing foreign markets, and growth

stocks generally out-performing value stocks. At this point, we consider it likely that the trend towards larger company stocks will prove sustainable, as this change in investor preference normally occurs in the more mature stages of bull markets. However, we doubt that either the trend towards growth stocks or the out-performance of the domestic equity markets will prove sustainable.

For more on our market perspective, please refer to the latest *LS&G Advisor Outlook*, which can be found on our web site www.lsggroup.com.

MODEL PORTFOLIO COMMENTS

Conservative Growth Model: Over the quarter, this portfolio posted a 0.28% gain, which out-paced the portfolio's benchmark of the average balanced fund (according to Thompson Financial Company) by just over 0.50%. More importantly, its 3.23% year-to-date return has out-paced its benchmark by 1.44% and its trailing 12-month return has bested its benchmark by 1.37%. Over the past year, this portfolio has produced 73.5% of the gains of the S&P 500 with only 60% of the risk (as measured by statistical volatility). At present, we are very pleased with the portfolio's allocation and do not anticipate any immediate changes.

As of the end of June, the portfolio was allocated with 20.29% to cash, 49.97% in domestic stocks, 8.85% in international stocks, and 20.89% in bonds. The equity allocation emphasizes mid cap (54%) and large cap stocks (34%) over small cap stocks (12%), and emphasizes value stocks (40%) and core stocks (35%) over growth stocks (25%).

Diversified Growth Model: Over the quarter, this fully-invested equity portfolio's 0.9% gain lagged the portfolio's S&P 500 performance benchmark by a small fraction. However, its year-to-date performance has out-paced its benchmark by 5.39% and its trailing 12-month performance has exceeded the benchmark by 10.59%. At this point, we are very pleased with the portfolio's allocation and do not anticipate any immediate changes.

As of the end of June, the portfolio was comprised of 5.89% in cash (cash held by the funds themselves), 77.63% in domestic stocks and 15.41% in international stocks, with a small 1.08% convertible bond position. The equity allocation is fairly evenly divided between value, core and growth stocks (29%, 39% and 32% respectively),

and emphasizes mid cap stocks (44%) over large cap stocks (26%) and small cap stocks (29%).

Core Growth Model: During the second quarter, this portfolio's 1.08% gain out-paced its benchmark of the average global asset allocation fund (according to Thompson Financial) by 1.7%. This brings the portfolio's out-performance over its benchmark to 4.47% and 5.77% for the year-to-date and trailing 12-month periods respectively. At this point, we are very pleased with the portfolio's allocation and do not anticipate any immediate changes.

As of the end of June, the portfolio held 5.53% in cash, 56.52% in domestic stocks, and 20.68% in international stocks, with 17.26% divided between traditional and convertible bonds. The equity allocation is somewhat slanted towards growth (39%) and core stocks (38%) over value stocks (24%). There is also an emphasis on large cap stocks (37%) and mid cap stocks (47%) over smaller stocks (17%).

Growth Model: In the second quarter, this portfolio's 1.63% loss lagged the portfolio's S&P 500 benchmark by just over 3%. However, its year-to-date performance has out-paced its benchmark by 2.36% and its trailing 12-month performance has exceeded the benchmark by just over 10%. The short-term under-performance was a function of the portfolio's emphasis on smaller domestic companies and because of the portfolio's 20% allocation to the foreign markets. While we still like the portfolio's foreign exposure, we may shift some assets to larger company stocks over the upcoming quarter.

As of the end of June, the portfolio held 16.36% in cash, 51.26% in domestic stocks, 21.74% in international stocks and just over 10% in convertible bonds. The equity allocation is fairly evenly divided between value, core and growth stocks (29%, 34% and 37% respectively), and emphasizes mid cap stocks (50%) over large cap stocks (23%) and small cap stocks (27%).

Aggressive Growth Model: During the second quarter, this portfolio's heavy reliance on international stocks hurt its performance and caused the portfolio to lag its NASDAQ benchmark by almost 10%. Despite this short-term under-performance, we continue to view the international markets as among the most attractive of the more aggressive asset classes. This is particularly true given our concerns about domestic technology and biotechnology valuations, and our

belief that investor preferences seem to be moving away from domestic small cap stocks. As such, we are presently inclined to ride through the current storm and do not anticipate any significant portfolio changes over the near term. From our perspective, this continues to be a difficult environment in which to manage aggressive growth portfolios, but we will make every effort to close this performance gap.

As of the end of June, the portfolio was fairly evenly divided between foreign stocks (41.27%) and domestic stocks (42.65%), with 13.76% invested in cash and 2.31% invested in convertible bonds. The international exposure is well diversified and almost evenly divided between Greater Europe and Greater Asia. The equity allocation has a decided bias towards growth stocks (54%), with lesser allocations of 29% to core stocks and only 16% in value stocks. The portfolio also has a strong emphasis on small cap stocks (24%), which hurt performance during the quarter, with 38% invested in mid cap stocks and only 17% invested in large cap stocks.

HIGHER EDUCATION MODELS

Retirement Growth Model: During the quarter, this portfolio gained 0.53%, which exceeded the return of its average global asset allocation fund benchmark (according to Thompson Financial) by almost 1%. This boosted its year-to-date and trailing 12-month out-performance over its benchmark to 4.15% and 7.29% respectively. While we are very pleased with the current allocation, we do expect to make a slight addition to the portfolio's international exposure over the coming months.

As of the end of June, the portfolio held 10.47% in cash, 36.51% in domestic stocks, and 31.48% in foreign stocks, with the remaining 21.52% divided between convertible and traditional bonds. Market capitalization is well diversified with 36% in large cap stocks, 40% in mid cap stocks and 23% invested in small cap stocks. There is also an emphasis on growth stocks (37%) and core stocks (35%) over value stocks (27%).

ORP Growth Model: In the second quarter, this portfolio posted a gain of 0.48%, which exceeded its benchmark of the average global asset allocation fund (according to Thompson Financial) by just over 1%. It has performed in-line with its benchmark on a year-to-date basis and has out-paced its benchmark by just over 2% for

the trailing 12-months. While we are generally pleased with the current allocation, we do plan on making slight additions to the portfolio's small cap value and large cap value allocations.

As of the end of June, the portfolio was invested with 9.79% allocated to cash, 50.12% invested in domestic stocks, 17.85% invested in international stocks and 22.23% divided between traditional and convertible bonds. The portfolio is maintaining a heavy emphasis on large cap stocks (56%), which helped its performance during the quarter. There is also a sizable 38% exposure to mid cap stocks and a very small 6% allocated to small cap stocks. There is also an emphasis on growth stocks (48%) and blend stocks (32%) over value stocks (20%).

Growth and Capital Preservation Model: Over the past three months, this portfolio gained 0.38%, which exceeded the return of its average global asset allocation fund benchmark (according to Thompson Financial) by almost 1%. This boosted its year-to-date and trailing 12-month out-performance over its benchmark to 1.66% and 1.82% respectively. We are quite pleased with the current allocation, but will be looking for the opportunity to reduce the portfolio's cash position over the coming months.

As of the end of June, this conservative portfolio held 21.85% in cash, 40.84% in domestic stocks, and 9.39% in foreign stocks, with 27.89% divided between traditional and convertible bonds. The equity allocation emphasizes large cap stocks (45%) over mid cap stocks (35%) and smaller stocks (19%). There is also a bias towards value stocks (34%) and core stocks (39%) over growth stocks (26%).

Robert S. Phipps III, CIO
And the Lucien, Stirling & Gray
Asset Management Team

Upcoming Events

Fireside Chats: 6:30 pm - 8:00 pm

September 9, 2004

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