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This month marks the one-year anniversary for Live Oak Capital, and we are pleased to report that the firm already manages over \$120 million on behalf of 30 family relationships. We greatly appreciate the opportunity to work with the clients who have appointed Live Oak Capital to serve as their investment advisor.

The recent quarter provided plenty of challenges for us to earn our keep. Our diversified approach to stocks and conservative posture with bond holdings served client portfolios well during the capital markets' third-quarter gyrations. While most of the economic news and focus on political topics unfolded according to expectations, there were, as is often the case, news events that surprised Wall Street.

As anticipated, the Federal Reserve continued making a series of small interest rate hikes to nudge monetary policy back toward a neutral position, which should bring overnight rates to around the three percent level sometime next year. Economic reports and corporate profits have generally been on track, with a gradual improvement in the employment picture and real GDP growth rates in the three to four percent area. It is also no surprise that attention has been focused on the Bush and Kerry campaigns and related political topics in advance of next month's Presidential elections.

However, we allow for surprises, because things often do not go smoothly or completely according to plan. Capital markets were buffeted by several unsettling news events during the quarter, with stories ranging from Mother Nature to tough business decisions to another potential scandal:

- Mother Nature and natural resources - Four hurricanes took swipes at the East coast, disrupting oil drilling operations in the Gulf of Mexico and contributing to oil prices surging to over \$50 per barrel. Oil prices are a concern at these historic highs. In addition to the obvious increase in transportation costs, petroleum prices affect the costs of manufacturing, agriculture and electricity that are part of our daily lives. We expected oil prices to remain high and volatile, but these prices are well above the \$35 level suggested by world supply and demand conditions. At these price levels, oil creates inflationary pressure on the economy, as well as a drag on forecasted growth rates. On a positive note, we have maintained a full participation in the energy sector, and high oil prices have contributed to strong performance for our holdings in that area.

- Tough business decisions - Merck stunned investors with the announcement that they are halting sales of their blockbuster drug Vioxx for treatment of arthritis, a product with over \$2.5 billion in annual revenues for the company. A recent clinical study indicated a high incidence of heart-related problems for patients who took Vioxx for more than 18 months. Merck's management knew the decision to pull Vioxx would be a painful setback for the company. Wall Street promptly mugged the stock, taking over a quarter of its market value. It is a reminder that bad things can happen, even to good companies. That is why we diversify holdings, with a typical stock position currently representing roughly two to three percent of a portfolio's total stock holdings. That limits the downside from unexpected changes at any one company.
- Another potential scandal - The Federal National Mortgage Association, otherwise known as Fannie Mae, has run into trouble with regulators over its accounting practices. We owned bonds issued by Fannie Mae, which are rated AAA due to the implied guarantee provided by the U.S. government. For now, that credit quality remains intact. However, just to be on the safe side, we sold Fannie Mae bonds and swapped into other agency obligations, such as Federal Home Loan Bank and Federal Farm Credit Bank bonds. Those agencies are not under a regulatory cloud, and they also have AAA credit quality. For taxable accounts, the Federal Home Loan Bank and Federal Farm Credit Bank bonds provide the added benefit of interest that is exempt from state taxes. We are sidestepping an issue before it becomes a problem.

It is one of the great ironies of capitalism that investors dread uncertainty, yet investors could not expect a return without uncertainty. An investment at today's price has to overcome a variety of risks to become more valuable at some later date. Risk and return; it is a love-hate relationship for investors. Asset allocation, diversification and patience are a few of the tools we utilize to profit from the capital markets while protecting against the inevitable surprises that will try to derail us. Live Oak Capital is dedicated to helping clients bring structure to their investment programs through a combination of long-term planning and tactical adjustments along the way.