



Strategies Report

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A Brief on Investment Markets and Financial Planning Issues

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THIS ISSUE:
Finally a Good Year!
Our 2004 Plan.
What you should do now.
Charts and Expectations.

STAAR Funds Achieve Positive 5-Year Returns

How did your investments do? For details and index comparisons, see Page 3.
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FINALLY! It was a very good year!

As you can see from the chart on the right, 2003 saw a tremendous rebound in the economy and the investment markets. After three losing years and the worst bear market since the great depression, that is good news indeed.

In fact, every major investment index experienced a positive return. And unlike the previous three years, it once again paid to take risk.

Technology, small company and international stocks led the way, with U.S. larger stocks not too far behind. The economy roared ahead, while the lid of uncertainty regarding possible war with Iraq was lifted.

Bullet Briefs on 2004 Economic Issues

Inflation: Very favorable. Some signs of increase, but definitely not alarming.

Interest Rates: Very favorable for borrowing and stocks. Unfavorable for bond market. With low inflation and slow job recovery, the Fed can afford to wait awhile before raising short-term rates. Over the first 3-6 months of 2004, rates should remain in the recent range, then begin to rise.

Dollar's Decline: Neutral. It needed to fall. As long as it isn't a continuing precipitous drop, the dollar can find a natural balance among world currencies. The silver lining is that it will help our exports and therefore our trade imbalance.

Economic Growth: Very favorable. Should cool down a bit, but a 3-5% rate over the next couple years will be just what the Dr. ordered. Enough to solidify business trends yet not so much as to produce significant inflation.

Federal Debt: Neutral. The expanding economy of the late 80's and 90's created a larger pie, which created more revenues even without tax increases. It is about to happen again, but governments need to do their part and reign in their uncontrolled spending habits.

State & Local Government Debt: Unfavorable. These are more troublesome than the Federal debt. There is too much institutionalized stupidity. Blame political inbreeding in many areas. They just don't get it.

Business Debt: Neutral. Nothing like productivity and growth to keep debt ratios in supportable ranges. The "junk" bond market has rallied fiercely, signaling investor's confidence in corporate balance sheet improvements.

Corporate Profits: Favorable. Definitely on an upswing; the only question is, how long and how high?

STAAR Funds Performance* (Read the Funds' prospectus for full information: 412-367-9076)	2003	3 Year Avg Ann Return	5 Year Avg Ann Return
Smaller Company Stock Fund	41.2%	5.3%	9.06%
International Fund	31.9%	-2.5%	1.35%
AltCat Fund	28.4%	-1.0%	5.98%
Larger Company Stock Fund	20.7%	-3.9%	0.05%
Long Term Bond Fund	5.9%	7.2%	5.09%
Intermediate Bond Fund	4.1%	6.3%	5.53%
Average of STAAR Funds (33% Interest-Bearing Conservative)	22.0%	2.4%	5.2%

Performance figures are total returns net of expenses, with dividends and capital gains reinvested. Past performance is no guarantee of future results. Investment returns and principal values fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost.

Consumer Debt: *Neutral to Unfavorable. Consumers have done their part in the recovery, including using more plastic. Tremendous savings as they refinanced mortgages and bought new homes at very low rates has tempered much of this. But people need to stay in control and stay out of consumer debt if at all possible.*

Personal Income: *Neutral to Favorable. It has been rising at a reasonable rate. However, not all segments of the working population have partaken. Not to mention the many who still are unemployed. Imbalances should gradually improve over the next year.*

Employment: *Neutral to favorable. The trend is improving, but it will not be a quick return to 4%. Companies that were burned by "irrational exuberance" will be slower to hire, but that is good. Slow and steady will win this one better than knee-jerk euphoria.*

Consumer Spending: *Neutral. Has been healthy and even showing some signs of control. (See consumer debt.) A comfortable and steady balance will be best.*

Business Spending: *Very favorable. Has picked up considerably and has heralded the likelihood that the recovery is not a temporary one.*

Technology Trends: *Very favorable. The long-term mega trend of this revolution will continue to fuel growth while presenting potential problems as well as tremendous gains in worldwide standards of living.*

Real Estate: *Neutral short-term. Should cool off. Prices likely to fall as demand lessens and interest rates rise.*

War on Terror: *Neutral to Favorable if we realistically recognize the ongoing risk. Too many of us have forgotten what President Bush told us in 2001. He said it would take a long time, that it wouldn't be easy and much of it we wouldn't see. On all three counts he was truthful. Anyone expecting differently has to be naïve. This is a war that will never completely end. Hindsight shows the two biggest single errors as Bush Senior's and the UN's failure to finish the Iraq job in 1991 and Clinton's failure to get Bin Laden when he was handed to him. But the biggest problem has been a long-term inconsistency in foreign policy. That said, progress has been made, including the surprising turn of Libya and little-reported victories by our special anti-terrorist forces in rooting out terrorists in other parts of the world.*

International Relations: *Mixed bag. While relations were somewhat strained when the U.S. went into IRAQ, olive branches are being exchanged with many countries. We have a long way to go, and realism dictates that there will always be "wars and rumors of wars." However, some positive opportunities are at hand. Let's hope and pray that world leaders will be injected with some wisdom.*

International Trade: *Neutral to Unfavorable with some positive signs. Continual deficits are troubling. Protectionism is a negative. Freer markets are a positive. The combination of a lower dollar, better politics and some entrepreneurial spirit could finally change the trend.*

Overall: *The world is a hostile place. But mankind is resilient and creative, and when put toward positive endeavors, often makes the world a bit better. Conditions are good right now. Opportunities abound for those who are able and willing to work hard and be smart. And to the extent we can think of and include the well being of our fellows here and abroad, we can accomplish great things. We should never lose hope. Whatever we face this year, let us move with goodness, mercy and responsibility. There will always be the sad, the tragic and the difficult, but remember: Whatever happens take the good with you. God bless.*

My 2004 Objectives

I have recently reviewed my priorities. Here are some I consider most important for 2004 and beyond.

1. Help our shareholders and clients increase their net worth through wise planning and sound investment management.
2. Meet with and listen to our clients and make sure we are serving them to the best of our abilities.
3. Approach every service and decision with shareholders' and clients' best interests in mind.
4. Increase the number of shareholders and clients and the amount of assets under management so that costs can be lowered in future years.
5. Maintain growth and profitability in our business so we can continue to serve our shareholders and clients as well as reward our employees and stockholders for their efforts and support.
6. Maintain quality in our operations by employing competent, hard-working and honest employees and third-party services.
7. Treating our employees and service providers well and working with them to provide the best possible results for everyone.

What to Do Now

Every year it's the same. But then, wisdom never grows old and always makes sense.

___ **Call your financial planner, investment advisor, broker, insurance agent, accountant and attorney** and get on their calendars. (Having an appointment creates a deadline, forcing you to act.)

___ **Get Organized** (Know what you have, where it is and how much it's worth. Gather statements, receipts and any other pertinent information. Organize it in easy-to-see file folders.)

___ **Get Control.** (If you need money from investments, program withdrawals now. If you are adding to investments, plan those deposits now.)

___ **Review Your Investment Strategy.** (Should you consider private management of your accounts?)

___ **Discuss 2004 Tax Saving Strategies with your Advisors** (Some strategies are better if done earlier.)

___ **Make IRA or Roth IRA contributions early this year.**

___ **Review Employer Plan Contribution Levels** ___ **Make Sure Your Emergency Funds Are Sufficient** (Generally we recommend 3-6 months living expense in a savings or money market fund.)

___ **Get Mortgage Financing before rates rise**

___ **Review Your Estate Plan, Wills and Trusts**

___ **Review Your Insurance Coverage**

___ **Add to Your Regular Investments Regularly**

A Statistical Review of the Past Five Years

(Ranked from best to worst 2003 Performance)

Chart A: Benchmark Performance*	2003	2002	2001	2000	1999	3 Year Avg Ann Return	5 Year Avg Ann Return
NASDAQ	50.5%	-31.5%	-21.1%	-39.3%	85.6%	-6.7%	-1.7%
Wilshire SmallCap 1750 Index	48.0%	-20.8%	-0.3%	0.0%	26.1%	5.3%	8.1%
Russell 2000 Small Co. Index	45.4%	-21.6%	1.0%	-3.0%	21.3%	4.8%	6.3%
Dow World (ex. US) Index	38.6%	-15.6%	-21.0%	-17.4%	31.5%	-2.6%	0.1%
EAFE International Index	37.8%	-17.5%	-22.6%	-14.2%	27.0%	-4.2%	-0.8%
S&P 500 Stock Index	28.6%	-23.4%	-13.0%	-9.1%	21.0%	-5.0%	-1.2%
Dow Jones Industrials	28.3%	-16.8%	-7.1%	-4.9%	27.2%	-0.3%	3.7%
Morningstar Large Core	22.2%	-23.8%	-14.4%	4.2%	17.8%	-7.3%	-0.4%
Lipper Intermed. Inv. Grade Bond Fds.	5.4%	8.3%	8.2%	10.6%	0.1%	7.3%	6.5%
Lipper Corporate A-Rated Bond. Fds.	5.0%	8.6%	7.8%	10.3%	-0.3%	7.1%	6.2%
Lipper U.S. Gov. Fds.	1.7%	10.0%	6.7%	11.9%	-1.5%	6.1%	5.6%
Inflation	1.7%	2.6%	1.9%	3.4%	2.7%	2.1%	2.5%
Money Market Funds	0.6%	1.1%	3.6%	5.7%	4.6%	1.8%	3.1%

*Preliminary numbers. Money Markets are an approximate average.

Average of Above Indexes w/out Inflation (33% Interest-Bearing Conservative)	26.0%	-11.9%	-6.0%	-3.8%	21.7%	1.4%	4.1%
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International Fund	31.9%	-14.4%	-17.3%	-16.8%	38.7%	-2.2%	1.5%
AltCat Fund	28.4%	-15.8%	-10.2%	5.5%	30.7%	-1.0%	6.0%

Larger Company Stock Fund	20.7%	-18.1%	-9.9%	-2.7%	15.9%	-3.8%	0.1%
Long Term Bond Fund	5.9%	8.4%	7.6%	9.4%	-4.8%	7.3%	5.2%
Intermediate Bond Fund	4.1%	7.2%	7.7%	9.1%	-0.1%	6.3%	5.5%
Average of STAAR Funds (33% Interest-Bearing Conservative)	22.0%	-8.7%	-3.5%	0.9%	18.5%	2.4%	5.1%

Performance figures are total returns net of expenses, with dividends and capital gains reinvested. Average returns assume each year begins with equal amounts invested in each category or fund. Indexes were quoted as published in various publications or sources, including the Wall St. Journal. Past performance is no guarantee of future results. Investment returns and principal values fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost.

Overall, an equal mix of the STAAR Funds outperformed a similar balance among major market indices by a little over 1% per year for the five year period ending 12/31/03, after all costs were deducted. Over the five years a \$100,000 investment would have grown to \$128,486 using the STAAR funds vs. \$122,166 using the indexes, a \$6,320 difference.

Reasonable Expectations

As you can see by the statistical summary of the last five years, investment returns can vary greatly from year to year. To make plans that offer a high probability of success, one needs to have reasonable expectations and avoid fear and greed. The best tool in developing expectations is history.

Consider that from 1926 through 2002 Large Stocks averaged a 10.2% annualized return against inflation of 3.0% per year. For that same period small stocks returned 12.1% per year and bonds 5.5%, while short-term U.S. treasury bills only earned 3.8% per year. These are pretty good long-term expectations to use in planning.

It is clear that, over long periods of time, stocks have been the best investment to achieve real returns above inflation and taxes. If you assume a 20% tax rate, the real return for U.S. T-Bills has been .04% whereas the real return for large stocks has been almost 5.2%.

Obviously there are some times when it is better to buy stocks and other times when it is more risky to buy them. The simple truth is found in the old adage, "Buy low, and sell high." Unfortunately that is not easy to do, especially because the emotions of fear and greed often short-circuit wisdom.

Two basic approaches have worked well for many. One is to simply "buy and hold" mutual funds and/or stocks in a diversified portfolio and let the averages work out over time. This is basic "Asset Allocation."

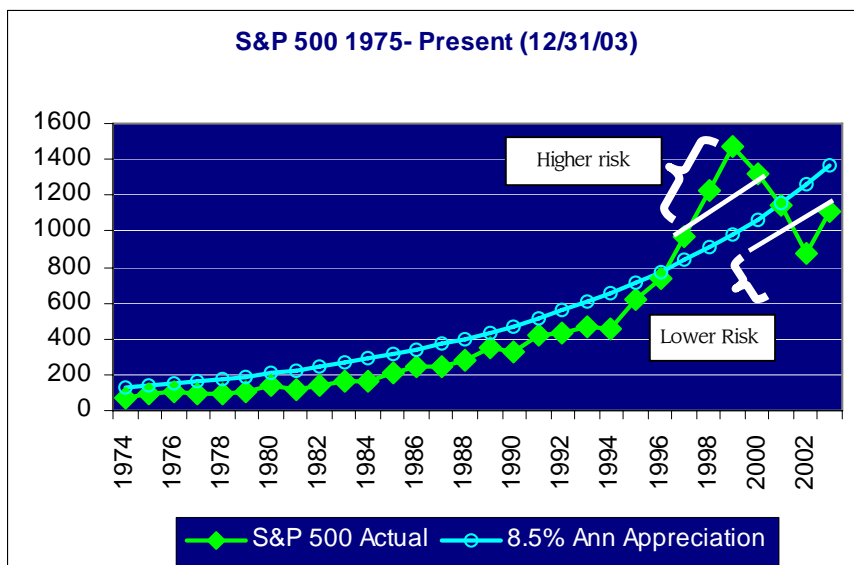
The second is to adjust your exposure to stocks (and bonds) as trends and relative value indicate. This is not short-term market "timing" or day trading. It is making adjustment to allocation weightings based on major market trends.

For instance, I have developed a long-term appreciation assumption for the S&P 500 of 8.5% (dividends not included) since 1950, factoring in extra productivity provided by the technological revolution. Without that assumption the long-term trend would be around 8% appreciation. Under both assumptions, the S&P 500 climbed well above the line by the beginning of 2000 and fell well below the line by October of 2002. Extreme variations from averages often signal increased risk or positive opportunity.

Tactical adjustments could be made to your allocation when the actual value goes 15% or more above or below the trend line. Near the line is "Fairly valued", 15% or more above is "Over-valued" and 15% or more below is "Under-valued." See chart.

Of course, other factors go into portfolio adjustments; this is just one example of the factors I use. In all asset classes there are times when it makes sense to reduce exposure or increase exposure to that asset class. This is called Tactical Asset Allocation. (STAAR stands for "Strategic & Tactical Asset Allocation Resources.")

This brings us back to expectations. If you are confident that technology will allow higher average growth over the next 10 to 20 years, then the S&P 500 is still undervalued. By this measure it would have to grow approximately 13% per year to reach the 8.5% trend line in five years.



If we use an 8% trend line, then the market is on the line now and is fairly valued to appreciate 8% per year (Price only, no dividends. Total Return is higher.)

When there are major divergences such as we see here, decisions can be easier. It is harder when trends are not as apparent. There are three general approaches to your investment strategy. Which is appropriate for you?

1. **Buy & Hold Asset Allocation:** Relies on long-term averages and the ability of mutual fund managers and/or the companies of individual stocks owned. Reasonable expectation for a “balanced” portfolio: 4-5% above inflation.
2. **Asset Allocation with “tweaking”** once a year or when major market changes occur: Relies on your attention to conditions and the information we supply through this letter and other communications. Expectation: Less losses in down markets, overall returns a bit above Buy & Hold.
3. **Private Management:** Hire a professional manager to change your allocation as trends change. The reasonable expectation is that the manager performs better than Buy & Hold after fees, measured over a five-year period.

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