

BCN ADVANTAGE: 2003 ANNUAL REPORT

January 2004	BCN Advantage Act/Mgmt	100% Invested Buy/Hold	50% Invested Buy/Hold	100% Cash
Total Return:	27.87% ^{1 2 3}	36.19% ^{1 2}	18.52% ^{1 2}	0.85% ^{1 2}
Jan ' 97 = \$100,000 ⁴	\$225,763	\$178,347	\$164,264	\$129,450
Beta (2003):	0.63	1.00	0.50	0.00
Risk Adjusted Return:	32.91%	36.19%	18.52%	0.85%

1 Performance results are based on the T. Rowe Mid-Cap Fund (38.2% for 2003), the Vanguard Index 500 Fund (28.5% for 2003), the Oppenheimer Global Fund (43.1% for 2003) and an average money market return of 0.85%. The results may not reflect the actual performance of BCN Advantage clients. Past performance does not guarantee future results.

2 Performance results show the year-over-year change to net asset values and do not include the reinvestment of dividends (if any) other than interest earned from the money market fund.

3 Performance results are net of BCN Financial management fees.

4 BCN Financial is the registered investment advisor. Performance from January 1997 to June 1998 was provided through Quest Securities as the registered investment advisor.

2003 BCN Advantage Signals

	Date	Market	Cash
1	01/01/2003	100%	0%
2	01/27/2003	0%	100%
3	04/22/2003	60%	40%
4	05/28/2003	100%	0%
5	08/04/2003	0%	100%
6	09/04/2003	60%	40%
7	12/31/2003	60%	40%
	Present	100%	0%

A Long Round Trip

On May 1st, standing on the deck of an aircraft carrier streaming through the Atlantic, President Bush declared an end to “major military operations” in Iraq. If you were a BCN Advantage client, your money was already 60% invested in the stock market, long before conventional wisdom recognized this current bull phase. The Nasdaq stood at 1472, the DJIA at 8454 and the S&P 500 at 916. Our decision to move back into the market in April 2003 will rank as one of our best calls ever... based not on luck, intuition or any other “gut feelings,” but on time-tested market indicators. The markets had seen their lows in October 2002 – we stated that flatly more than a year ago. BCN Advantage clients were fully invested coming off those lows, prudently in cash while we side-stepped the war, and once again fully invested by the end of May 2003.

Had it been a “perfect” year, we would have stopped right there, but before we get to our August misstep, it’s important to look back at the much longer journey just completed. This marks the seventh year of the BCN Advantage service, in what has truly been a trial by fire. We have navigated through 1999, one of the best years in stock market history, through a 3-year bear market that saw, at its lows, the Nasdaq implode 78.4% from its March 2000 high, and now through this cyclical rebound of 2003. How have we fared?

Since the beginning of 1999, BCN Advantage clients are up an average of 42.5%. By the same measure, passive “buy-and-hold” would have gained merely 10.2%. From our all-time index high of \$259,587 achieved at the end of 1999 (before the “bubble burst”), we are off 13%. This with the Nasdaq still nearly 60% below its all-time high. That’s pretty darn good shooting. These are the results of more than market timing, but also excellent fund selection, allowing BCN Advantage clients to generally equal or exceed the S&P 500 – while remaining over 30% in cash for most of 2003. Don’t overlook the value of fund selection... a vital component of the BCN Advantage service.

The First Sign of Trouble

The critical question now: how much upside is remaining in this market? In last year's annual report, we explained the high probability that the markets are now in long-term trading CHANNELS. Every post-mania market for the last 75 years has formed a similar channel: DJIA 1932 – 1950, DJIA 1966 – 1982, Nikkei 1989 – present, DJIA 1999 – present, Nasdaq 2001 – present. The DJIA is already 5 years into its trading channel, so we have a good handle on its likely tops and bottoms. The Nasdaq is just getting started, and consequently is much more difficult to navigate. But if historical patterns hold, the analysis we do today could serve our clients well for the next decade!

Our initial analysis showed a possible top for the Nasdaq at approximately 1800. We moved out of the market in early August 2003 (AHEAD of one of the worst downturns of the year), then returned 60% in early September 2003 when the market made a clear move above 1800. Our August move was not correct. But missing 5% on the Nasdaq to secure our first substantial profits in 40 months did not seem too high a price to pay.

Why so jittery? Let me quote this warning, courtesy of Comstock Partners: "The market remains highly overvalued on every metric we use. Over a long period of time, the S&P 500 has sold at an average P/E multiple of about 15 with a range prior to the late 1990s between 22 at peaks and 7 at lows. The average P/E at cyclical bottoms in the post-war period has been about 11. Currently the index is selling at 23 times the consensus estimate for 2003 reported earnings. This means that if the S&P 500 declined only to its historical average, we would be looking at a drop of 35%. It is far more likely, however, that the next major decline would carry the index closer to its more typical major low of 11 times earnings, which would result in an overall drop of 52%. The S&P 500 is similarly overvalued on the basis of dividend yield, price-to-book value and price-to-sales.

"It is virtually inconceivable that one of the greatest financial and economic bubbles in history was cured by the relatively mild recession that followed. In fact, a far deeper decline was averted only by an unprecedented policy of massive stimulus including 13 FOMC interest rate cuts, three major federal tax reductions, hundreds of billions of dollars of cash-outs on mortgage refinancing and a 33 percent drop in the dollar. This stimulus won't be repeated in coming quarters, and we have grave doubts that the economy can sustain itself on its own. These moves have temporarily bailed out the economy, but have failed to correct serious structural imbalances that will come back to haunt us. These include the massive U.S. trade imbalance, record debt relative to GDP, a low consumer savings rate, and a major Federal budget deficit."

Insider Trading... not "Market Timing"

When New York Attorney General Eliot Spitzer kicked off the mutual fund scandal in September 2003, his filings used the term "market timing," but let's be clear. Market timing is a legitimate and legal investment technique. What the mutual fund companies are really being investigated for is "insider trading." Well-connected investors (in many cases the fund managers themselves) were getting real-time information about a mutual fund's portfolio, information that is not available to the public. Those well-connected investors then used that information to make profits. "If it's material, nonpublic and they're trading on it to their advantage, it's insider trading," says Stephen Cutler, director of enforcement at the SEC. Exactly.

The mutual fund industry is being investigated for two basic abuses: late trading and rapid trading (more accurate nomenclature than "market timing"). Under late trading, which is illegal, some firms have been accused of allowing preferred customers to buy and sell shares after the official close of trading. Rapid trading allows a handful of investors to move in and out of funds before prices can be updated to match the exact value of assets. Both late trading and rapid trading drive up fund expenses and hurt the returns of other customers. To date, some of the biggest names in the mutual fund industry have been implicated: Putnam, Strong, Janus, Nations, Pilgrim. We can only hope the problems are corrected... without a slew of new industry regulations driving up costs for the average investor.

As always, we look forward with great optimism. We appreciate your faith and confidence. And we are eager to apply the lessons learned for your benefit.

BCN Financial is the Registered Investment Advisor

We are required to offer Form ADV Part 2 to our clients each year. Contact BCN Financial for a copy.