1st Quarter, 2005

The Compass™

The Appleton Group
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The Appleton Group, LLC was founded to fulfill an investor's desire to participate in the U.S. equity markets while simultaneously addressing the need to manage investment risk. Our firm was founded in April of 2002 by Mark C. Scheffler who serves as Senior Portfolio Manager.

The Appleton Group, LLC currently serves 49 clients, and manages $43.7 million of investable assets. We serve individuals, families, corporations, institutions, endowments, trusts and company sponsored retirement plans.

The Appleton Group, LLC is a Registered Investment Advisor, regulated by the United States Securities and Exchange Commission.

Inside this issue:

Consistency Matters

You know that feeling of comfort you get when you arrive home after a vacation? The feeling that the holiday was enjoyable, relaxing and all, but somehow getting home to your routine just feels good! I find myself embracing that feeling a lot more now that I'm a husband, a dad, and a homeowner. I have to admit, that feeling of wanderlust, that "get out into the world" and explore other lands, other peoples, other cultures has always appealed to me. But more and more, I enjoy my routine, I enjoy my work, I love our house. Maybe I'm finally slowing down a bit (that'd make my parents happy), and I like the consistency of my life.

This wasn't always easy for me to understand, but with time I'm catching on. Consistency is a good thing. It removes uncertainty, it makes life predictable, it helps us to deal with the changes that inevitably force themselves upon us. Intuitively, I've always known that for most people change is hard, and dealing with uncertainty can be a difficult thing.

I came to realize one thing early on in my financial services career: consistency is especially important in investments. Consistent returns, predictability, steady growth and income are all valuable. As it turns out, consistency goes right to the top of the list when the time comes to start taking assets out of a portfolio. For many, this is that magic retirement day. It can also be a spending goal like paying for the kids' college expenses, buying a new house or taking a year off of work. For larger institutions, it can be identifying how much can safely be taken out of an endowment fund without jeopardizing future security. Whatever the goal, however large or small the client, making predictions is challenging at best. But we've got a pretty good thing going.

For more than five years now, I've been using the services of Financeware®, an independent firm that provides wealth planning tools in a most flexible and innovative format. Among other things, Financeware® uses a process they call *WealthCare* to

Mark C. Scheffler

Senior Portfolio Manager, Founder

help determine whether or not it is reasonable to expect specific outcomes at specific times. For example, how reasonable is it to expect a specific amount of income in retirement given a client's current savings pool? Or how reasonable is it to expect that a charitable foundation can expect a specific amount of income over a given period of time without touching principal?

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Introducing *The Appleton Group Tax Managed Portfolio*

The Appleton Group LLC is pleased to announce the formalization of a wealth management portfolio designed specifically for investors concerned about high tax burdens. *The Appleton Group Tax Managed Portfolio* combines the successful risk management techniques used in our existing disciplines with techniques that reduce an investor's annual tax burden.

The Federal Tax Code rewards investors who hold assets for a specific period of time (365 days or longer). Specifically, the tax rate for this holding period drops from as high as 35% to a more tolerable 15%, assuming that the asset in question is sold and the investor made money. For clients who invest in tax sheltered accounts (such as IRAs, 401(k)s, variable annuities etc.) or for clients who are not subject to taxation (such as non-profit

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Consistency Matters
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Goals can be reasonable, goals can be frivolous. But goals help to identify what's important to a client, and *WealthCare* helps us to determine if any goal can reasonably be expected to be met on schedule.

Here's where it becomes tricky, and where the process really adds value. I've included a chart from a hypothetical client who has two goals in mind: a specific amount of income coming to them in retirement, and the goal of passing $2.5 million of inheritance to their kids at their death. We input all relevant data: current holdings, asset allocation, income goals, other sources of income, assumed inflation, age, tax rates, and so on. *WealthCare* takes this data and gives us a picture of how likely it is that these goals can be met on schedule.

Look at the chart on the right. The first column tells us) as a percentage) how likely it is that the goal will be met with the color green symbolizing success, yellow symbolizing uncertainty, red symbolizing failure. For example, in the first column, you see "75." This means that there is a 75% likelihood of having $4,487,126 or more at plan end, well above the $2.5 million goal. This line is written in green, and gives us a fairly good degree of comfort (75%

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Percentile	Ending Value	Plan Failure Age	Market Period	Return
0	$128,479,661		Simulated	16.92%
n/a	$46,028,620		optimistic return	13.61%
5	$43,702,417		Simulated	13.42%
10	$32,557,881		Simulated	12.86%
15	$27,028,498		Simulated	12.22%
20	$22,823,091		Simulated	11.95%
25	$19,865,546		Simulated	11.20%
30	$17,341,630		Simulated	12.14%
35	$15,718,806		Simulated	10.51%
40	$14,307,433		Simulated	11.08%
45	$12,791,016		Simulated	10.38%
n/a	$11,767,716		assumed return	10.32%
50	$11,254,814		Simulated	9.65%
55	$9,760,483		Simulated	9.37%
60	$8,682,850		Simulated	9.88%
65	$7,330,785		Simulated	8.95%
70	$6,096,782		Simulated	9.31%
75	$4,487,126		Simulated	10.31%
80	$3,135,458		Simulated	9.65%
n/a	$2,731,905		Target Value	
85	$1,380,382		Simulated	9.76%
90	-$911,777	97/85	Simulated	7.25%
n/a	-$1,019,758	97/85	pessimistic return	7.13%
95	-$2,590,212	92/80	Simulated	8.34%
100	-$7,952,758	80/68	Simulated	4.18%

Growing Up, Going Up...

The Appleton Group LLC is pleased to announce that effective January 15th, we will be relocating to the third floor of The Appleton Center. Our new offices will be located in the same building as our current space, giving our clients the same easy access and ample parking that we have enjoyed for the past several years. Our new offices can be found just off of the elevators on the north side of the building.

Due to our recent growth and the anticipated launch of several new wealth management offerings in the coming months, additional space was necessary. We are significantly expanding our staff, adding two sales persons and an administrative position, all of whom will be joining our staff in the coming months. The new office space will comfortably accommodate our existing clientele and will additionally allow us to offer increased privacy and service.

As the first quarter of the new year rolls onward, we look forward to introducing you to our new office space. We trust you will find it welcoming!

From the desk of Mark C. Scheffler:

Defense Wins Championships...

I'm thrilled to be going to my first Green Bay Packer's game this Sunday at Lambeau Field. As you can imagine, I've been a life-long Packers fan (who isn't?), and when I tell friends that I'm going to my first game, many are shocked that I haven't been to one sooner. The best man from my wedding just got tickets from a guy who lives in Chicago (go figure), and since he wasn't able to go, we got the tickets.

I've always watched the games on TV—I don't think I've missed more than a couple since Brett Favre began to play– and going to the stadium itself will require a different perspective. No close-ups, no statistics rolling on the bottom of the screen, no refrigerator in the next room, and other fans cheek-to-cheek around the field. But the Packers have the #1 offense in the NFC, a seasoned quarterback, a good running game, and a fantastic offensive line. Defensively, they're spotty, know what I mean? So, what do I watch for in the game against the Vikings?

I fancy myself a bit of a strategist, and during the late 90's when the Packers were consistently in either the NFC championship game or in the Super Bowl itself, I loved to watch the defense. Sure, Brett was exciting to watch—it was assumed that he'd do well. But it always seemed that if the opposing team could score consistently, Brett would try to do too much, throw an interception or two, and the game would be lost. However, if the defense could come up with a big play here and there, it seemed that the Packers could stick to their game plan of controlling the clock and moving the ball.

Look at what happened last year in Philadelphia: they lost the game not because the offense couldn't score but because the defense couldn't stop the Eagles from scoring (who can forget "4th and 26"). The same thing happened the year before when the Pack lost to Atlanta at Lambeau Field—they couldn't stop Michael Vick from scoring on 'em. So, I've come to the conclusion that in football at least, defense helps win games, and it certainly wins championships.

As I run financial plan audits regularly for many of my clients, I've noticed the same thing. Having a good defense, it seems, is the real key to remaining financially successful over one's lifetime. As important as it is to make money when the opportunity presents itself, what good comes of it if you give it all back when the market is uncooperative? Same thing with the Packers, right? What good is scoring a touchdown if the other team marches right down and ties the score? Getting ahead is all well and good, but staying ahead is arguably more important.

In *Consistency Matters* (see page 1), we discuss some real life examples of the benefits of consistency and the importance of defense. Performance, consistency and risk management play critical roles in helping you meet all of your important financial goals on schedule.

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Consistency Matters (concluded from page 2)

likelihood) that this outcome will occur or be exceeded on schedule.

This process also tells us about some less than likely outcomes. For example there is a 10% chance that the portfolio will exceed $32,557,881 at plan end (not very likely to occur, but still possible). Likewise, there is a only a 10% likelihood (look at the red "90" line) that the client will be in debt to the tune of $911,777 at plan end (still possible, but not likely). For items printed in red, we also show at what age the failure is likely to occur if it does, in this case not until well into their 90's.

We get these measurement is a very useful way. By looking at how the portfolio is currently invested (or is likely to be invested after retirement), we can run a series of simulations that use real-life performance. We know how the client's mix did going all the way back to 1926, so we can tell how it did during bad years (great depression, 2000-2002), and how it did during great years (1995-99). We also know how it did during average years (1950s and 60s). We make the assumption that all of these years will probably happen again at some point, but we just don't know when and in which ORDER they're likely to reoccur.

Sorry for the long journey, but here's where consistency matters: Look at the last column which shows performance. THEY'RE NOT IN THE RIGHT ORDER! For example, if you can find the return for the 75th percentile (10.31%), the actual dollars that are left at the end equals roughly $4.4 million. Go all the way up to the return for the 50th percentile, and you get a return that is lower, but resulted in more dollars (nearly $7 million more!) How can this be???

It all has to do with the consistency of the returns. The simulations will put returns in random order, showing best case, worst case, and everything in between. The worst possible time to have a down year is when you first start taking assets out of your portfolio, for many the first years of retirement. From a performance standpoint, you might make a lot of the performance back in subsequent years, but because you also took money out, what is left in the portfolio has to work so much harder just to keep up with your withdrawals. In practically every scenario I've run over the past five years, the result is the same.

My clients know how much of an advocate I am for managing investment risk. Some would probably call me a "risk zealot," but the models we run really clarify the importance of managing the risk of significant market decline, especially when withdrawals are required. I welcome the opportunity to run these models at any time, and encourage all investors to utilize *WealthCare* in their own financial planning.

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Compass Portfolio Component	*Morningstar Category*	*Q4 2004 Total Return*	*2003 Total Return*	*2002 Total Return*	*2001 Total Return*	*2000 Total Return*
Compass Classic PLUS—NASDAQ 100	Lg. Cap Growth	+12.53%	+41.29%	-2.85%	+49.89%	+18.11%
Compass Classic—NASDAQ 100	Lg. Cap Growth	+12.53%	+42.07%	-12.47%	+8.27%	-7.41%
	Vs. NASDAQ 100 Index	**+14.75%**	**+49.12%**	**-37.58%**	**-32.65%**	**-36.84%**
Compass Classic PLUS—S&P 500	Lg. Cap Blend	+8.69%	+19.73%	-12.86%	+25.77%	-8.12%
Compass Classic—S&P 500 Index	Lg. Cap Blend	+8.69%	+23.62%	-14.31%	+4.02%	-8.88%
	Vs. S&P 500 Index	**+8.73%**	**+26.38%**	**-23.37%**	**-13.04%**	**-10.42%**
Compass Classic—Dow Jones Ind. Avg.	Lg. Cap Value	+7.14%	+24.93%	-12.26%	+2.24%	-6.01%
	Vs. Dow Jones Industrial Average	**+6.97%**	**+25.32%**	**-16.76%**	**-7.10%**	**-6.17%**
Compass Classic—Russell 2000 Sm. Cap Gr.	Sm. Cap Growth	+14.68%	+44.52%	-14.97%	NA	NA
	Vs. Russell 2000 Sm. Cap. Gr. Index	**+14.96%**	**+47.56%**	**-30.70%**	**NA**	**NA**
Compass Classic—Russell 2000 Sm. Cap Value	Sm. Cap Value	+12.68%	+46.00%	+2.07%	NA	NA
	Vs. Russell 2000 Sm. Cap Value Index	**+12.61%**	**+43.27%**	**-13.21%**	**NA**	**NA**
Compass Classic—Managed Income Portfolio	Domestic Hybrid	+7.48%	+16.76%	+14.96%	NA	NA
	Vs. Balanced Benchmark	**+5.44%**	**+17.42%**	**-10.72%**	**NA**	**NA**

*Important information: The Compass Portfolio performance information provided indicates what effect the buy and sell signals generated by the Compass Wealth Management Discipline have had on a model portfolio comprised of the index shares (iShares) indicated if such buy and sell signals were implemented. Although the buy and sell signals are actual recommendations which have been generated by the Compass Portfolio Management Discipline since December 31, 1999, the performance results are for a model portfolio and do not represent the actual performance of accounts managed using the Compass Portfolio Management Discipline. Performance statistics have been calculated net of a 1.00% management fee, net of applicable mutual fund expenses and net of brokerage costs using the internal iterative rate of return (dollar weighted) calculation method. While performance is compared to the benchmark indicated, client accounts may be fully invested, partially invested in cash equivalents, or invested in inverse ("bear market") funds, depending on the portfolio selected. The actual amount of time invested in the market will vary with economic conditions. Unlike an actual performance record, these performance results do not reflect the impact a client's economic circumstances might have had on the investment adviser's decision making if the investment adviser were managing a client's money. Investors should not consider the performance data a substitute for the performance of actual client accounts, nor should investors consider this data as an indication of future performance. The principal value and return of common stocks and equity mutual funds will fluctuate with changing market conditions, and may be worth more or less than your initial investment. All dividend, interest, and capital gain distributions assume reinvestment into the targeted investment. Performance statistics do not consider potential tax liabilities as a result of management activity. Please consult your tax advisor for further information. The Appleton Group, LLC became the investment advisor for The Compass Portfolios on April 5, 2002, with Mark C. Scheffler serving as the sole portfolio manager. Prior to that date, Mr. Scheffler managed The Compass Portfolios on a non-discretionary basis while employed as a broker with Robert W. Baird & Company, Inc. A complete history of all portfolio recommendations is available upon request. The unmanaged index for the Compass Classic—Managed Income Portfolio is a composite of the S&P 500 Index (60%) and the Vanguard Total Bond Market Index Fund (40%). Deviation from the models will produce substantially different results. The Appleton Group LLC is regulated by the U.S. Securities and Exchange Commission and by the State of Wisconsin, Department of Financial Institutions.

Introducing *The Appleton Group Tax Managed Portfolio* (continued from page 1)

institutions) the tax difference is not an issue. However, for individuals with high current income, the tax savings can be significant. One hitch, though, is that the assets have to be held for a longer period of time, which can expose the investor to significant risk if the market should be uncooperative (see years 2000-2002). That's where *The Appleton Group Tax Managed Portfolio* adds real value.

Our newest portfolio uses some of our most successful managed components (NASDAQ 100 PLUS, S&P 500 PLUS , and our Managed Income components) to offset the weakness that is periodically experienced by those components of the portfolio that are held for longer periods of time. During periods of sustained market weakness, the managed components are designed to appreciate, offsetting the losses that would be incurred by other parts of the portfolio.

The portfolio becomes more tax friendly by holding a portion of the assets indefinitely (deferring taxation on some assets), and by capturing dividends on these positions (which also receive favorable tax treatment).

As with all equity portfolios, an understanding of the discipline's limitations is important before deciding to undertake a specific strategy. We'd be more than happy to help you determine if *The Appleton Group Tax Managed Portfolio* is right for you.

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