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# 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 48 clients, and manages $33.25 million of investable assets. We serve individuals, families, corporations, institutions, endowments, trusts and company sponsored retirement plans.

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## Sand Versus Stone

Late last year, my wife and I agreed that with our two-year-old son discovering that he has legs (and knows how to use them), we needed a house that would give all of us a bit more space. Problem was, we loved our little house, a "gingerbread" cape cod just a few blocks from Lake Winnebago. It was the house Karen and I lived in after we got married, it was the house we brought Will home to when he was born. A house full of memories and a house we loved dearly. It would take an equally special house which we could eventually call home!

We knew the neighborhood we wanted to move to, and so we began a diligent search for just the right house. A new house didn't seem right, and so we agreed to focus on something more historic. After a few weeks of searching, we found the perfect house for us: an 1890's Queen Anne Victorian, lovingly neglected which needed just the right amount of tender restoration. Best of all, the neighborhood sets us within walking distance from downtown Appleton. So our story begins…

### Building a Solid Foundation

The house we found has stood the test of time. Over a hundred years of pounding rains, hail storms, blistering heat waves and the kinds of blizzards my grandparents would tell me about weren't enough to bring down this stately lady. She was built on a foundation of rock some two feet thick at its base, with pillars of support standing sentry for the last century. Each floor was stacked upon the other with great care, supporting the weight of occupants and possessions, as well as the carcass of the house itself.

Now for the "however." As we surveyed the needs of a 21st century occupant and reconciled the ability of a 19th century structure to meet them, we realized several shortcomings. You see, when this house was built, indoor plumbing didn't exist, and electricity was neither dependable nor readily available. Nor were there the kinds of modern technologies such as phone service, indoor laundry, refrigeration, gas furnaces or air conditioning. While stately and proud, much work needed to be done, and in some cases undone to make this house our home.

***Mark C. Scheffler***

Senior Portfolio Manager, Founder

### Home Improvement

We decided to tackle the critical items first, starting with electricity. While many of you may know that The Appleton Edison Light Company became the first organization in the world to commercially distribute

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*Inside this issue:*



## The First Rule of Magic

I have a young friend who goes to my church. She loves magic. Now, I'm no magician, but a thirty-four-year-old needs not have great skills to pull one over on a five-year-old, especially when it comes to hiding plates, forks and an occasional cookie.

She and I agree that our first rule of magic is simple: "Everything has to be somewhere." Well, what about the magic act that the investment industry has been playing for the better part of the past decade?

Hidden fees, under-the-table compensation, mysterious arrangements resulting in undisclosed compensation, and so the list goes. How easy is it to make it appear an investor is getting something for nothing, or less than nothing? Let's take a look...

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## Sand Versus Stone (continued from page 1)

electric power, few homes outside of the immediate downtown area were wired from the start. The knob-and-tube wiring present in our house was likely added after the dwelling was built and was certainly capable of handling the few demands of the time such as lighting, radio and not much more. While previous occupants have upgraded much of the original service, most of the upstairs bedrooms didn't have ceiling lights, the attic still had the original fixtures, and several lights throughout the house were hung in a way that would tempt any normal little boy to practice his trapeze act.

I'm no electrician. I could learn, but I know when to call in a professional (see plumbing, heating and structural items below!). In my professional role at The Appleton Group, I try to be realistic about risk. I realize that there are some risks that are worth taking. Electrical service is one of them. Seventy years ago, the occupants at the time realized that there was a benefit to replacing kerosene lamps (the cause of many house fires at the time) with electrical lighting. Today, new electrical boxes, circuits and wiring make electricity even safer, but it still needs to be treated with respect and diligence. With each bedroom updated, new electrical boxes and updated service coming to the house, we moved on to the bathroom.

When our house was built, the concept of indoor plumbing was almost literally a "pipe dream." Two pantries were converted to bathrooms back in the early 1930s, and lacked the space (and heat) that was needed. The original fixtures of the house had served their purpose but lacked the features that we desired. Likewise, the parade of plumbers bidding on our upgrade each indicated that the normal life of the original cast-iron pipe (which ran from basement to attic) was approximately 70 years, meaning it was time for a change there too. Out went the pipe, along with conventional copper water lines in favor of lightweight plastic pipe and state-of-the-art flexible water lines. Also out was the original Kohler sink and cast-iron tub (to be used later) in favor of new Kohler fixtures. Out went the linoleum, in goes the ceramic tile. Out went the indoor/outdoor carpeting from the master staircase, in goes the du Pont Stainmaster™ carpeting. New materials, hopefully with enduring qualities and enhanced durability.

As we were in need of a bit more space than the upstairs bathroom provided, we decided to invade the adjoining bedroom. This process gave us a very interesting and informative look into the original workmanship of the house. First, we discovered that much of the original wood in the house was mature when it was felled to be made into lumber. That meant that it was likely these trees were saplings when our country was still in its own infancy! We also discovered that the outside carcass of the house had no insulation, and what little insulation did exist in the ceilings was made out of cotton batting! Quite a shock.

Months later, after careful planning and timely execution, we now have the house that will in time become our home. We think it is the perfect balance of history, modern conveniences, space and location that will enhance Karen's teaching, give Will the space to discover his young legs, and help me to better serve my clients with a three minute commute to my office.

*"Built in haste, the portfolio may crumble. Built wisely, the portfolio endures."*

### Lessons Learned and Applied

You've probably heard the story of the two men who each built new homes, one out of sand, and one out of stone. The man who built his house out of sand finished first, completing his foundation and walls in no time at all. In contrast, the other man labored many hours in the quarry, cutting and hauling stones, piecing the walls together, enduring backbreaking work to create a lasting monument for his family. When the inevitable storm hit, each man sought shelter in the home he had built. The house made of sand quickly washed away, as do so many things made in haste. The stone house endured, weathered that storm, and served as a model for other builders to follow.

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## Tidbits...

**308,000**: The number of new jobs created in March, 2004 by the U.S. economy. January and February's payroll reports were revised higher than originally reported by 64% and 219% respectively.

**-12.97%:** The percentage decline from April 1-12th for the Cohen & Steers Real Estate ETF, a popular index of commercial and residential investment real estate. The stunning decline is largely due to the prospect of a higher interest rate environment on an overbuilt real estate market.

**$110 Million**: The amount of the recently imposed fine on Putnam Investments by the Securities and Exchange Commission for ignoring market timing abuses by managers and clients.

**$41 Billion**: The amount of money investors have withdrawn from Putnam investments since September, 2003 resulting in approximately $844 million in lost annual revenue.

## Casting for a Trophy: "Fishing" with Compass STAR Plus

My brother Matthew is a superb outdoorsman. When we were growing up he seemed to have a knack for seeing wild animals before any one else, and it seemed that he was always in the right place at the right time. Whether it was finding a trophy buck, spotting a bald eagle circling far overhead, or identifying just the right spot to cast for musky, he was the guy you wanted to be with.

A few years back we went fishing up north together one summer day, and we had a fair amount of success catching your typical pan fish: bluegill, sunfish, perch and maybe a few crappie. No big fish, just a lot of nice small ones that would make a good meal for the two of us.

I also remember him telling me once how he had recently gone musky fishing, an entirely different experience than fishing for pan fish. With perch and bluegill, you'd let the fish come to you. A lot of small fish, a lot to eat, but nothing worth hanging on your wall or putting in a photo album. Musky fishing was different: first of all, you had much larger tackle, and you'd cast maybe a hundred times or more even for one strike. But boy, when you hooked into one, did you have a story to tell!

I share this with you because a similar scenario often plays out with the Compass STAR Plus Portfolio. This more assertive portfolio is designed for an investor who wishes to profit both from sustained market advances and sustained market declines. Big fish, in other words.

The volatile markets of the early 2000s continues to be a favorable environment for this portfolio discipline. The sustained bear market of 2000-2002 and the sustained bull market of 2003 have combined to yield trophy results (see page 4 for performance information and appropriate disclosures). However, the process tends to require a bit of preparation for the investor.

You see, there tends to be a lot of "casting," that is, we get periods of time in which nothing happens (just like in musky fishing), and then all of a sudden we hook into a big sustained market move and boy do we have a story to tell! Historically, there have been periods of time in which the returns of the Compass STAR Plus Portfolio have been completely the opposite of the overall market. Portfolio advances coming during periods of market weakness; modest portfolio declines coming during periods of market advance.

Having two guys literally in the same boat, one fishing for pan fish (more like Compass STAR where

consistency is the name of the game) and one fishing for musky (Compass STAR), will most assuredly result in very different results from the same trip and from fishing in the same waters. Watching your companion haul in a lot of small fish is hard when you're getting nothing. Watching your friend land a trophy musky is difficult when all you get is a lot of little stuff.

Big fish or small, choosing which portfolio to use will depend on your personality, and in knowing what to expect ahead of time.

**-MCS**

## The First Rule of Magic (continued from page 1)

First, there's the hidden fee. It's as easy to find as looking at the TV commercial for the bank that promises to give you free check writing, free bill-pay, free direct deposit, free this and free that. How do they do it? By simply lowering the amount of interest you get on your checking or savings account. Voila! No fee per se, but you certainly pay for it out of your earnings.

That's a pretty simple example. Let's take one that's a bit more complex: How about a brokerage firm selling you a municipal bond that has just come to market? This is a good one, because you have to look at both sides of the transaction to see the big picture. The brokerage firm is paid by the municipality issuing the bond to "do the deed," to find buyers for the bond. This is called "underwriting," and the brokerage firm's fee comes out of the proceeds that are raised from the eventual sale of the securities. When the brokerage firm turns around and sells the bond to the public, it gets another fee (a commission) to sell it to you (typically 1%). Always disclosed, perfectly legal, but tucked away neatly so as to not to show up on your confirmation.

Here's an instance that is not as clean. MFS, the self-described inventor of the mutual fund, recently ended a practice for which it has drawn fire. MFS is a loaded fund family, which simply means that brokers are paid a commission to sell it to the public. You can imagine that some brokerage firms (and incidentally banks, insurance companies, etc.) end up selling more MFS shares than others. Some of these "top producers" also happen to be in the business of selling stocks to mutual fund companies, and if MFS were to need additional shares of a particular stock for its own portfolio, they would reward the top producing firms by buying shares through them, giving them an extra commission to boot.

Since our founding, The Appleton Group has made a commitment to its clients by issuing a "Fee Only Guarantee." This guarantee simply states that the only form of compensation we will receive are the asset management fees our clients' pay us to manage their hard-earned assets. We accept no other forms of compensation: no commissions,

no payments for referrals, no kickbacks from mutual fund companies, no hidden compensation and therefore no conflicts of interest. We believe that transparency is important, and we therefore disclose any and all fees that are incurred as a result of the professional wealth management our clients expect.

"Everything has to be somewhere." This is a concept that is catching on in the investment community, and will hopefully make the landscape more equally balanced for all investors.

**-MCS**

# The Compass Portfolios: Historic Performance Summary*

| Compass Portfolio Component | Morningstar Category | Q1 2004 Total Return | 2003 Total Return | 2002 Total Return | 2001 Total Return | 2000 Total Return | Avg. Annual Return Since Inception |
|---|---|---|---|---|---|---|---|
| Compass Classic PLUS—NASDAQ 100 | Lg. Cap Growth | -2.74% | +41.29% | -2.85% | +49.89% | +18.11% | +22.43[a] |
| Compass Classic—NASDAQ 100 | Lg. Cap Growth | -2.06% | +42.07% | -12.47% | +8.27% | -7.41% | +4.81%[a] |
| ***Vs. NASDAQ 100 Index*** | | **-2.01%** | **+49.12%** | **-37.58%** | **-32.65%** | **-36.84%** | **-20.06%**[a] |
| Compass Classic PLUS—S&P 500 | Lg. Cap Blend | -3.80% | +19.73% | -12.86% | +25.77% | -8.12% | +3.55%[a] |
| Compass Classic—S&P 500 Index | Lg. Cap Blend | -0.97% | +23.62% | -14.31% | +4.02% | -8.88% | +0.09%[a] |
| ***Vs. S&P 500 Index*** | | **+1.29%** | **+26.38%** | **-23.37%** | **-13.04%** | **-10.42%** | **-6.14%**[a] |
| Compass Classic—Dow Jones Ind. Avg. | Lg. Cap Value | -0.36% | +24.93% | -12.26% | +2.24% | -6.01% | +1.14%[a] |
| ***Vs. Dow Jones Industrial Average*** | | **-.92%** | **+25.32%** | **-16.76%** | **-7.10%** | **-6.17%** | **-2.43%**[a] |
| Compass Classic—Russell 2000 Sm. Cap Gr. | Sm. Cap Growth | +0.58% | +44.52% | -14.97% | NA | NA | +9.85%[b] |
| ***Vs. Russell 2000 Sm. Cap. Gr. Index*** | | **+5.47%** | **+47.56%** | **-30.70%** | **NA** | **NA** | **+3.41%**[b] |
| Compass Classic—Russell 2000 Sm. Cap Value | Sm. Cap Value | +3.79% | +46.00% | +2.07% | NA | NA | +21.39%[b] |
| ***Vs. Russell 2000 Sm. Cap Value Index*** | | **+6.51%** | **+43.27%** | **-13.21%** | **NA** | **NA** | **+13.23%**[b] |
| Compass Classic—Managed Income Portfolio | Domestic Hybrid | +2.19% | +16.76% | +14.96% | NA | NA | +15.08%[b] |
| ***Vs. Balanced Benchmark*** | | **+1.34%** | **+17.42%** | **-10.72%** | **NA** | **NA** | **+2.72%**[b] |

*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.

[a]Inception date:12/31/1999. [b]Inception date: 12/31/2001.

## Sand Versus Stone (concluded from page 2)

Building a sustainable portfolio is much like the process of renovating our Victorian Queen Anne. Decisions have to be made regarding construction materials. Sand or stone, the longevity depends on the quality and strength of the materials. Built in haste, the portfolio may crumble. Built wisely (time will tell), the portfolio endures. In renovation, the key issue involves deciding what to keep and what to remove. We chose to keep the enduring characteristics that had made the house both strong and serene. The hardwood floors, the carved staircase, finials, moldings, pocket doors and copper hearths. In a portfolio, using the enduring structures of free market enterprise, capitalism, primary and secondary markets and free and fair trade all work their magic to create wealth over time. Adding new and better ways to manage investment risk (tactical and strategic asset allocation), new ways to diversify (exchange traded funds) and new ways to structure the client experience (The Appleton Group business model) work harmoniously to help clients experience the best in professional wealth management.

Once completed, Karen and I welcome the opportunity to open the doors of our home to you. We wish to sincerely thank all of our clients for helping to make this dream of ours a reality!

*-MCS*