4th Quarter, 2003

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 40 clients, and manages $25.3 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 State of Wisconsin, Department of Financial Institutions.

Inside this issue:

Toward a Sustainable Society

How long will it last? That's one question I get a lot from clients and friends when we discuss the market activity of the current year. While we've certainly seen more than a little bit of growth in our portfolios, sustaining the gains is as critical as creating the gains. After all, what good is the market advance if it all dissolves before it can be put to good use?

As an occasional observer of society, I am grateful for the unique position I am in. Not only am I fortunate to serve an engaging and diverse clientele, but I have the luxury of occasionally contemplating far-reaching stewardship issues, among them observing and doing my part to steer society (in a very small way) toward one that is more stable, more predictable, and one that augments the good works I observe around me. Grand thoughts indeed from a very tiny office, and arguably my sometimes tiny mind.

Readers familiar with our quarterly newsletter will remember an article published earlier this year which focused on the emerging discipline of "Biomimicry." This discipline focuses on using nature as a model for such varied fields as engineering, architecture, investment, and government. One of the key outcomes of this process is sustainability. A sustainable society is one that maintains a high standard of living, full employment, personal development and learning, and a high standard of health throughout life.

Arguably, there have been few points in human history when we have been more prepared to transition toward a sustainable global society. Without sacrificing the high standard of living we all enjoy, what would such a society look like? I believe it begins with sustainable development.

Mark C. Scheffler

Senior Portfolio Manager,
Founder

Sustainable development is the process by which we work to maintain our high standard of living. The most widely used definition appeared back in 1987: "Development that meets the needs of the present without compromising the ability of future generations to meet their own needs." One model is Britain's Sustainable Development Strategy, published in May 1999, which defines sustainable development in terms of four objectives:

1. Social progress which recognizes the needs of everyone

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Balancing Tax Efficiency and Investment Risk Management

The old saying goes, "You can't have your cake and eat it too." So it is with the twin goals of keeping your tax burden on investment gains as low as possible while simultaneously managing the risks of investing in the volatile markets of the new millennium.

First, a bit of language clarification: Gains in a portfolio are classified as either "unrealized" or "realized." Most simply put, unrealized gains exist when you have an investment that is currently worth more than you paid for it, but have not yet sold. Easy enough. Realized gains exist after you have sold the investment for a profit, and it is at that point that taxes on the gains need to be calculated. Generally speaking, if you held the investment for less than one year before you sold it for a profit, your gain is taxable as regular income, often as high as 35%! Recent changes in the

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Toward a Sustainable Society (continued from page 1)

2. Maintenance of high and stable levels of economic growth and employment
3. Effective protection of the environment
4. Prudent use of natural resources

A popular way of understanding sustainability is the concept of the "triple bottom line" of economic, environmental and social accountability. This idea proposes that an organization's license to operate in society comes not just from satisfying stakeholders through improved profits (the economic bottom line), but by improving its social and environmental performance (which many corporations already embrace). In this environment, shares of corporations become even more prized.

The Sustainable Development Strategy modeled in Great Britain believes that by maintaining and trying to increase stocks of these capital assets, we can live off the inherent income, without reducing the capital itself. But for this to happen it is the responsibility of every organization, business or otherwise, to manage these capital assets in a sustainable fashion.

12 Features of a Sustainable Society

By describing what a sustainable society should look like, the "12 features" model helps organizations and communities evaluate the sustainability of their projects.

IF we invest appropriately AND achieve the flow of benefits, the following statements would be true. They represent the OUTCOME of a successful capital investment strategy for sustainable development - that is, a sustainable society:

Sustainability of Natural Capital

1. In their extraction and use, substances taken from the earth do not exceed the environment's capacity to disperse, absorb, recycle or otherwise neutralize their harmful effects (to humans and/or the environment)
2. In their manufacture and use, artificial substances do not exceed the environment's capacity to disperse, absorb, recycle or otherwise neutralize their harmful effects (to humans and/or the environment)
3. The capacity of the environment to provide ecological system integrity, biological diversity and productivity is protected or enhanced

Sustainability of Human Capital

4. At all ages, individuals enjoy a high standard of health
5. Individuals are adept at relationships and social participation, and throughout life set and achieve high personal standards of their development and learning
6. There is access to varied and satisfying opportunities for work, personal creativity, and recreation

Sustainability of Social Capital

7. There are trusted and accessible systems of governance and justice
8. Communities and society at large share key positive values and a sense of purpose
9. The structures and institutions of society promote stewardship of natural resources and development of people
10. Homes, communities and society at large provide safe, supportive living and working environments

Sustainability of Manufactured Capital

11. All infrastructure, technologies and processes make minimum use of natural resources and maximum use of human innovation and skills

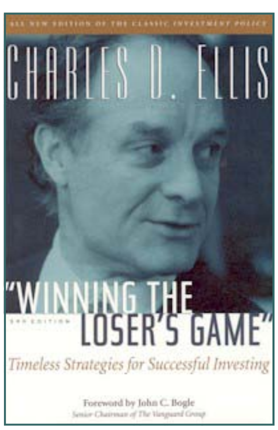
Sustainability of Financial Capital

12. Financial capital accurately represents the value of natural, human, social and manufactured capital

Transitioning toward a sustainable society is already well underway, and represents challenges to all of us. Dealing with these challenges on both a personal and societal level will almost certainly produce great debate as we move forward. I welcome your feedback.

-MCS

Reader's Corner: "Winning the Loser's Game" by Charles Ellis



When I first read this headline, I was startled. The concept of a "loser's game" is introduced in Charles Ellis' book "Winning the Loser's Game." Ellis serves as the Senior Chairman of The Vanguard Group, known worldwide as the central player in a strategy known as indexing. Written in the throughs of the bull market of the late 90s, Ellis offers his thoughts on investment management, risk management, and getting ahead in today's market. The headline did its job; I was hooked!

Simply put, in a winner's game the outcome is determined by the correct actions of the *winner*. In a loser's game, the outcome is determined by mistakes made by the *loser*. Baseball is very much a winner's game since the team (or individual on the team) that scores the most runs over the course of the game wins. On the other hand, amateur tennis is a prime example of a loser's game since the majority of points scored are a result of the mistakes made by your opponent. To take it further, "Professionals *win* points, amateurs *lose* points."

"Professional tennis players stroke the ball hard, with laserlike precision, through long and often exciting rallies, until one player is able to drive the ball just out of reach or force the other player to make an error. ...Amateur tennis is almost entirely different. Brilliant shots, long and exciting rallies, and seemingly miraculous recoveries are few and far

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Balancing Tax Efficiency... (continued from page 1)

Federal tax laws have helped to reduce the tax responsibilities on gains captured after owning the investment for one year or more, now pegged at only 15%.

Wow! What a huge difference. It sounds like for investors in high tax brackets capturing only long-term gains would be the only way to go. In an ideal world, that would be true. Except that the reality of all markets dictates that there are inherent risks of prioritizing tax efficiency over investment risk management.

During the bear markets of the early 2000s, the true cost of tax efficiency equated to sizable and often painful capital losses. Holding equity assets, no matter their past performance or the emotional ties an investor may have had meant navigating a sometimes treacherous path of potential losses. Selling the asset and realizing a capital gain, on the other hand, often would have meant paying taxes, for some a more painful experience than enduring the uncertainty of lower future values. What to do?

As managing investment risk is the core discipline of the Compass Wealth Management Process, superior performance during unfavorable markets often means choosing not to participate in the markets. This often results in higher tax burdens as a consequence of selling, but also often results in higher retained value. Balancing these twin desires is a challenge, now made easier by the pain of the bear market and recently reduced tax rates.

One novel solution is a portfolio process that addresses an investors desire to participate in the markets, manage investment risk, and simultaneously be tax efficient: Compass Voyager.

Compass Voyager, our signature "buy and hold" managed portfolio uses the exceptionally tax-efficient indexes present in our more actively managed portfolios, and employs an asset allocation process designed to generate primarily long-term capital gains. Investment risk is managed through the broad diversification present in the index mutual funds, and can often be enhanced further by employing a tactical strategy with more volatile components. In layman's terms, we hold more conservative investments for one year or more while actively managing more aggressive investments. This dual approach helps balance the desire to minimize tax responsibilities while simultaneously managing investment risk.

Compass Voyager also employs an annual rebalancing feature, systematically trimming positions that have grown over the past year and adding to positions that have declined in value. Additionally, by using index mutual funds that pay dividends, we further reduce our tax responsibility. Under the new tax law, dividends from qualifying investments are now taxed at only 15%, as opposed to regular bond interest which is taxable at the investor's highest applicable tax rate.

Due to our firm's commitment to serve a limited clientele, it is easy to customize portfolios to meet a specific client's needs. Both fully managed and strategically managed portfolios can be part of a comprehensive investment management program. We are pleased to offer our clients both!

-MCS

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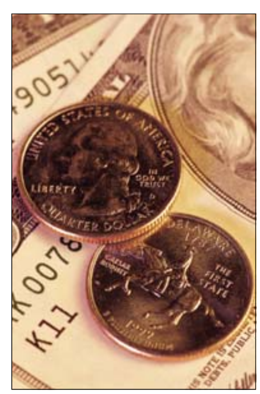
Did you know???

- In ancient times, people believed that major life decisions should be made by the gods. They devised a way to coax the gods to answer questions with an unequivocal "yes" or "no" by the flip of a coin. Julius Caesar was the first person to institute the practice of coin flipping to determine one's fate. Caesar's own head was cast on every Roman coin and it was the head side that indicated the winner. Litigation was often settled in this same manner. A heads-up landing of the coin meant that the emperor, in absentia, agreed with a particular decision.
- Over 42 million Americans currently have no health insurance.
- Martha Washington is the only woman whose portrait has appeared on a U.S. currency note. It was on the face of the $1 Silver Certificate of 1886 and 1891, and the back of the $1 Silver Certificate of 1896.
- Nigeria recently launched its first satellite into orbit. It is designed to measure deforestation, erosion, oil piracy and climate change. The average Nigerian earns only $300 per year, making it one of the 20 poorest in the world.



The Compass Portfolios: Historic Performance Summary*

Compass Portfolio Name	*Morningstar Category*	*Q3 2003*		*YTD 2003*		*2002*	
		Total Return	*Un-managed Index*	*Total Return*	*Un-managed Index*	*Total Return*	*Un-managed Index*
Compass Classic PLUS—NASDAQ 100	Lg. Cap Growth	8.25%	7.09%	27.72%	32.44%	-2.82%	-37.37%
Compass Classic PLUS—S&P 500	Lg. Cap Blend	2.38%	1.39%	7.58%	13.20%	-13.57%	-22.81%
Compass Classic—Dow Jones Ind. Avg.	Lg. Cap Value	3.58%	2.59%	8.52%	11.19%	-14.68%	-16.32%
Compass Classic—S&P 500 Index	Lg. Cap Blend	2.38%	1.39%	13.57%	13.20%	-15.81%	-22.81%
Compass Classic—NASDAQ 100	Lg. Cap Growth	8.25%	7.09%	28.50%	32.44%	-13.17%	-37.37%
Compass Classic—Russell 2000 Sm. Cap Gr.	Sm. Cap Growth	11.30%	10.32%	30.71%	31.11%	-12.52%	-30.30%
Compass Classic—Russell 2000 Sm. Cap Value	Sm. Cap Value	7.74%	6.88%	27.14%	23.67%	+0.72%	-11.37%
Compass Classic—Managed Income Portfolio	Domestic Hybrid	-3.75%	0.68%	12.10%	6.14%	+14.66%	-9.76%

*Important Information: The Compass Portfolio information provided indicates what effect the buy and sell signals would have had on an investment portfolio comprised of the index shares (iShares) indicated if such buy and sell signals were implemented. Although the buy and sell signals are actual signals which have been generated by the Compass Portfolio Management System since December 30, 1999, THE PERFORMANCE RESULTS ARE FOR A MODEL PORTFOLIO and do not represent the actual performance of accounts managed using the Compass Portfolio Management System. Actual client accounts are typically invested in equity mutual funds which may hold all, some or none of the stocks which comprise the iShare used as the model. In addition, although performance is compared to a benchmark indicated, client accounts are typically either fully invested, partially invested in cash equivalents, fully invested in cash equivalents, or in inverse ("bear market") funds, depending on the portfolio selected. The actual amount of time invested in the market will vary with economic conditions. Furthermore, unlike an actual performance record, these performance results (1) do not reflect the money market interest a client may have earned during defensive postures, and (2) 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 actually 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 continuing to serve 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. Clients in the Compass Program are invested in mutual funds, and the performance does not reflect the deduction of mutual fund expenses. Share prices have been adjusted for all dividends, splits and distributions for the period indicated. The unmanaged index for the Compass Classic—Managed Income Portfolio is a composite of the S&P 500 (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 State of Wisconsin, Department of Financial Institutions.

Reader's Corner... (continued from page 2)

between. Instead, the ball is often hit into the net or out of bounds, and double faults at service are not uncommon. The amateur seldom beats his *opponent*, but he beats *himself* all the time."

It can certainly be said however that in investing the vast majority of professionals (mutual fund managers, independent money managers, and most brokers) also have a difficult time "winning points," that is to say beating the market. Providing substantial protection in down markets and overachieving returns in rising markets is a daunting task, according to Ellis, and this money manager agrees.

"The stark reality is that most money managers have been losing the money game. The historical record is that in the 25 years ending with 1997, on a cumulative basis, over three-quarters of professionally managed funds underperformed the S&P 500 Index" writes Ellis. No doubt true, and verified in large-part by both Morningstar™ and Barclay's Global Investors in separate studies.

The market activity of the past seven years had crystallized a key fact of investment reality: the vast majority of mutual funds, variable annuity subaccounts and independent money managers who maintain fully invested portfolios serve only to give investors access to the equity or fixed income markets. Once the decision to allocate money to these entities has been made, you are exposed to market risk with little or no recourse should markets fail. Through both favorable and unfavorable markets, an investor's results will correlate strongly to that of the markets themselves with a strong likelihood of consistent and sometimes significant underperformance.

"The only way to beat the market, after adjusting for market risk, is to discover and exploit other investor's mistakes" writes Ellis. Now we're on to something, as I believe the most often-repeated investment mistake investors make (both professional and amateur alike) is failing to effectively manage investment risk. Assuming this is true, perhaps the best way to stay ahead is to exploit other investors' mistakes, taking advantage of ineffective investment risk management. Under this premise, less is more: less risk can indeed mean higher returns, greater stability, and certainly more peace of mind.

Ellis continues: "There are three kinds of investment risk. Two can be virtually eliminated. The third must be managed." The "third risk" he means is market risk, the risk that all equities or all bonds will be negatively impacted by a total market event: a sustained bear market. For our purposes, this risk is managed by objectively choosing how much risk we should prudently be exposed to given what we know about the current market environment. This point is critical: if in the long-term the markets only move in one direction, then a fully-invested portfolio of index mutual funds is the superior investment choice (see "Balancing Tax Efficiency and Investment Risk Management" from page 1).

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-Charles Ellis

-MCS