Summer 2004 **VOLUME 10:2**

PDV *OBSERVATIONS*

A Quarterly Newsletter for PDV Clients and Friends

FREQUENTLY ASKED QUESTIONS

In this issue of ***Observations***, we answer some commonly asked questions about **PDV** for the benefit of our newer clients as well as those readers who contemplate engaging **PDV** for financial advisory and management services.

What Does PDV Stand For?

Our name "**PDV**" is an acronym for patience, discipline and value-orientation. These are the qualities and principles that guide and shape our investment style and philosophy, forming the basis for how we help our clients manage their assets.

How Long Has PDV Been in Business?

PDV has been in business since 1994, and has experienced robust growth since inception.

What is the Background of PDV's Senior Management?

Mr. Che H. Lee, co-founder and President, attended elementary school in Hong Kong and secondary school in England. He graduated *Summa Cum Laude* from Occidental College, where he obtained an A.B. Degree in Economics (he was the top graduate in the Economics Department) and a minor in Philosophy. He then attained his J.D. Degree from Boalt Hall School of Law at University of California, Berkeley, where he was elected a member of the Law Review. Che practiced real estate law as a member of the California State Bar for 9 years before founding **PDV *Financial Management*** in 1994 to pursue his longtime passion for the financial markets and to help clients achieve their financial goals.

Che serves as the chief investment manager for all client accounts and supervises all investment work conducted by **PDV**. He spends his time researching, analyzing and monitoring promising undervalued investments for client portfolios, and helping clients with financial and investment matters.

Ms. Deborah W. Lee, co-founder and Senior Financial Advisor, attended elementary and secondary schools in Hong Kong, before moving onto Cal Poly Pomona, where she graduated *Cum Laude* with a B.S Degree in Hotel & Restaurant Management. She then obtained her M.S. Degree from Purdue University in Restaurant, Hotel and Institutional Management.

After co-founding **PDV** in 1994 and seeing the firm experience steady and robust growth, Debbie moved on to work as Senior Portfolio Analyst at AMI Asset Management, where she was in charge of that firm's "back-office" operations and conducted investment research and analysis. Since returning to **PDV** in 2002, Debbie acts as the assistant portfolio manager for client accounts, helping with investment research and analysis, and providing various financial planning services, such as consultation and analysis on 529 Education Savings Plans. Debbie is also in charge of back-office operations at **PDV**, supervising the **PDV** staff in helping clients with operational and administrative issues relating to their accounts, providing assistance on Schwab-related matters and generating portfolio data to support investment decisions.

What Is PDV's Investment Philosophy?

Our investment philosophy is to exercise discipline to seek out investments whose underlying business value is being under-priced by the short-term market price, and practice patience to wait for the value and price to converge over time. These investments are often discovered after we develop a variant or contrarian view of the investment's long-term prospects that are different from the consensus prevailing at the time.

How Is PDV Different From a Stockbroker?

We are completely different from brokers. Many people make investment decisions based on recommendations from their stockbrokers. Stockbrokers make their living from commissions, and their primary activity is therefore to sell financial products to their clients. The good stockbrokers will sell products that are intended to advance their clients' goals, while the bad ones will sell products that generate high commissions regardless of whether they benefit clients. Unscrupulous brokers with discretionary authority over client accounts will "churn" accounts to generate commissions. **PDV** does not sell any financial products or earn any commissions from actions it takes on behalf of its clients.

What Are the Fees for PDV's Services?

PDV primarily offers investment advisory services for a percentage of the market value of assets under management. We offer two investment programs with different fee structures, but the same minimum account size requirements. Some clients have elected to have their portfolios managed under a combination of these two programs, with a separately negotiated fee schedule.

Program One applies to any account whose size is at least $500,000 and for which **PDV** will primarily (but not necessarily exclusively) select and invest in individual securities (as opposed to open-end or closed-end mutual funds) on behalf of the client. The annual fee for a Program One account is 1% of amounts up to $1 million; 0.80% of that portion of the account that exceeds $1.0 million but is less than or equal to $3 million; and 0.65% of any portion of the account that exceeds $3 million.

Program Two applies to any account whose size is at least $500,000 and for which **PDV** will primarily (but not necessarily exclusively) select and invest in open-end or closed-end mutual funds on behalf of the client. The annual fee for a Program Two account is 0.80% for amounts up to $1 million; 0.65% of that portion of the account that exceeds $1.0 million but is less than or equal to $3 million; and 0.55% of any portion of the account that exceeds $3 million.

Fees are payable quarterly in arrears based on the market value of the assets (including all accrued interest) in the account as of the last day of the calendar quarter equal to one-quarter of the annual rate specified above.

How Do I Transfer My Assets So That PDV Can Begin Managing Them?

In order to manage your assets, **PDV** will need them transferred to a broker/dealer. The procedures for the transfer will depend on where your assets are currently being kept and what is the nature of your assets. Bank accounts can be closed and the cash balance in the accounts can be easily transferred to the broker/dealer. Funds invested in certificates of deposit can be withdrawn at maturity. Many securities also can be easily transferred. Annuities, however, involve special considerations. Also, if your assets are held in a retirement account, your ability to transfer the assets without suffering adverse tax and other adverse monetary consequences will differ based on the type and particular details of the retirement plan. Most tax-deferred accounts can be directly rolled over into another tax deferred account without withholding or income tax, and PDV will be happy to assist you in accomplishing this. **PDV** will work with you and the broker/dealer to determine if it is possible to transfer assets into the custody of the broker/dealer without incurring any adverse monetary consequences. Even if your assets cannot be transferred because of the type of retirement account involved, in situations where you have complete or some discretion as a plan participant to direct the investment of your portion of the plan assets, **PDV** can still assist you with your investment decisions.

Does PDV Take Custody Of Client Assets?

Except as described below, **PDV** does not take custody of client assets, which are kept with the broker/dealer through whom trades are executed. **PDV** obtains discretionary authority to invest and manage client assets pursuant to an investment management agreement, though **PDV** does have one or more non-discretionary accounts from time to time. The client remains the account holder of the brokerage account at the broker/dealer, which is authorized by the client to take investment instructions from **PDV** pursuant to a form of limited power of attorney signed by both the client and **PDV**. **PDV** will ***not*** be able to withdraw funds or assets from client accounts; however, if the client authorizes **PDV** management fees to be automatically deducted from his or her account, then this will be implemented as described below.

Most clients have given Charles Schwab & Co., Inc., as custodian of their assets, the authorization to deduct fees directly from their accounts, per fee requests submitted by **PDV** at the end of each calendar quarter pursuant to investment management contracts between **PDV** and those clients. If a client consents to having **PDV** management fees deducted automatically from his or her account following their due date, **PDV** sends the client and the broker/dealer acting as custodian at the same time an invoice showing the amount of the management fee, value of the client assets on which the fee was based, and the manner in which **PDV**'s fee was calculated. Such custodian also sends the client a statement, at least quarterly, indicating all amounts disbursed from the client's account, including the amount of **PDV**'s fee paid directly to **PDV** from the account.

Does PDV Select A Broker/Dealer For The Client?

PDV will honor a client's preference for a broker/dealer. If the client does not have a preference, **PDV** will select a broker/dealer for the client based on, among other factors, the reasonableness of its commission schedule, the efficiency of its back-office operations, the accuracy of its trade execution, its ability to facilitate the administration and management of the client's portfolio and some other factors set forth in our Best Execution Policy Manual, which is available for review upon request. Currently, for those clients who do not have a preference for a broker-dealer, **PDV** anticipates recommending Charles Schwab & Co., Inc. to its clients as the custodian and broker/dealer for equity, fixed-income and mutual fund trading and Tradebonds.com and Stone & Youngberg for fixed-income trading, though this is subject to change without notice. **PDV** and its employees currently maintain accounts at Schwab, but are not in any way affiliated with Schwab or paid by Schwab, Tradebonds.com or Stone & Youngberg for the recommendation.

Will the Asset Allocation for a Client's Portfolio Change Over Time?

At least three factors will change the asset allocation of a client's portfolio over time. First, adjustment to the asset allocation may be necessary if the client's financial condition or goal, or risk tolerance level changes. Second, while **PDV** does not believe in timing the market, it does focus on macro-economic conditions. Under certain circumstances, **PDV** may determine it is appropriate to adjust the asset allocation to more aggressively seek out capital appreciation or defensively preserve capital. Third, fluctuations in the value of the securities in the various asset classes after the initial asset allocation will alter the respective asset allocation percentages. Portfolios may be adjusted when their asset allocation make-up changes drastically because of these fluctuations.

How Does PDV Define And Address Risk?

We believe that the concept of "risk" should best be qualified by an adjective. There are many types of risk: market risk, business risk, inflation risk etc. When making investment decisions, investors need to make trade-offs between different sets of risks. The type of risk **PDV** worries most about is "risk of permanent capital loss," as opposed to quotational or paper loss caused by market fluctuations and volatility.

What Can You Do to Help Your Investment Results?

Among other things, you can help your investment results by doing the following: develop a coping system to address your emotions and resist feelings of fear and greed; exercise patience; have realistic expectations about level, speed and consistency of investment progress; avoid listening to the media, neighbors, friends, colleagues and relatives offering free investment advice etc.

What Types of Investments Does PDV Favor?

We will invest in securities possessing financial characteristics that tilt the odds of success in your favor, rather than in Wall Street's favor. Our investment philosophy is to endeavor to shop for values anywhere in the market, without letting artificial distinctions like big cap, mid-cap or small cap hinder us; we will go wherever the investment bargains or opportunities manifest themselves.

When Does PDV Sell An Investment?

We generally sell under one of four circumstances: a) the stock has become grossly overvalued, b) after taking tax and transaction cost considerations into account, a much more compelling investment comes along, c) subsequent events following our stock purchase have demonstrated an unexpected and likely permanent deterioration in business value that does not appear to be adequately discounted by the current stock price, or d) the stock has become too large a position (generally defined as over 10% of the total assets under management).

How Many Investments Might a Typical Individual Equity Portfolio Contain?

A portfolio invested in only individual equities might typically contain anywhere from fifteen to twenty five separate positions, though exceptions exist depending on account size.

What Is the Typical Holding Period for An Investment?

We are prepared to hold an investment, as long as there is no reason to sell it based on the factors described above. If an investment appreciates quickly to grossly overvalued levels, we are happy to sell it even if it is only after a short time period. However, when we make the initial investment on behalf of our clients, we do not expect the stock price and business value to converge quickly, and are prepared to give the situation at least a couple of years to work out, though we would constantly be reevaluating the situation along the way.