August 11, 2004

We hope you are well. Enclosed is the AAM mid-year 2004 client report. In addition to the semi-annual letter, you will find detailed information about your financial program including mid-year tax information.

The menu for the 2004 mid-year letter provides an appetizer consisting of our view of the current macroeconomic environment, a four course serving with our assessment of the major asset classes, an intermezzo reviewing the AAM investment approach, the usual sides of history, pop culture, and investor psychology, as well as some informal remarks for dessert. (Many of us in the office have been dieting and we've been fantasizing about large meals.) Please select your beverage of choice and read on.

LIFE'S A BEACH

"Do not anticipate trouble, or worry about what may never happen. Keep in the sunlight."
-Benjamin Franklin-

"Keep in the sunlight but wear sunscreen."
-Eileen Alter-

Successful long-term investing requires the optimism of Franklin coupled with the **"margin of safety"** that Howard's mother advocates.

When the sunlight is bright and things get hot like they did in the late 1990's, your advisor is packing on the SPF 50 and heading for the shade. We may look a little pale compared to our bronze colleagues, but we are minimizing the risk of a highly unfavorable long-term outcome. Conversely, when the sun sneaks behind some clouds and things look dark as they did in 2002 – come down by the water and you'll find us walking along the shore scooping up pearls.

As we write to you in early August, the market is in the doldrums. Mr. Market can't find the sun and your advisor is walking on the beach analyzing an assortment of new opportunities. Below, we briefly highlight some of the current cloud formations:

- Stagflation
- Interest Rates
- Energy
- Nuclear Proliferation
- Vietnam
- Nixon/Carter
- Weak Consumer Spending
- The Middle East

LIFE'S A BEACH - CONTINUED

Oops, wrong clouds. Those were formations from the 1970's before the start of one of the greatest bull markets in U.S. history. Here is the current meteorological survey:

- Stagflation
- Interest Rates
- Energy
- Terrorism
- Iraq
- Bush/Kerry
- Slower Consumer Spending
- The Middle East

The plethora of things to worry about has led to lower share prices recently. In our view, strong underlying economic fundamentals and powerful corporate earnings growth have created a unique opportunity for common stocks. We believe that the aggregate U.S. equity market is undervalued in early August of 2004.

We have discussed our use of the 'Fed Model' as a valuation tool. This model measures the relative valuation of the stocks vis-à-vis bonds, and it was popularized by the Federal Reserve in a 1997 report. Based on the Fed Model, the U.S. stock market is currently under-priced by about 15 to 20 percent.

Academics like Jeremy Siegel of the Wharton School of Business also point out that the poor performance of stock prices this year has a silver lining, "With earnings up and prices down, the price-to-earnings ration for the Standard & Poor's (S&P) 500 has fallen to about 17, based on projected earnings for 2004. In recent years, the ratio has often been well above 20 and sometimes above 30. The higher the number the greater the risk. Over long periods, the P/E ration has averaged about 15, though a figure in the low 20s should be considered the norm today, largely because interest rates and inflation are low. Hence, stocks may be slightly undervalued today. By historical standards, they certainly cannot be considered especially risky."

HERE COMES THE SUN

Below we highlight the foundation and potential catalysts for higher intermediate-term share prices.

- Cleaner Companies: Over the past two years, we have witnessed a dramatic improvement in the quality and transparency of corporate behavior. Corporate executives now temper investor expectations while working hard to exceed them, many companies are properly expensing stock options, and accounting has become more conservative.

- Cash: The intrinsic value of any business is the discounted free cash flow it is expected to generate over its lifetime. Corporate profits are at a six-year high with the typical S&P 500 company reporting earnings gains exceeding 20% for the first half. Cash-flow generation currently exceeds capital spending requirements for S&P 500 businesses for the first time in 30 years.

HERE COMES THE SUN - CONTINUED

At the end of the first quarter, 374 industrial companies in the S&P 500 were collectively holding $555.6 billion of cash and short-term investments — more than double their balances at the end of 1999. This is even more impressive given that corporate debt/equity ratios are at a 16 year low.

- Adding Value: The tremendous health of corporate balance sheets leaves many options for companies to enhance shareholder value.

A change made to U.S. tax law in 2003 has capped the top individual tax rate on long-term capital gains and dividends at 20%. Consequently, corporations are accelerating the return of capital to investors through dividend payouts. Most recently, Microsoft announced a special $3 dollar dividend to its shareholder base. The company has been seeking to create shareholder value with cash that it is accumulating at a rate in excess of $1 billion per month.

In addition to dividend payouts, corporations are rapidly increasing the level of share repurchases. Businesses add shareholder value when they buy back their own shares at prices below their intrinsic value. Over 150 new and expanded share repurchase programs have been announced since the beginning of June. We believe many of these announcements and related actions will have the desired impact of higher share prices over time. Most recently, Home Depot (trading at a historically low price to earnings ratio) announced an expansion of its share repurchase program to $7 billion.

Strategic mergers and acquisitions are also likely given the availability of capital. Even the hedge fund community has gotten involved in some recent high profile deals with D.E. Shaw picking up FAO Schwartz and ESL Investment's high profile investment in Kmart. Given reasonable valuations and a strong secular trend toward globalization, we anticipate a waterfall of deal activity throughout various sectors of the economy.

In summary, we believe the transitory nature of many of the current clouds hanging over U.S. equities, a general condition of undervaluation, and the efficient use of corporate capital will have favorable intermediate term implications for the companies in our portfolios.

NO GAIN! STOP THE PAIN!

"All things come to those who wait provided they know what they are waiting for."
-Woodrow Wilson-

The lack of movement in share prices during the first half of the year is consistent with the historical behavior of the market. A Sanford Bernstein study found that the vast majority of long-term returns are derived from just seven percent of all trading months. On average, the returns of the remaining 93 percent of months are virtually zero.

NO GAIN! STOP THE PAIN! - CONTINUED

Given that the long-term secular trend for equity share prices is positive (10% average annual total return)–short-term thinking (i.e. market timing) is clearly inconsistent with a sound capital allocation strategy. The odds of being correct are roughly 12 to 1 against the average investor who attempts to rapidly trade in and out of the market. One seemingly has a better chance of seeing the Chicago Cubs and Boston Red Sox play in the same World Series.

So why are investors so fixated on the short-term? Most are hard-wired for *loss aversion*. The sense of pain from losing $1 is much greater than the sense of joy from gaining the $1. Behavioralists have noted a tendency for investors to experience what is called *myopic loss aversion*. Since the pain from losses outweighs the joy from gains, and the gains tend to come with low frequency but great intensity, those of us with the need for an hourly or daily portfolio fix are likely to experience too much pain to adhere to a long-term investment strategy.

Peter Lynch, who ran the Fidelity Magellen Fund, which racked up average annual gains in excess of 15% under his stewardship, estimates that more than 4 in 5 investors lost money in his fund. Myopic loss aversion is a major catalyst of the buy high and sell low phenomenon.

The Investment Policy Statement and frequency of our reports are framed to place our client base on the type of investment track that is appropriate for the long-term growth of your capital.

GOOD THINGS COME IN BIG PACKAGES

Where are the opportunities in common stocks today? Given that our approach is bottom-up and value oriented, the macro picture is usually nothing more than a spice in the overall security selection recipe. Yet, even a bottom-up investment process at certain times reveals certain prevalent conditions in the larger stock market.

We are opportunistic with regard to the market capitalization of the businesses we own for client portfolios. Over time we are equally likely to purchase a $2 billion business with a "margin of safety" as we are a $20 billion company with similar characteristics.

Stocks of small to midsize companies with market capitalizations under $4 billion, however, have outperformed large capitalization businesses every year for the past five years. More recently they have been showing up with less frequency on our "buy" list. Conversely larger companies are currently available at reasonable prices to an extent that we have not seen in many years.

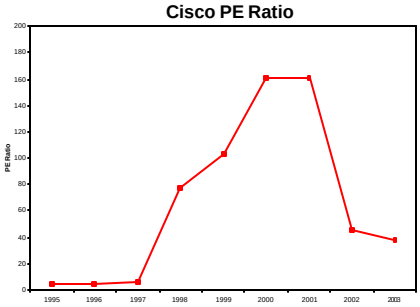
As recently as 1999, large companies sported valuations that doubled their small cap brethren. That premium contracted to 39% by the end of 2001, and it has now disappeared for the first time since the early 1980s. We are finding particularly compelling opportunities in large capitalization businesses tied to financial services, health care, retail, media, and technology.

MERCURY FALLING

The total return on common stocks that are purchased at fair valuations and held over long periods will roughly match their growth in earnings and dividends. Stocks purchased at a discount to intrinsic value, however, should outperform over time as they benefit from a potential double play – earnings growth coupled with multiple expansion. Conversely, securities purchased at prices well above their fair value will likely be poor performers over time as earnings gains are more than offset by eventual multiple contraction.

In our 1999 mid-year letter, we noted in a section entitled "Mercury Rising" that the market price of a publicly traded common stock reflects two components: the company's earnings and the multiple (PE Ratio) that investors are willing to pay for those earnings. We highlighted Cisco (CSCO) — a company we considered overvalued. This business generated above average earnings growth in the 1990's, but we believed that investors were paying a rich premium for these earnings. When returns were analyzed from January 1, 1998 to June 30, 1999, approximately 90% of Cisco's price appreciation was from PE multiple expansion and just 10% was from earnings growth.

Cisco: 1995-2004



	Price	=	EPS	X	P/E
Dec. '99	$53.56		$0.40		133.97
Aug. '04	$20.46		$0.75		25.50

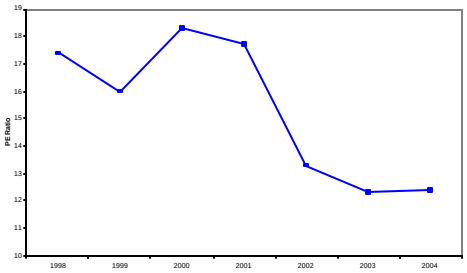
We observed, "Just as marginally brave speculators drive prices up, when there's a reversal, the marginally fearful will drive prices back down." Since 1999, the PE multiple for CSCO has contracted from 134.0 to 25.5. Cisco shareholders have lost 81% of their capital if they held from the PE peak in 2000 to June 30, 2004. This is remarkable given that earnings have grown by almost 90% over this period. Price is what you pay and value is what you get.

MERCURY FALLING - CONTINUED

Over the past four years, PE multiples have consolidated for many large-cap companies that meet our quantitative and qualitative criteria. Multiple contraction and earnings growth have set the stage for valuations that are as favorable as we have seen since the mid-1990s. Four examples of businesses now selling at historically reasonable PE's with sound growth prospects are highlighted below.

Citigroup: 1998-2004

Citigroup PE Ratio

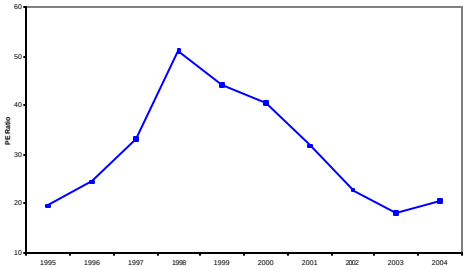


	Price	=	EPS	X	P/E
Dec. '99	$38.95		$2.21		17.63
Aug. '04	$44.18		$3.81		**11.60**

Citigroup's stock price has grown modestly as the PE ratio never reached the extremes of some other businesses while earnings grew by more then 70%.

Pfizer: 1995-2004

Pfizer PE Ratio

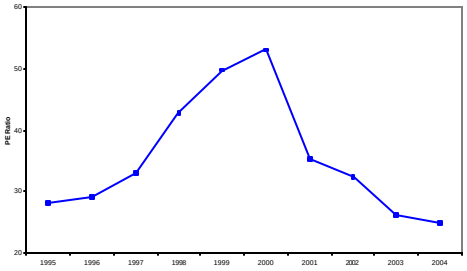


	Price	=	EPS	X	P/E
Dec. '99	$32.44		$0.82		39.40
Aug. '04	$31.48		$1.99		**15.82**

Pfizer's stock price has barely moved. While earnings grew dramatically, its high PE ratio in 1999 discounted the good news to come.

Microsoft: 1995-2004

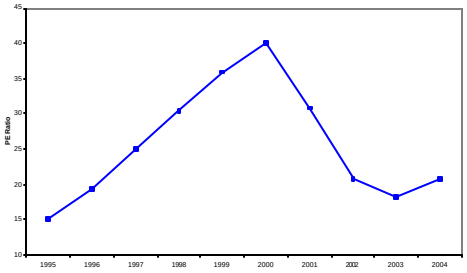
Microsoft PE Ratio



	Price	=	EPS	X	P/E
Dec. '99	$58.38		$0.80		72.97
Aug. '04	$27.72		$1.20		**23.1**

General Electric: 1995-2004

General Electric PE Ratio



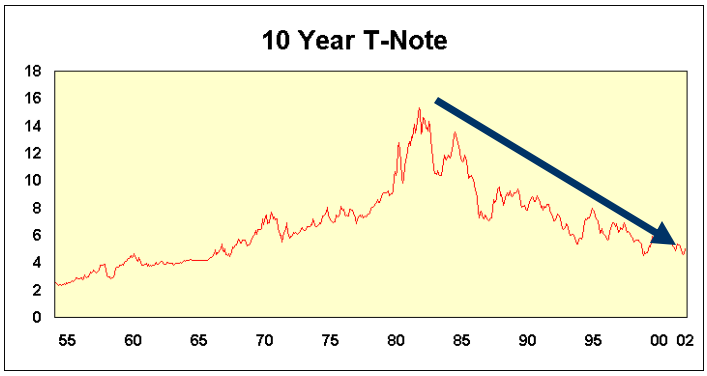
	Price	=	EPS	X	P/E
Dec. '99	$51.58		$1.08		47.91
Aug. '04	$32.09		$1.55		**20.70**

Over the past four years, Microsoft and General Electric have experienced price depreciations despite earnings growth of between 40% -50%. PE ratios declined to more reasonable levels from historically highs.

BONDS DIRTY SECRET – THEY GO BOTH WAYS

Fixed income securities have in general experienced a longer uninterrupted bull market then equities. So far removed are we from the peril of owning long-duration bonds that many people are simply unaware of the headwind created by rising interest rates. We'll offer a brief primer.

BONDS DIRTY SECRET – THEY GO BOTH WAYS - CONTINUED



1) Interest rates and bond prices are inversely correlated.
2) The longer the duration of a bond the greater the sensitivity to interest rates.

During a period of declining rates a virtuous cycle unfolds. Investors earn the coupon on their bond and benefit from price appreciation due to the impact of falling rates. As rates move lower, investors have to buy even longer maturity bonds to capture the same income stream. This is okay because longer-term bonds have even higher total returns in an environment of falling interest rates.

In a rising interest rate environment long-term bonds price will be negatively impacted. We believe the general investment public's lack of experience with a bond bear market will yield some surprises over the coming years.

Interest rates have made a long-term low in our view (similar to the long-term high we perceived in the NASDAQ in early 2000). A combination of faster economic growth, a moderate pick-up in inflationary pressure, coupled with rising Federal and trade deficits have turned the odds against the long-term bond investor.

Finally, we believe the U.S. Federal Reserve will continue to be responsive to creeping cost pressures, low unemployment, a weakening currency, and on-trend economic growth by raising the Fed Fund's rate over the next two years. Expect money market rates to double over that period of time.

I'M SO HUNGRY I COULD EAT A HOUSE

We've been getting our hair up about real estate prices for the last year or so. The only thing outstripping this phenomenon has been the continued rise in home prices. So rather than reconfigure the same argument we've made recently (we believe it to be more valid then ever) your Advisor has turned to his friends in the book publishing industry for further validation.

Book publishers are notorious for jumping on trends to sell books without much marketing push. The industry joke is that the shelf life of a book has fallen somewhere between milk and yogurt.

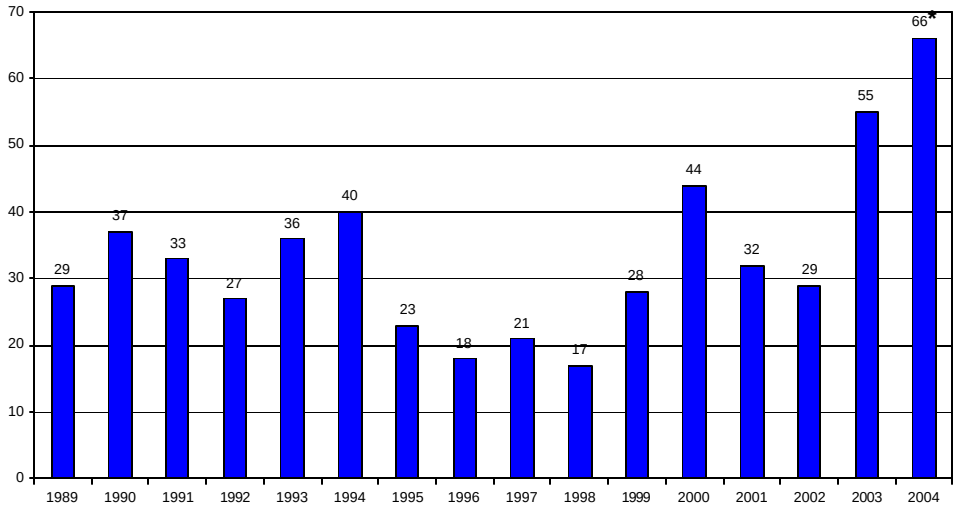
I'M SO HUNGRY I COULD EAT A HOUSE - CONTINUED

As the publishing business is a good indicator of fads, it can be a useful contrarian indicator. For example, in 1999, there were just 15 low-carbohydrate diet books in print. Fast forward to 2004 and there are more than 140 low-carbohydrate books in active print with 51 more due out this year. New titles are now geared to exploit every nook and cranny of the new diet mania: *Low-Carb Cocktails*, *Low-Carb Slow Cooker Recipes*, and *Low-Carb Smoothies* (We are keeping our fingers crossed that our submission *Low-Carb for Money Managers* will be accepted by Random House – no word yet.). The mania hit a fever pitch when *Living the Low Carb Life*, a book that compares the low carb diet books, briefly displaced *The Da Vinci Code* as the best-selling title at Barnes and Noble.

Just as publishers roll out a spate of new books there are signs that the market for low-carb is waning. The percentage of Americans who say they are following a low-carb regimen, like the Atkins or South Beach diets, peaked in February 2004 at 9%. This number has since dropped to about 6% this summer according to NPD Group, Inc., a market-research firm in New York.

Not surprising, but of cause for concern, is the record number of "money making" real estate books for 2004. The top tick for housing will clearly be when *Buying a Home with No Money Down and Flipping in 30 Days With A Remodeled Low Carb Kitchen* hits the *New York Times* Best Seller List. The table below highlights the mania in real estate publishing.

Real Estate Books Published



Years (1989 - 2004)
*Estimate based on publications for the first 6 months of 2004

IN CONCLUSION

We believe that a bottom-up value approach to common stocks will continue to serve investors well over time. Clouds of worry have created buying opportunities with a margin of safety in many businesses that we respect and understand – more so now among large capitalization businesses than in any recent time.

IN CONCLUSION - CONTINUED

We are clearly less sanguine among the intermediate term prospects for residential real estate and long term bonds. Cash returns today, while historically low, are likely to rise substantially over the next several years. All of our clients should maintain adequate liquidity for their short to intermediate term expenses. We are available to review liquid assets at your convenience.

POTPOURRI

Many in the AAM family have fought and continue to fight cancer. We are awed by your strength. Watching cancer survivor Lance Armstrong's 6th victory at this year's Tour de France was an inspiration to us all. As a tribute to Armstrong, The Lance Armstrong Foundation (LAF) and Nike launched the **Wear Yellow Live Strong** campaign. To raise money to battle cancer, the foundation has been selling yellow wristbands with Lance's mantra, "Live Strong."

We are supporters of LAF and we encourage clients to drop by to pick up a complimentary yellow wristband from our office. Yellow is the color of hope, courage, inspiration and perseverance — as well as the color of the leader's jersey in the Tour de France. Live Strong yellow wristbands allow everyone to share that spirit.

On the business front, we have recently completed a renegotiation of commissions that you pay to Charles Schwab. Commissions are now $0.025 to $0.04 per share with a minimum charge of $15 per trade. All clients with at least $1 million in household assets at Schwab will pay only $10 in commission per trade regardless of transaction size.

Merrill Lynch's fees remain somewhat higher at $0.05 per share with a $15 minimum charge per trade. We know that a number of our client families have particular reasons for using other custodians and we are supportive of such decisions. Schwab clearly seems to be offering the most enticing value proposition.

As we highlighted in our last client letter, there was to be a drawing among the active users of our web site with the winning family having the opportunity to select the charity of choice for which AAM would make a $1,000 donation. The winning family selected the Central Asia Institute. More information about this organization can be found at www.ikat.org.

We are in the beginning stages of the next generation of our website www.alterasset.com and welcome your comments. We look forward to speaking with you all over the next several months and appreciate your continued confidence and enthusiasm for our efforts. In addition to AAM's privacy policy, a copy of Form ADV II is included for your review. We hope the rest of your summer is full of good health and personal fulfillment.

With Best Regards,

Howard Steve George