



A POPULAR INVESTMENT VEHICLE

MUTUAL FUNDS OFFER EFFICIENCY, DIVERSIFICATION

One of the nation's most commonly used groups of investment vehicles, mutual funds, now holds several trillion (with a "T") dollars worth of shareholders' investments. Mutual funds have continued to grow in popularity because they have several excellent advantages for individual investors.

First, they provide immediate diversification, a hallmark of prudent investing. They are efficient. Capital gains and income can be immediately reinvested to compound their benefits. Regular, systematic investments likewise can be immediately put to work on the investor's behalf. Not to be overlooked is the distinct benefit of professional portfolio management for investors who have neither the inclination, time nor temperament to create and manage an investment portfolio.

To maximize the benefits and efficiency of using mutual funds, investors must understand three areas of costs: the fund's expense ratio, the choice of share class, and pricing and breakpoint efficiencies.



The expense ratio is the annual reflection of management expenses, administrative costs, some marketing expenses, and shareholder servicing costs. Highly efficient funds have lower costs associated with them. The lower the cost to the investors, the greater the opportunity for gain.

Certainly expense costs are not the only consideration when selecting a mutual fund, but they are an important consideration. The expense ratio does not reflect the costs of trading, buying, and selling activities within the fund. The friction of these costs can be significant. Active trading is an important aspect of some portfolios investment strategies and is not bad in itself.

continued on page 2

MUTUAL FUNDS OFFER EFF

SHARE CLASS SELECTION

Most funds have pricing options typically referred to as “A” class shares, “B” class or “C” class. Although other share classes exist, they are less common and are derivatives of these classes.

“A” shares are the oldest style of pricing. These involve an up-front, one-time sales charge that often ranges from 3% to 5.75% of the total investment. An investor buying \$10,000 of an “A” class mutual fund would actually only invest \$9,500 in the fund. The \$500 difference would represent a sales charge credited to the financial advisory firm and the fund distribution company. This is a fairly steep fee, but it is only paid at inception.

Because of these sales charges, it is obvious that “A” shares are only appropriate for long-term investors.

A general guideline would suggest that an investment horizon must be longer than five years to warrant paying this up-front charge. “A” shares do have the ability to garner breakpoints, or reduced sales charges, based on larger investments. This benefit will be discussed thoroughly later in this article. You might think of “A” shares as paying cash for a car.

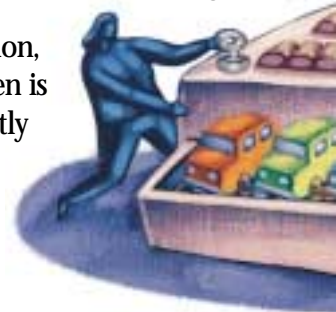
“B” shares have been in existence about 20 years. With this class of shares, there is no sales charge on the invested amount. If an investor buys \$10,000 of “B” shares, the full \$10,000 is invested in the fund. However — and this is a big however — the client is charged an additional .75% annually as a 12-b(1) fee. This additional fee typically lasts eight years and then goes away. Over eight years, the costs would be 6% of the investment and its gains.

Additionally, the investor would have a fee imposed for liquidation, called a contingent deferred sales charge (CDSC). The CDSC fee often is 4% declining annually to 0% in four to six years. Each fund is slightly different in the amount and timing of the CDSC. As with “A” shares, “B” shares are only appropriate for long-term investors, in this case because of the CDSC.

“B” shares compare favorably with “A” shares except for large invested amounts. With “B” shares, there is no reduction in fees or charges for larger investments as exist with “A” shares. Generally, “B” shares are inappropriate for short-term investments or larger amounts. If “A” shares are analogous to paying cash for a car, “B” shares can be thought of as financing a car over time.

“C” shares are the newest share pricing class. These are purchased with no sales charge. The entire amount invested goes to work. As with “B” shares, they have an additional fee of .75% per year associated with the class. With “C” shares, this 12-b(1) fee continues in perpetuity. It does not disappear after a set number of years. “C” shares have no CDSC or if there is a redemption fee, it is small and very short lived, generally one year. “C” shares have no provisions for reduced sales charges.

This share class is very advantageous for actively managed mutual fund portfolios. The lack of a sales charge and redemption fee creates great liquidity to allow for portfolio changes or rebalancing. “C” shares are not good choices for very large investment amounts and inactively managed accounts. “C” shares might be thought of as leasing a car.



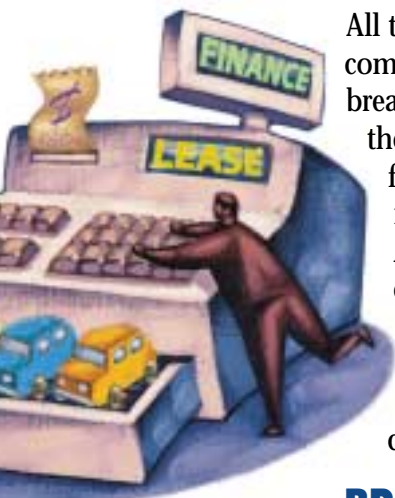
EFFICIENCY, DIVERSIFICATION

You can, and should, ask your financial consultant to do an expense analysis on various share classes to ensure the best choice for you. Each has distinct advantages and disadvantages depending on an investor's unique circumstances.

"A" SHARE BREAKPOINTS

Purchasers of mutual funds with front-end sales charges can qualify for a reduction in these charges based on the size of the investment at initial purchase or on the accumulation of investments. These reduced sales charges are not only considered for investments in a particular fund but also include the total investments in the fund family.

All the pertinent, and often complicated, information on breakpoints is contained in the fund prospectus. Each fund is unique in its rules and regulations. An initial purchase may qualify if the dollar amount is above a specified level. An example of a breakpoint chart is shown below:



BREAKPOINTS

Amount of Sale / Account Value Sales Charge

| | |
|-----------------------|-------|
| Less than \$49,999 | 5.75% |
| \$50,000 - \$99,999 | 4.75% |
| \$100,000 - \$249,999 | 3.95% |
| \$250,000 - \$499,999 | 2.75% |
| \$500,000 - \$999,999 | 1.95% |
| Over \$1 million | 0.00% |

In this example, an investor purchasing less than \$50,000 would have a 5.75% sales charge. If the purchase amount was greater than \$100,000 but less than \$250,000, the sales charge would be reduced to 3.95%. Investments of greater than \$1 million have no sales charge.

The accumulated investments also are considered. These are called Rights of Accumulation (ROA). Let's consider a person who invests \$25,000 in this fund family. The initial purchase has a sales charge of 5.75% or \$1,437.50. After three years pass, this amount grows to \$65,000. The investor now has more funds, \$35,000, that can be invested. Because the value of the account is \$65,000, an additional investment of \$35,000 would bring the accumulated value to \$100,000. Thus the new \$35,000 investment would be subject to only a 3.95% sales charge, or \$1,382.50.

It doesn't stop there, however, in the calculations. These Rights of Accumulation may be granted not only considering the individual investor's accounts, but also any account of a spouse or minor children.

Some fund families go so far as to consider parents of the investors, in-laws, and even 401(k) plans. Each fund family is different in its policies.

It matters neither through whom you purchased the funds nor where the funds are held or custodied. Funds held by D.A. Davidson & Co. are considered as well as those held by another brokerage firm or at the fund complex itself. Certainly, only you can provide your financial consultant with all the information on your families' holdings. It does make it far easier if everything is consolidated in your D.A. Davidson accounts. When you purchase a mutual fund at D.A. Davidson, we will make every attempt to ascertain if you qualify for a reduced sales charge based on the fund's rules.

Mutual funds are, and will continue to be, one of the most efficient and effective vehicles used by the public for investing. We have always found that informed investors are the best investors. Be willing to ask your financial consultant the questions you need answered about your mutual fund investments, and be willing to answer their questions on your existing investments held elsewhere.



MANAGED ASSETS — **Another process worth a look**

Many investors have turned toward separately managed accounts for professional portfolio management. This approach to investing has several advantages. It is not an investment product but rather a process.

The process begins with the investors and financial consultant doing a thorough analysis of the needs, goals, resources, and risk tolerance unique to the client. From these factors, an investment policy is created that is a formal statement of intent, measurements, and asset allocation. The investment policy statement leads to an implementation plan consisting typically of appropriate and carefully selected portfolio managers. Lastly, the process includes periodic reviews of the portfolio to ensure the results are consistent with the policy and client's needs. It is a continuous and circular process.

Separate account management has total transparency. Investors see every position held on their behalf and all activity in their accounts. Additionally, because the accounts are not commingled with others, the tax ramifications are unique to each investor and can allow input into timing of gains and losses. In some cases, investors can provide input into the avoidance of certain sectors of the market that might reflect their personal views or circumstances. Of course, one of the greatest benefits is the professional management employed on the behalf of each investor.

These accounts are available for amounts as small as \$100,000, but in most cases, \$300,000 or more is desirable to allow adequate diversification.

D.A. Davidson & Co.'s Managed Assets Department has over \$350 million dollars of our clients' assets placed with dozens of the nation's best managers. Could this be a wise choice for your hard earned investment assets? A review with your financial consultant can give you the answer. It is worth asking the question.



D.A. Davidson & Co. Statement of Financial Condition Available for Review

Obtain a free copy of D.A. Davidson's
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