Investment Report and Market Commentary

BRAGG
FINANCIAL ADVISORS

Fourth Quarter 2004

We are pleased to enclose your Investment Report for the Fourth Quarter of 2004. This report provides you with a concise accounting of your investment with Bragg Financial Advisors. We hope you find the format to be informative and easy to read. As always, we appreciate your feedback as we strive to provide you with pertinent information and quality service.

Market Index Total Returns as of December 31, 2004

Market Index	Fourth Quarter	1 Year	3-Year Annualized	5-Year Annualized
Standard & Poors 500 (Large Cap)	9.23%	10.88%	3.59%	-2.30%
Standard & Poors 400 (Mid Cap)	12.16%	16.48%	10.53%	9.54%
Russell 2000 (Small Cap)	14.09%	18.33%	11.48%	6.61%
MSCI EAFE (Foreign)	15.32%	20.25%	11.89%	-1.14%
Lehman Brothers Aggregate Bond	0.95%	4.34%	6.19%	7.71%
Lehman Brothers 3 Year Municipal	0.18%	1.78%	3.71%	4.78%

Stocks rallied in the fourth quarter and carried the market to a second consecutive positive year. 2004 was certainly a year that required patience; almost all of the return for the year came in the fourth quarter. As the table above shows, it was worth the wait. Large Cap stocks as measured by the S&P 500 were up 10.88% for the year with 9.23% of that return coming in the last two months of the year. Mid Cap, Small Cap and Foreign Stocks were up significantly more than Large Caps again, extending their period of out-performance by another quarter.

While the market, as measured by the S&P 500, is still about 20% lower than the peak reached in March of 2000, it is up about 55% from the bottom reached in October of 2002. Fifty-five percent is no small jump for a 500-stock portfolio (the S&P 500 measures the return of 500 of the largest companies in the US). Add in exposure to Mid Cap, Small Cap and Foreign and you have an even higher return during this very short period of time. And this short period of time was chock full of scary things to worry about too…the next terrorist attack, deflation, inflation, excess capacity for corporations, war in the Middle East, corporate fraud, mutual fund scandals, record budget deficits, massive hurricanes and flooding, insurance company scandals, record high oil prices, a falling dollar, uncertainty surrounding the presidential election, slow employment growth, outsourcing of jobs, fears of higher interest rates and most recently the catastrophic tsunami disaster in Asia. Some of these fears are behind us, while some are very real today…we list them to point out the fact that there will always be something to worry about but these worries should not alter our long term investment plans.

2004 turned out to be a fine year for bonds as well. The Lehman Aggregate Bond Index was up 4.34% for the year, confounding the pundits who for the last three years called for a lousy bond market due to rising interest rates. As expected, the Federal Reserve Board, led by Alan Greenspan, effectively raised short-term interest rates by 1.25% over the course of 2004 in an effort to reduce the stimulus being provided to the improving economy. The Fed's mandate is to use monetary policy as a "governor" on growth to help the economy grow at a sustainable rate with a manageable level of price increases (inflation). It does this by setting short-term interest rates higher/lower making it expensive/inexpensive for consumers and corporations to borrow. The effect of the Fed's action in 2004 was indeed to raise short rates but there was little effect on intermediate and longer maturity bonds. While higher rates may be around the corner, the much-called-for setback for bonds has not happened yet and investors who maintained their bond positions in 2004 earned approximately 3.5% more than they would have in a money market fund.

We often look back at previous reports for insight while writing this commentary. If you are like us, you might be interested in the following **reprint of parts of the Investment Commentary we sent out in October of 2002.** We have edited it somewhat for brevity but the gist of our message is here.

(*Over*)

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Reprint from 2002 - Table and commentary in italics below is from Oct., 2002 report written just as the market bottomed.

2002 Market Index Data	Year-to-Date 9/30/02	One-Year 9/30/02	Three-Year Annualized 9/30/02
S&P 500 (Large Cap)	-28.16%	-20.49%	-12.89%

The S&P 500 Index dropped more than 17% in the 3rd quarter *bringing the year-to-date loss to 28.16%. Fearful investors continued to focus on the slow economy, accounting scandals, poor earnings reports, the threat of terrorism and the conflict in Iraq. Since reaching a peak in March of 2000, the S&P 500 has declined by 47% and the tech-heavy Nasdaq has dropped by a staggering 77%. As the table above illustrates, no part of the equity market has been immune. While Mid Cap, Small Cap and Foreign Stocks have fared better than US Large Caps, their losses have also been deep.*

The market will stop falling at some point and then it will go up. *The question for this market is "When will that happen?" Extremely low valuations and panic selling have characterized past bottoms. According to First Call estimates, the market is currently valued at a Price to Earnings (P/E) multiple of about 15 times estimated forward earnings, which is slightly less than the long-term average. That doesn't mean panic selling won't drive the market even lower. No one knows when it will bottom but we think that four to five years from now, we'll look back and realize that it was not important what the market was going to do in the short-term when we were investing for the long-term.*

As investors, we've endured a lot over the past two and a half years. *We've been reminded that investing doesn't come without risk and that the market isn't always rational. Speaking for all of us at Bragg, let me say that we take very seriously the job that you have hired us to do and sending you this report, reflecting the worst stock market of the last thirty years, is difficult. Despite our disappointment, we have great conviction about the long-term, buy and hold strategy that we employ. We feel strongly that this disciplined approach gives you the greatest probability of achieving your financial goals. As a word of caution in the months ahead, beware of people trying to sell you a raincoat after this two-year thunderstorm. Just as technology funds were the greatest thing going three years ago, today you'll hear about hedge funds, portfolio protection, protected growth, and market timing strategies. Something is always "in season" but we only recognize it with the benefit of hindsight.* **(End of reprint of 2002 material)**

What a somber tone, huh? It helps us to read that and remember the way we felt in the midst of the crash. It was a difficult time! We think it is prudent to remind ourselves that we will certainly endure periods like that again and we should always maintain discipline and focus when it comes to our portfolios. In short, we should always own what is appropriate for our age, our risk tolerance and our need for return. Please let us know if you want to discuss your holdings.

In contrast to that somber tone, you may know that one of my dad's favorite things to say is that "life is good and getting better." Indeed, despite the war, other conflicts and hardship in the world, we feel that way right now. In the US, the economy is growing; the market is up; valuations seem reasonable; unemployment is down; interest rates and inflation are low and congress seems intent on reforming some of our broken social programs. Internationally we also are seeing strong economic growth; more nations are moving (with great friction) toward freely elected governments (Afghanistan, Iraq, Palestinians, Ukraine) and record numbers of people are enjoying economic opportunity for the first time in their lives. Finally, the global outpouring of relief for the victims of the Asian tsunami demonstrates that the people of the world can see beyond their own struggles and care about the lives of folks they will never know. Life is good and getting better.

Thank you for letting us help you with your planning and investing. Best wishes to you in 2005!

Benton S. Bragg

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