

# Cedar Fund, L.P.

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*אֲרְבֵּעַ אֲרָזִים מִצֵּינִים וְעֵץ אֲרָזִים*

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Dear Fellow Partners:

The Cedar Fund's 6.0% return for 2004 lagged the S&P 500's 10.9%, but outperformed the 5.3% earned by the Dow Jones Industrial Average. Over the past five years, the Cedar Fund outperformed the S&P 500 by nearly 60% (or 10.6% annually). The Cedar Fund increased 48.7% (8.3% per year) versus -11% (-2.3% per year) for the S&P 500 for the past five years.

An investment of \$100,000 five years ago would have grown to \$148,700 in the Cedar Fund. In the S&P 500 Index, that same initial investment would have fallen to \$89,000. This is why investing is so counter intuitive. Many successful investors make much of their money in declining markets. For this reason, absolute returns are more important than relative returns based on a benchmark index. Successful investors don't lose money!

We have made several important changes in the Cedar Fund portfolio. Selected American and Legg Mason Value Trust were removed because of lagging long-term performance. Added was FPA Crescent, an allocation fund, managed by Steven Romick, a risk-averse value investor in small cap stocks. We were fortunate to get into the fund before it closed to new investors. The second new manager is Private Capital Management (PCM), a mid-cap account of individual stocks run by Bruce Sherman and Greg Powers. Sherman follows financials, newspapers and manufacturing, while Powers seeks out undervalued stocks in technology and related industries. Both new funds have returned in excess of 15% per year over the past five years. The Sequoia fund was replaced by the Clipper fund, a large cap value manager similar in style and investment philosophy.

The stock market faces several difficult challenges. First, it is coming off a 35% increase over the past two years. This cannot be sustained, especially if the market averages only 5% or less per year over the next 10 to 15 years. Second, the increase in corporate earnings, year over year, is dropping sharply from 19% last year to 10% this year. High commodity prices, especially oil, and increases in wage and health care costs are squeezing profit margins.. Third, higher interest rates, which are expected to continue for the next year or so, negatively impact business. These concerns seem to be confirmed by our investment managers. High, over valued markets often are accompanied by two indirect indicators: high cash positions and mutual fund closings. Currently, several of our managers are carrying higher than normal cash positions because they cannot find good investment values. Recently several of our mutual funds closed to new investors, again, because they have difficulty putting their cash to work in stocks. So, avoiding risks and remaining cautious are still in order. Many investors today are ignoring these risks and yearning for the double-digit returns of yesteryear. Until expectations are lowered to 5%-6% per year, investing will prove to be a frustrating and disappointing experience.

Despite these concerns, the Cedar Fund, anchored by Berkshire Hathaway, should provide stable and respectable returns over time. All our managers are averse to risk, have keen analytical skills and are able to identify companies with high quality of earnings. In other words, they are stock pickers which should serve us well.

If you have any questions or comments, feel free to call or write any one of us. We appreciate the confidence you have in the Cedar Fund. The Fund will open for additional money on April 1, and every calendar quarter thereafter. Enclosed are: (1) 2004 Cedar Fund financial statements audited by CPA firm Ramsey, Rodefeld, Kassens & North, LLP, which list our investments and (2) the year-end value of your investment in Cedar Fund. Additional information may be found on our web site [www.cedarfund.harfam.org](http://www.cedarfund.harfam.org) using user name: *Cedar Fund* and password: *43091*. The following is available upon request: (1) Printed copies of any document on the web site and (2) Form ADV, Investment Advisor Registration, which the Indiana Securities Division requires be made available to investors upon written request.

HARRIS HARPER COUNSEL, INC., *General Partner*

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