

PEARSON Investment Letter

Published Monthly Since 1982

www.pearsoncapitalinc.com**FEATURED STOCKS**

Advanced Auto	Monro Muffler
Asta Funding, Inc	PSS World Med
Eagle Materials, Inc	United Surgical
Lennar Corporation	WebEx Comm

GROWTH & INCOME STOCKS

Caterpillar, Inc	Kinder Morgan, Inc
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THE RIGHT DECISION**BY DONALD PEARSON**

Many times in our publication I have advised our clients to seek the

need 80% of your current salary. If you're making \$80,000 annually, you will need \$64,000 for a comparable retirement. With Social Security providing approximately \$15,000 and your pension providing \$20,000, your Savings will have to make up the difference. If your savings portfolio contained \$400,000 and you withdrew 5 percent annually (\$20,000), you'd be \$9,000 short of your current lifestyle. This means you would immediately begin with \$175.00 less per week, and this could continue to deteriorate if inflation continues to outperform your savings.

The solution is simple! Pay yourself first and build your savings before getting there. Do this by immediately prioritizing your long range savings objectives. If you are not saving a minimum of 10 percent of your salary for your retirement, make the necessary adjustment. If you are currently withdrawing from your account, and you can get along without, or with less, call us and reduce your distribution. Let it work for you and take it when you really need it at a later date. Maximize your 401k, or contribute enough to get the full match from your employer. The Individual Retirement Account (IRA) has been around for thirty years, but many of us who qualify for these do not have one. Many who do have an IRA stopped contributing or do not contribute the maximum. The Roth IRA which originated in 1998 should be funded by everyone who qualifies. Imagine the Federal Government telling you that because you're hard at work today, they will allow you to invest in anything you want and continue to pile up your profit, tax free. They know you are behind in your saving so the \$2,000 and \$3,000 they have allowed you to invest has been increased to \$4,000 a year for 2005, 2006, and 2007. For 2008 it will increase to \$5,000. If you are over fifty, you are allowed to increase your contribution another \$500 this year and \$1,000 every year thereafter.

We all know we cannot stop or turn back the clock,

guidance and advice of professionals. I do this because the different decisions we make not only impact our lives, but they also impact the lives of our immediate family, our grandchildren and generations yet to be. This message is not about your stock portfolio; this message is about you personally. Did you know that men or women who smoke lose about thirteen years from their lives? Chronic diseases are almost always due to lifestyle factors. About 70 percent of colon-cancer cases are avoidable, as are 80 percent of heart disease cases, and 90 percent of diabetes. Simple changes such as a daily diet adjustment or ten minutes of exercise could add ten or twenty years to your life. If you decide to make these adjustments, and I hope you do, I might then ask if you've got enough monetary resources put away for this extension of life.

Most people today rely on three key sources to carry them through their retirement years. Social Security, a tradition defined benefit (pension), and an assorted diversified savings account. Social Security and pensions are fixed entities that we cannot impact, but our savings and investments are not fixed, and this is where we all have an opportunity to improve our positions. Gasoline prices are approaching \$3.00 and thought to be heading higher. Real estate prices continue to climb, yet salaries for the working person today no longer increase at the same pace. Inflation never sleeps, and the financial growth of our investments must keep up. In almost every case the quality of one's retirement depends on it.

Take a minute to evaluate your personal situation. Here is a simple, yet effective, way of analyzing your personal situation for retirement if you're not there yet. To retire and enjoy your current lifestyle you would



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Chairman



Donald E. Pearson
President



Sandra Alberti
Publishing President

Investment Letters are complimentary to our clients with managed accounts!

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GASOLINE! HOME BUILDERS!

By Walter Pearson

If asked, "What is a big problem today?" many would answer, "The price of gasoline." But, if we look back in time, we would find that the price of gasoline has been cheap in comparison to many other entities which we use every day. Let's go back a few years and work this out. In the 1930s gasoline was selling at eight gallons for one dollar. That figures out to twelve and a half cents a gallon. Until recently, we could buy gas for \$1.50 a gallon, which would make it about twelve times the price in the thirties. At \$2.00 a gallon the figure is up to about 17 times as much. We should also consider that each gallon of gas carries a high tax which is included in the price we pay.

Let's look at a few other items to see how much out of line these prices are. I can recall that a loaf of bread could be bought for five cents back then. If one pays one dollar for a loaf today that means today's prices are twenty times as much. A can of beans in the 1930s cost a nickel as well, and I find that most today are selling for about 85 cents, which means 17 times as much. On that basis the price of beans had gone up about as much as gasoline, but bread has risen further and faster.

Looking back many years, I can also remember looking at a new home in Connecticut with my sister. It had five rooms and was near the water in Stratford, Connecticut. The price we were quoted was \$5200. I haven't been to Stratford for a number of years, but I think I can state with no problem that the same home in that same area would be a buy today at \$520,000. This would mean that housing has gone up a hundredfold. How come

we haven't screamed as much about housing prices? I believe it's because, unlike gasoline, we don't buy them on a daily basis.

This brings us to the home builders. We have found that this has been a very good area for investment over the past few years. Some people in this business refer to it as the housing bubble and are expecting it to burst. The interesting thing in this business is that no one knows—these prognostications are only educated guesses. It is my opinion that one should get all the figures together and then add the column in order to come out with the right answer. In this regard, an important consideration is our government.

Today our government has opened our borders and we are having a tremendous influx of new people. There are only so many homes in this country, and as more and more people come into the country, we will require more and more homes. I believe there will be no change in government policy slowing the influx of people, and, on that basis, I believe the home building

business will continue to prosper.

Each of us should think very carefully about the above information. What is screaming from each sentence is that we have built in inflation. On the basis of housing inflation, the millionaire of the 1930s now has only \$10,000 to spend. He may still have those same dollars, but they don't spend as well. Think too about that millionaire who took only \$10,000 of that money and invested it in Coca Cola or Gillette or Mc Donald's. It is only a matter of finding a growing company while the growth is still there. In this manner you have turned inflation around; it works for you.



Walter Pearson is the former President of First New England Securities, Co., Inc. and at that time, also managed the Statistical Department. He is the author of the book, "Investing for the Millions" and Publisher Emeritus for the Pearson Investment Letter. At this time, Mr. Pearson is Chairman of the Board of Pearson Capital, Inc. He is a contributing columnist for various publications and is listed in Who's Who in America.

"Remember the Lord your God, for it is He who gives you the ability to produce wealth. Deut. 8:18"

PEARSON CAPITAL'S RECOMMENDED STOCKS FOR SEPTEMBER

ADVANCE AUTO PARTS, INC. (AAP) NYSE PRICE: \$60.93

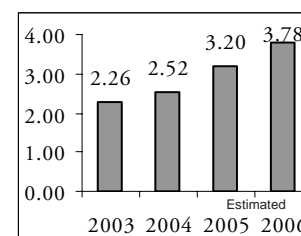
Advance Auto Parts, Inc. (formerly Advance Holding) has turned auto parts retailing into less of a one-company race. The company is now the #2 chain (AutoZone is #1) after its 1998 acquisition of Sears, Roebuck's Western Auto Supply and its 2001 purchase of Discount Auto Parts. AAP operates in the automotive aftermarket industry in the U.S. It offers various products, including replacement parts, accessories, maintenance items, batteries, and automotive chemicals for cars, and light trucks that include pickup trucks, vans, minivans, sport utility vehicles. AAP also provides automotive tires and service. As of January 1, 2005, it operated 2,617 stores in 39 states in the northeastern, southeastern, and midwestern regions of the U.S.; and 35 stores under the Western Auto trade name in Puerto Rico and the Virgin Islands.

Type: Growth
Sector: Services

Institutional Holdings: 214
Industry: Auto Parts stores

Ratings & Recommendations Earnings per share

Current P/E Ratio: **20.6**
Annual Yield: **0%**
Annual Dividend: **\$0**
Investor's Bus. Daily: **B-**
Pearson Growth Rating: **A-**
Pearson Value Rating: **B**
Stand.&Poor Rating: **A+**
Value Line Rating: **1-3-1**



ASTA FUNDING, INC. (ASFI) NASDAQ PRICE: \$30.89

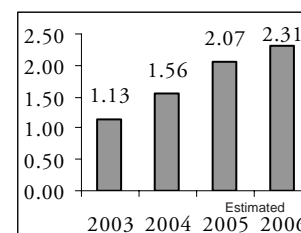
Asta Funding, Inc., along with its subsidiaries, engages in the purchase and liquidation of performing and nonperforming consumer loans. The company acquires, collects, and services charged-off receivables, semi-performing receivables, and performing receivables. Asta Funding was formed in 1994 as an affiliate of Asta Group, Incorporated and became a public company in 1995. The company is based in Englewood Cliffs, New Jersey. Chairman Arthur Stern, his son CEO Gary Stern, and other members of their family own more than 55% of the company. Asta Funding Inc.'s (Corporate Governance Quotient /CGQ®/) as of 1-Aug-05 is better than 69.4% of Russell 3000 companies and 67.1% of Diversified Financials companies.

Type: Growth
Sector: Financial

Institutional Holdings: 46
Industry: Credit Services

Ratings & Recommendations Earnings per share

Current P/E Ratio: **15.4**
Annual Yield: **0.40%**
Annual Dividend: **\$0.14**
Investor's Bus. Daily: **A+**
Pearson Growth Rating: **A**
Pearson Value Rating: **A**
Stand.&Poor Rating: **B**
Value Line Rating: **3-3-3**



EAGLE MATERIALS, INC (EXP) NYSE PRICE: \$112.64

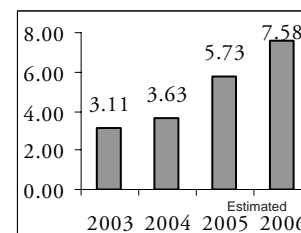
EXP a holding company, produces various basic construction products used in residential, industrial, commercial, and infrastructure applications in the U.S. The company operates in Cement, Wallboard, Paperboard, and Concrete and Aggregates divisions. Its operations include the mining of limestone and the manufacture, production, distribution, and sale of portland cement; the mining of gypsum, and the manufacture and sale of gypsum wallboard; the manufacture and sale of recycled paperboard to the gypsum wallboard industry and other paperboard converters; and the sale of readymix concrete, and the mining and sale of aggregates. The company was formerly known as Centex Construction Products, Inc. and changed its name to Eagle Materials, Inc. in January 2004.

Type: Growth
Sector: Industrial Goods

Institutional Holdings: 148
Industry: Cement

Ratings & Recommendations Earnings per share

Current P/E Ratio: **16.4**
Annual Yield: **1.1%**
Annual Dividend: **\$1.20**
Investor's Bus. Daily: **A**
Pearson Growth Rating: **A**
Pearson Value Rating: **A**
Stand.&Poor Rating: **B+**
Value Line Rating: **3-3-3**



LENNAR CORPORATION (LEN) NYSE PRICE: \$62.10

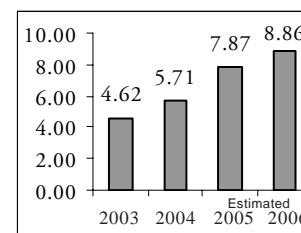
LEN engages in homebuilding and financial services business in the U.S. The homebuilding operations include the sale and construction of single-family attached and detached homes, as well as the purchase, development, and sale of residential land directly, and through unconsolidated entities. Lennar offers financial services, such as mortgage financing, title insurance, closing services, and insurance agency services for both buyers of the company's homes and others. It also provides Internet and cable television services to residents of the company's communities and others. Lennar offers its services primarily in AZ, CA, CO, FL, IL, MD, MN, NV, NJ, NM, NC, OH, OR, PA, SC, TX, VA, Washington, and Wisconsin. LEN was founded in 1954 and is headquartered in Miami, Florida.

Type: Growth
Sector: Industrial Goods

Institutional Holdings: 255
Industry: Residential Constr.

Ratings & Recommendations Earnings per share

Current P/E Ratio: **9.5**
Annual Yield: **0.90%**
Annual Dividend: **\$0.55**
Investor's Bus. Daily: **B**
Pearson Growth Rating: **A**
Pearson Value Rating: **A-**
Stand.&Poor Rating: **A-**
Value Line Rating: **2-3-3**



PEARSON CAPITAL'S RECOMMENDED STOCKS FOR SEPTEMBER

MONRO MUFFLER BRAKE, INC. (MNRO) NASDAQ PRICE: \$29.83

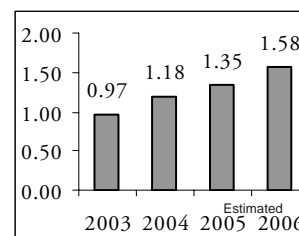
Monro Muffler Brake, Inc. principally provides automotive undercar repair services in the United States. It offers a range of services on passenger cars, light trucks, and vans for brakes; mufflers and exhaust systems; and steering, drive train, suspension, and wheel alignment. These services apply to all makes and models of domestic and foreign cars, light trucks, and vans. It also provides other products and services, which include tires and routine maintenance services, including state inspections. As of March 27, 2004, the company had 595 company-operated stores, 10 kiosk locations, and 18 dealer-operated automotive repair centers located primarily in the northeast region of the United States. Monro Muffler was founded in 1957 by Charles J. August. The company is headquartered in Rochester, New York.

Type: Growth
Sector: Services

Institutional Holdings: 48
Industry: Consumer Services

Ratings & Recommendations Earnings per share

Current P/E Ratio: **20.5**
Annual Yield: **0.60%**
Annual Dividend: **\$0.20**
Investor's Bus. Daily: **B**
Pearson Growth Rating: **B-**
Pearson Value Rating: **B**
Stand.&Poor Rating: **C**
Value Line Rating: **2-3-3**



PSS WORLD MEDICAL, INC. (PSSI) NYSE PRICE: \$14.49

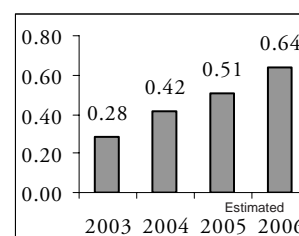
PSSI engages in the marketing and distribution of medical products, equipment, and pharmaceutical-related products to alternate-site healthcare providers in the U.S. It operates through two segments, Physician and Elder Care. Its Physician segment distributes medical supplies, diagnostic equipment, and pharmaceutical related products to primary care office-based physicians. As of 10/01/04, this segment operated 30 full-service distribution centers, 21 break-freight locations, and two redistribution facilities serving physician offices in all 50 states. The company's Elder Care segment offers medical supplies, incontinent supplies and personal care items, and enteral feeding supplies. This segment also offers medical instruments, oxygen supplies, tracheotomy, and housekeeping supplies. PSS World Med. is headquartered in Jacksonville, Florida.

Type: Emerging Growth
Sector: Services

Institutional Holdings: 90
Industry: Medical Equipment

Ratings & Recommendations Earnings per share

Current P/E Ratio: **22.4**
Annual Yield: **0%**
Annual Dividend: **\$0**
Investor's Bus. Daily: **B+**
Pearson Growth Rating: **A-**
Pearson Value Rating: **B+**
Stand.&Poor Rating: **A**
Value Line Rating: **2-1-3**



UNITED SURGICAL PARTNERS INTERNATIONAL, INC. (USPI) NYSE PRICE: \$38.31

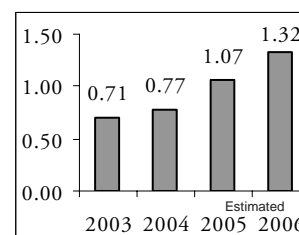
USPI brings together surgeons from the US and the UK. In the US, the company owns interests in and/or manages about 75 surgery centers and nine surgical hospitals; it has several additional centers under construction. In addition, United Surgical Partners owns three surgical hospitals and a cancer center in the UK. The firm sold its Spanish operations, which included nine surgical facilities. The company provides surgical facilities to patients and physicians. Its surgery center support staff includes nurses and operating room technicians. As of 12/31/04, the company operated 84 short-stay surgical facilities in the U.S., including 48 facilities jointly owned with not-for-profit healthcare systems, as well as 3 facilities in the UK. USPI was formed in 1998 and is headquartered in Addison, Texas.

Type: Emerging Growth
Sector: Healthcare

Institutional Holdings: 187
Industry: Health Services

Ratings & Recommendations Earnings per share

Current P/E Ratio: **18.9**
Annual Yield: **0%**
Annual Dividend: **\$0**
Investor's Bus. Daily: **B+**
Pearson Growth Rating: **B+**
Pearson Value Rating: **A-**
Stand.&Poor Rating: **D-**
Value Line Rating: **1-3-3**



WEBEX COMMUNICATIONS, INC. (WEBX) NASDAQ PRICE: \$25.78

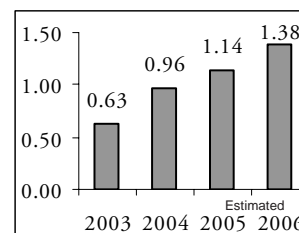
WEBX engages in the development and marketing of services that enable end-users to conduct meetings and share software applications, documents, presentations, and other content on the Internet using a standard Web browser. The company also provides integrated telephony and Web-based audio and video services using standard devices, such as telephones, computer Web-cameras, and microphones. Its services enable users to share voice, data, and video with others in remote locations. WebEx Communications was co-founded by Subrah S. Iyar and Min Zhu in 1996. The company was formerly known as Silver Computing, Inc. and changed its name to Stellar Computing Corp. in June 1997, to ActiveTouch Systems, Inc. in Dec. 1997, to ActiveTouch, Inc. in May 1998, to WebEx, Inc. in Dec. 1999, and then to WebEx Communications, Inc. in July 2000.

Type: Emerging Growth
Sector: Technology

Institutional Holdings: 109
Industry: Comm. Services

Ratings & Recommendations Earnings per share

Current P/E Ratio: **22.1**
Annual Yield: **0%**
Annual Dividend: **\$0**
Investor's Bus. Daily: **C+**
Pearson Growth Rating: **B+**
Pearson Value Rating: **B+**
Stand.&Poor Rating: **C-**
Value Line Rating: **3-4-2**



WALL STREET INDEXES

Indexes	1999	2000	2001	2002	2003	2004	05/YTD
S&P 500	21.1%	(10.1%)	(13.3%)	(23.4%)	26.4%	9.0%	0.7%
Dow Jones	25.2%	(6.2%)	(7.1%)	(16.8%)	25.3%	3.2%	(2.8%)
Nasdaq	85.6%	(39.3%)	(21.1%)	(31.5%)	50.0%	8.6%	(1.1%)
Russell 2000	21.3%	(4.2%)	1.0%	(21.6%)	45.4%	17.0%	2.3%
Our CD Buster	Data available on our website			8.1%	56.7%	22.8%	(In Dispute)
CD Annual Average	4.9%	5.4%	3.0%	2.3%	1.5%	1.5%	3.0%

MARKET VIEW

Christopher Carothers - PCI's Stock Analyst



ECONOMIC FLOWS:

People believe that their house is a cash-generating machine. John Maudlin, the author of Bulls Eye Investing, one of the great weekly e-mails I receive about investing, has talked about the problems of the housing market. He states that the Federal Reserve is changing its thinking and ideas to an overall risk management policy. Hence, paraphrasing from one of Greenspan's most recent speeches, "Our forecasts and policy are increasingly driven by asset price changes." Almost one-half of first time buyers, and one-quarter of all buyers, did not need any money down to buy their house. Many people are using alternative methods of financing, such as adjustable rates and interest-only loans. This is causing inflated asset pricing in the housing market. The housing market, however, unlike the stock market, is somewhat illiquid. For example, housing along the coasts is appreciating greatly, while the housing market in the Midwest has hardly had any appreciation whatsoever. To me, the Fed's recent speeches have emphasized that the lowering of interest rates during 2002-2003 was an attempt to prevent deflation. I believe that they thought they were doing the right thing to prevent a terrible recession. But now it has created unintended results by this housing problem. So now he's going to "whack" the homes. I would remind him that he also "whacked" the tech companies during the dot-com era. Did he let everyone know about this move? No. Did investors deserve it? Maybe, maybe not. But tech investors with money are different from average home buyers. Many of these are families with limited income and are first time home buyers, or have refinanced, thinking that housing will steadily appreciate in the future. Do they deserve to be "whacked?" You be the judge.

Key point: *Greenspan is going to "whack" the housing market.*

EARNINGS FLOWS:

Earnings season is just about to end. This is the time when Wall Street takes a vacation and earnings warnings come around. Most of the time prices of stocks level off and become buying opportunities. September and October are usually the worst months of the market.

Key point: *Warnings abound causing buying opportunities.*

CASH FLOWS:

Once again dividends will take center stage as the center of investing and the housing market loses its dominance. Many people believe that the cyclicals, energy, metals, and gold, will take its place. I will take the stand that the place to be will be with healthy consumer stocks with decent cash flows. But it will take time to get the best at a decent price. I would snap up Coke, Johnson and Johnson and others once they get into our buying range.

Key point: *Consumer stocks will take center stage.*

Additional notes:

- The Fed will increase interest rates, dampening the stock market's return.
- Dividend increases and cash buy-backs will continue.

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SEPTEMBER'S RECOMMENDED GROWTH & INCOME STOCKS

CATERPILLAR, INC. (NTE) NYSE PRICE: \$55.49

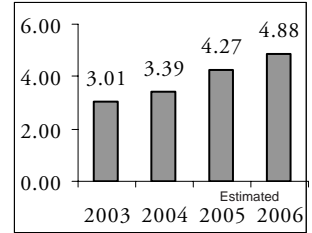
CAT manufactures construction and mining equipment, diesel and natural gas engines, and industrial gas turbines. It operates in three segments: Machinery, Engines, and Financial Products. Machinery segment engages in the design, manufacture, and marketing of construction, mining, agricultural, and forestry machinery, including track and wheel tractors, track and wheel loaders, pipelayers, motor graders, wheel tractor-scrappers, track and wheel excavators, backhoe loaders, mining shovels, log skidders, log loaders, off-highway trucks, articulated trucks, paving products, telescopic handlers, skid steer loaders, and related parts. The company was formed as Caterpillar Tractor Co. in 1925, pursuant to the merger of The Holt Manufacturing Company and the C. L. Best Tractor Co. Caterpillar Tractor Co. changed its name to Caterpillar, Inc. in 1986.

Type: Growth & Income
Sector: Industrial Goods

Institutional Holdings: 497
Industry: Machinery

Ratings & Recommendations Earnings per share

Current P/E Ratio: **15.9**
Annual Yield: **1.8%**
Annual Dividend: **\$1.00**
Investor's Bus. Daily: **A+**
Pearson Growth Rating: **B**
Pearson Value Rating: **B**
Stand.&Poor Rating: **B**
Value Line Rating: **3-2-3**



KINDER MORGAN, INC. (KMI) NYSE PRICE: \$95.47

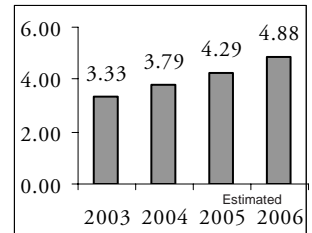
KMI provides energy transportation, storage, and related services in the U.S. It operates approximately 35,000 miles of natural gas and petroleum products pipelines, and approximately 135 terminals. Through its subsidiary, Natural Gas Pipeline Company of America (NGPL), the company owns and operates approximately 9,800 miles of interstate natural gas pipelines, storage fields, field system lines, and related facilities. NGPL provides transportation and storage services to third-party natural gas distribution utilities, marketers, producers, industrial end-users, and other shippers. In addition, KMI offers retail natural gas distribution services to residential, commercial, agricultural, and industrial customers in CO, NE, and WY, as well as owns and operates natural gas-fired electric generation facilities. The company is based in Houston, Texas.

Type: Growth & Income
Sector: Utilities

Institutional Holdings: 264
Industry: Gas

Ratings & Recommendations Earnings per share

Current P/E Ratio: **21.1**
Annual Yield: **3.1%**
Annual Dividend: **\$3.00**
Investor's Bus. Daily: **A**
Pearson Growth Rating: **B-**
Pearson Value Rating: **C+**
Stand.&Poor Rating: **C-**
Value Line Rating: **3-3-3**



CUTTING TO THE CORE

By Donald Pearson

When we build a portfolio for our clients, we begin with what we refer to as core stocks. This group represents companies whose stock is selling for considerably less (under valued) than we believe it should be, and the companies long range performance will allow the stock to perform with double-digit growth for the next five years. Lowe's (LOW), the nation's number two home-improvement chain, is one of our premier selections. The Mooresville, NC, chain is planning to expand into Canada in 2007 with 100 new locations. With 1,112 stores in the U.S., while second to home Depot, they continue to post higher same store sales growth, and this equates to higher earnings. Another Lowe's growth strategy is to move into more major metropolitan markets. Stores in metro markets average \$48 million in yearly revenue—well above the company's average of \$35 million. Lowe's first quarter earnings growth was up 32% from the prior year, while home Depot grew at 16%. Over the last five-year period sales have grown at an average of 18% while earnings have grown at 27%. Whether the housing boom continues or not they are streamlining their business in many other areas. They have begun a new inventory control program, and they have also begun sourcing more merchandise from China and other less expensive markets. Roofing and siding were recently added to their list of installation services, which already included carpets, counter tops, and cabinets. With their continued efforts in appliance sales they have become the number two seller of appliances in the country with a 17.3% market share. Lowe's is a true buy and hold core stock for your portfolio.

THE RIGHT DECISION

Continued From Page 1

so making the necessary changes should be done as soon as possible. In most cases any of the changes referred to above can be done with a phone call and one form. The unfortunate alternative that many will face when they arrive at retirement is finding out they'll have to postpone it for another few years, or they'll have to supplement their cash flow with a part time job. Don't let that be you if something can be done today that might prevent it. Happy retirement!

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Source Rating Key for PCI's featured stocks: Pearson Investment Growth Rating measures long-term past and future growth.

Pearson Value Rating measures current value in terms of potential for the dollar. **Investors Business Daily** measures growth and relative price strength. **S&P** measures financial quality and growth potential. **Value Line** measures timeliness, value and safety.