INVESTMENT OUTLOOK

1ST QUARTER 2004

Close your eyes...clear your mind. Imagine it is January 2002. Someone says to you; in two years GDP growth will exceed 4%, corporate profits will be up 15%-20%, budget deficits will be half a trillion dollars, commodity prices will be up 40%-50% and oil will be $35 per barrel. Where does that voice in your head tell you interest rates will be? Higher, for sure. But they aren't. In January 2002 the 10 year U.S. Treasury bond yield was 5%, today it is lower.

When our Government releases monthly Consumer Price Index (CPI) and Producer Price Index (PPI), the economic talking heads tell us to ignore:

< the price of gasoline
< the price of food
< the price of homes
< the price of healthcare
< the price of business raw materials
< the price of insurance

That's absurd; a disproportional part of our income is consumed by these items and their cost keeps accelerating. Yet, the bureaucratic numbers crunchers tell us inflation stands at about 1.7% annual growth rate. Something doesn't jive. Never-the-less, the market is master and is always right.

On April 2nd, the bond market got wacked in Tony Soprano style. Job growth finally caught fire, interest rates rocketed and bond prices cratered.

Just as we patiently waited for corporate capital expenditures to advance, we've had to patiently wait for new job formation. It's here and it appears to be real.

Demand for goods, services and supplies of most raw materials is on the upswing. The days of not passing along higher prices to consumers appears to be behind us.

We were too early shortening your bond durations in expectations of higher rates. If this is the beginning of a real sustained interest rate rise, then it's far better to be early than late. Expect to see some small degradation in the value of your holdings.

If this interest rate rise in fact has massive follow through, it may be bloodier than we experienced last June, July and August. It's never pleasant but it's survivable.

The good news, and there is some, is that credit spreads will widen. That is, the yield on corporate bonds will increase over comparable Treasurys. In 2002 spreads were close to historic highs, in late 2003 they got to historic low levels. A new order of balance is due the bond market. After 3 ½ great years of declining rates, the most stimulative Federal Reserve in 40 years, a bloody bear market in stocks, it's time for the bond market to correct and generate higher yields for our portfolios.

This year, the year that China and Japan purchased Treasury bonds with abandon, kept rates artificially low. A recent survey of government bond investors shows them to be the most pessimistic since 1990 because accelerated job growth will prompt the Federal Reserve to raise interest rates. Well, no matter if it's the market forces or Fed forces that raise rates, your short duration portfolio will give us the ammunition to properly maneuver.

As always, I am available to you and welcome your questions, comments and conversation.

Sincerely,