INVESTMENT MANAGEMENT & CONSULTING GROUP

VIEWPOINTS

4TH QUARTER 2004 — *ADVISORY NEWSLETTER*

MARKET COMMENTARY

FREDRIC W. WILLIAMS

Relief?...or Angst Rally?

Depending on where in the political spectrum one was found in the last half of 2004, the upward movement in the domestic equity indices from their late October lows could be viewed with either a smile or a furrowed brow. After a strong January, the stock markets drifted lower for the balance of the year, fretting about oil, interest rates, and global geopolitical events, to say nothing of the outcome of the U.S. presidential election scheduled for the fall. In late October we saw crude prices drop by about 24%, providing the catalyst for the rise, which was then fueled further with the resolution of a non-dangling-chad-delayed political contest on November 4th. Over the course of the last two months of 2004, the indices then proceeded to turn a flat-to-lower year in to a modestly positive one, at least temporarily.

The driving forces behind the capital markets last year were a macro change in the direction of interest rates, coupled with the dramatic rise in the price of crude oil. Both factors, given their direction, were (and are) not considered to be positive influences on the economy, nor on the future for corporate earnings and their stock or bond prices. At the May 4th F.O.M.C. meeting, the notes indicated that desired monetary goals could move from accommodation to neutral without an immediate adverse impact on domestic economic growth. Beginning the following month we saw the Fed raise the short end of the market (the Funds rate) 5 straight times by twenty five basis points, closing out the year at 2.25%. Oil, in contrast, was driven higher by a more "pure" form of supply and demand: a constrained supply due to numerous global events effecting production and distribution, combined with China's continuingly insatiable demand for oil to fuel its rapidly expanding economy. The price of crude climbed 34% in 2004, with the September year-over-year change coming in at a staggering 78%.

Through the 4th quarter, the impact of these developments were not readily apparent in the domestic economy: 3rd quarter GDP was revised upward from 3.9% to 4% and it appears that the 4th quarter will come in at that level as well, given the year end expiration of tax incentives to businesses for capital investments. In addition, a reasonably positive holiday sales season continued to indicate that, at least through the end of the year, the American consumer was still in a spending mood. Although we've felt like Don Quixote in the past on this subject, we feel that 2005 for the consumer will be like 2004 was for interest rates – a change in both trend and direction:

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"That leaves it up to old reliable, the consumer. It has been a favorite if somewhat futile pastime among the more pessimistic soothsayers to forecast when the consumer will run out of the urge or the means to consume. So far he has lost neither. Through the 'Nineties, the great bull market generously supported his habit. When equities took a dive, housing, with an assist from Mr. Greenspan, more than took up the slack through mortgage refinancing, cash-outs and equity loans. We suspect that 2005 will be the year that the consumer pulls back."

"One reason is that, as interest rates continue to creep up and housing becomes less and less affordable, his home may still be his castle, but not his cash box. We also think that the old rule of reversion to the mean is ripe to come into play. Steve Roach points out that the consumption share of GDP shot up to some 71% by mid-2002 -- appreciably higher than the 67% share that prevailed, on average, in the 25 years from 1975 to 2000. It's time for a change." *Alan Abelson, Barron's; January 3rd 2005*

These dynamics, in addition to the continued lack of "quality" (read as "higher paying with benefits") jobs here at home, make the prospect of a free spending consumer in 2005 less than likely. Although unemployment peaked in June at 6.4%, November's number was still stuck at 5.4%, with ongoing productivity gains, as well as excess corporate capacity, impeding any improvement in the demand for labor.

Between the whiffs of potential inflationary pressures and the weakness of the dollar, we are not sanguine about the prospects for the domestic bond market providing the positive total return that it did in the year past. After bottoming earlier in 2004, we've seen a modest, but steady, increase in both the CPI and its core components, with the November data coming in at a 3.5% year-over- year rate, and the core posting a 2.2% increase. There's been the obvious increase in energy costs, but other imported commodities, as well as domestic services like medicine, housing and tuition are all contributing to the higher prices that can constrain the consumer's discretionary income.

The U.S. dollar, which declined between 4% and 8% last year versus other major currencies, could also contribute to the pressure that raises domestic interest rates even further. Between our trade deficit, budget deficit and current account deficit, there aren't a whole lot of reasons that the rest of the world would want to continue to hold our currency. The dramatic rise in the Euro versus the dollar (approximately 50% over the last two years) is an indication that the one remaining reason, the dollar being the globe's reserve currency, may also be in the midst of a transition. Should foreign central banks choose to curtail their acquisition of our debt, primarily through the purchasing of our Treasury bonds with their current account surplus reserves, we could experience a jump in interest rates in an attempt to stabilize our currency and make our debt more palatable to overseas investors.

The impact of this concern can be seen in the 2004 bond market returns, as the intermediate portion of the yield curve did better (the 10 year T-note provided a total return of 5.06%) than the long end (as seen in the Lehman Mortgage Backed Securities index being up only 4.7%) of the bond market. Although it is statistically true that intermediate term bonds provide a better risk- adjusted return than long term bonds, this inversion indicates that bond market participants already have a concern about the erosion of bond values at the long end of the yield curve. To address both of these concerns in 2005, we will continue to use intermediate term bonds, as well as their shorter term floating rate cousins, in combination with non-dollar denominated foreign debt, as our fixed income allocations – our goal will be to hedge against both rising interest rates, as well as a declining dollar, in our quest to preserve both principal and purchasing power.

In the midst of these continuing cross currents, the capital markets produced surprisingly consistent results during the last year, with foreign markets outpacing the U.S., particularly on a currency adjusted basis. The S&P 500 was up 8.99% in 2004, while the NASDAQ increased 8.59%; the Dow lagged, up only 3.15%, as a result of the problems its large market capitalization drug and insurance companies had with products and regulators. Overseas, in local currency terms, London's FTSE-100 was up 7.5% for the year, the Paris CAC-40 rose 7.2%, Frankfurt's DAX increased 7.3%, and the Nikkei added 7.61%. While most of Asia was modestly ahead, there was a Chinese-markets disparity that was indicative of the mainland's attempt to curtail the rate of growth to sustain their economic expansion without risking a recession. Although Hong Kong's Hang Seng was up a robust 13%, the Shanghai Composite declined 15.4%, as a result of the government's moves to tighten credit and exert macroeconomic control to slow the economy down. None the less, add the aforementioned 4-8% decline in the dollar and you can see why last year it once again paid to have a portion of your portfolio invested overseas – something we will continue to do in the coming year.

As with 2004, we see 2005 as a year when geopolitical events and the global economy will hold sway over the capital markets. Outside the obvious concern about the continuing impact and cost of the war on terror, we are focused on the need to rebalance the world's financial system. The deficits currently being run by the U.S. will need to be corrected so capital can be allocated efficiently to best meet the needs of any country's economy, rather than merely being recycled back into Treasury bonds, thereby feeding the American need to consume. In addition, work in this area will redirect funds back into export oriented economies, like China and India, so they can enhance infrastructure and start to develop domestic demand as an additional fuel for their national economies. We see the coming year as an arena within which to address these vexing, and interrelated, issues. We will continue to use our value orientation to portfolio management as a discipline that affords us the ability to proactively seek out opportunities in a challenging domestic, and global, environment.

WEALTH MANAGEMENT UPDATE — CHARLES W. DIBNER, CFP

What is "Wealth Management?"

IMCG is entering it eleventh year and some of our principals have been in the financial services industry in excess of 20 years. As such, we view financial planning as a multifaceted science with an accurate description extending the answer into overlapping and contingent parts. We find that an explanation of how IMCG employs the coordinated integration of the investment and wealth management sciences also provides a worthwhile understanding of our disciplined processes and procedures.

The financial services as a whole are a relatively young profession having been established on a broad scale with the appearance of a substantial middle class in the first two decades of the twentieth century. The subsequent formalization of financial services into clearly defined protocols . . . securities, insurances, banking, property, et. al. . . . has been a steady progression that continues through this day. But, as with all other professional sciences, eventually the thrust in financial services began to reorient from product sales to needs counseling.

This reorientation began with the appearance of the Information Age and is, as with most other things in our culture, a child of the media. In the 1970's, the codification of the science of financial planning arrived and, today, appears in institutions of higher education as formal, degree-based areas of study and in business as professional certifications. Unfortunately, "Financial Planning" may not be the best name to describe the scope of the profession. We at IMCG feel that "Wealth Management" is more inclusive, more descriptive and more accurate.

Wealth Management clarifies the areas of personal, familial and business financial counseling into, arguably, six areas: Cash Flow, Risk Management, Asset Growth, Taxation/Asset Erosion, Retirement and Long Term Care and Estate Transfer. Cash Flow concerns earning and spending money; Risk Management analyses the "what if" of death, injury, health, damage or liability; Asset Growth plans to enhance the way your assets work for you; Taxes concern, well . . . taxes; Retirement evaluates the transition from an active income base to a passive income base; Long Term Care and Estate Planning provides some foresight into the potential effects of aging and plans for financial continuation beyond one's life.

Notice, too, that there is an important conceptual divergence between this overview and a view that focuses solely on investing, banking or insurance. The Financial Planning/Wealth Management protocols are interrogatory, they ask questions, e.g. . . .considering the salient features and questions of your personal financial life, what answers can you adopt to optimize success, safety and comfort? No two situations are the same; no established plan can be fixed in stone; no expectations can be left unattended. Most vital to the practice and successful use of Wealth Management is the continuous exchange of information. Stale information hinders success. Wealth Management/ Financial Planning is an ongoing relationship with structured parts. As such, it is our mission at IMCG to provide our clients with as thorough and careful an analysis in these disciplines as we do in the areas of Portfolio Management.

EARLY CONTRIBUTION TAX DEFERRAL STRATEGIES — TRACY W. ROGERS

Contribute Early...and Often in 2005

With the numerous tax favored savings vehicles that have been legislatively created over the last decade or so, investors are often overwhelmed by the choices relative to which strategy would be most appropriate for their individual circumstances. The most effective plan(s) will be derived from our planning analysis, and will include such topics as tax implications or augmenting college and retirement funding. The one common theme amongst all these plans [IRA, Roths, Coverdells, SEPs, SIMPLEs, 529s as well as employer plans like 403(b)s and 401(k)s] is that they provide a benefit over time for making contributions earlier in the tax year rather than later.

Many investors wait until the last minute to fund their IRAs or other workplace retirement accounts, which cause them to miss out on 15 months worth of potential tax-deferred growth. Although you have until April 15, 2005, to put in $3,000 (or ($3,500 if you're 50 or older) into either your traditional or Roth IRA or a combination of the two for 2004, don't wait to make your 2005 IRA contribution, as contributing earlier takes better advantage of the benefit of what is often referred to as the eighth wonder of the world: compound interest.

IRA Contributions Start At Age	Total Years Investing	EARLY Contributions (Beginning Of Each Year)	LATE Contributions (Tax Deadline April 15th)	DIFFERENCE Individual	You And Your Spouse
35	30	$532,481	$488,097	$44,384	$88,768
40	25	$361,846	$331,718	$30,128	$60,256
45	20	$241,478	$221,407	$20,071	$40,143
50	15	$155,146	$142,288	$12,858	$25,717
55	10	$83,222	$76,373	$6,849	$13,699
60	5	$32,487	$29,876	$2,610	$5,221

Assumes a 7% annual rate of return. This calculation assumes the maximum contribution will be made each year according to IRS regulations as defined in the Tax Relief Act of 2001 (the contribution limit increases to $4,000 in 2005 and to $5,000 in 2008). This calculation also includes the full catch-up contribution in the year the individual turns age 50 and every year thereafter (the catch-up is $500 years 2002 through 2005 and increases to $1,000 in 2006).

As life expectancy continues to increase, IRAs, and other tax favored savings vehicles, are more crucial than ever. From the current tax benefits realized, to the accrual advantages that the tax deferrals can provide in the future, it's important to be realistic about how you will support yourself in retirement and to make sure you can enjoy those years in financial comfort. Which of these plans, and in what structure is something we will assist you in analyzing - please contact us if you have questions about any of your savings or employer retirement plans.

IMCG NEWS

We're please to announce a number of changes and additions to the firm as we continue our expansion:

TRACY W. ROGERS – *PORTFOLIO MANAGER & DIRECTOR OF OPERATIONS;* Joining us from the financial services industry, Tracy's Denver based management experience will be of great value as we continue to expand our infrastructure and personnel. In addition, he brings his clients and portfolio management experience, along with a planning background that includes a specialization in risk management product analysis.

STEPHANIE KELLEY – *RESEARCH & PLANNING ASSOCIATE;* Continuing her growth at IMCG, Stephanie is migrating to the more analytical aspects of our work and will be assisting portfolio managers in the numbers crunching necessary for both the investment management and planning disciplines to work in an integrated fashion.

SCOTT WHYTOCK – *RESEARCH & PLANNING ASSOCIATE;* An entrepreneur who has also had experience in management and as a fund accountant, we're looking forward to Scott's combined talents within our analytical work and our office infrastructure.

ANGELA FORRESTER – *ADMINISTRATIVE ASSISTANT & RECEPTIONIST;* With experience in the insurance, securities and legal professions, we feel Angela will be an invaluable additional to our client support and operational activities.