



VIEWPOINTS

1ST QUARTER 2005

ADVISORY NEWSLETTER

MARKET COMMENTARY

FREDRIC W. WILLIAMS

Oil Slick & Dollar Daze...

After 2004's spirited year end rally, the domestic capital markets spent the first quarter of 2005 marking time in a trading band bounded by continuing geopolitical developments, and concerns about the impact that the ongoing rise in interest rates and crude oil prices would have on an already suspect global economy. With the war on terror and tsunami relief continuing to provide backdrop, the new year's headlines were dominated by the twin concerns of incipient inflationary pressures and the F.O.M.C.'s measured increases in short term interest rates. China's demand for raw materials to feed its expanding economy kept pressure on commodity prices, while global thirst for petroleum taxed the producing world's ability to build sufficient inventories such that any supply disruption wouldn't further fuel the rise in the price of oil. Although the sky had yet to fall, the Chicken Littles of the investment world were on point with their alarm about the impact that rising interest rates would have on the American consumer's monthly debt payments, as well as the displaced consumption (or lack thereof) that a doubling in gas and heating oil prices would have on their ability to continue to spend and drive the global economy.

Greenspan & Company provided two more 25 basis point increases in interest rates during the quarter, along with commentary suggesting they were yet to be finished with the tightening trend they initiated last year. With seven such moves since June of 2004, the Fed Funds rate now stands a 2.75%, with an expected target in a "normalized" 4-5% area. Each of these moves is immediately reflected in the commercial lending market, as well as impacting all the variable rate debt popular with the equity based loans being used to perpetuate continued consumer spending. As Alan Abelson commented in this week's Barron's:

"The market continues to be weighed down by a mean combo of factors, tangible and psychological, which in concert are pretty potent stuff. For openers, the Fed's nickel-and-dime tightening is finally, after all these months, having an effect, although you can argue that more decisive and less protracted action might have cleared the air a heck of a lot more efficiently. Moreover, the effect seems to be more evident on interest rates than inflation, but then you can't have everything.

Mr. Greenspan and his colleagues would like us to believe this "measured" approach to raising rates is deliberately designed to cause the least amount of pain. The truth, we suspect, is that it reflects a sorry lack of conviction about the economy, inflation, the twin deficits and the dollar, let alone a clue as to what should be done about them.

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Oil continues on its most unmerry way to the moon, getting a fresh lift, as if it needed any, from Goldman Sachs' prediction of a "super spike" that might carry the price of a barrel of crude as high as \$105. That, incidentally, sounds like one of those numbers, like the Dow at 36,000 or Google at \$400 a share, that are the product more of fantasy than analysis. But they inevitably make quite a splash.

However high it's going, oil already has come a frighteningly long way. Last we checked, crude was at a new high of \$57.27 a barrel and gasoline was averaging around \$2.25 a gallon. The toll such elevated prices are taking on the sentiment (and pocketbooks) of ordinary folks and of investors, whether ordinary or not, can't be easily calibrated. But it's ponderable and growing."

These macro developments contributed to disappointing, although not completely unanticipated as we pointed out in our last issue, results from the domestic markets: The Dow and S&P 500 were off 2.6%, while the NASDAQ dropped a much sharper 8.1%. Rising interest rates pushed the 10 year T-note down by 1.23%, with the one bright spot being the Dow Jones Utility Average, which jumped 6.98% in the quarter as investors continued to be attracted to the sector's current yield and dividend tax break.

The overseas markets were once again the place to be, as positive real returns in local currencies ranged from 1.76%, the FTSE-100 in London, to 6.9% with France's CAC-40. Since the start of 2002 international investing has had the tailwind of a declining dollar to enhance its returns as stronger overseas currencies were repatriated into a weaker U.S. dollar (the dollar was down 31% versus the euro and 19% versus the yen). The first quarter of 2005 saw a reversal in this trend, as the dollar bounced 4.4% versus the euro, 1.5% against the pound sterling and 4.5% in comparison to the yen. Although a pleasant respite for the weary American traveler, we believe that the structural challenges posed by our current account deficit will be expressed in a weaker dollar over the next several years, especially versus the basket of Asian currencies, as the central bank reserve imbalances get recycled through the global economy. As Warren Buffett pointed out in his annual letter to Berkshire Hathaway shareholders when commenting about the relatively new positions in other currencies that they've taken as a hedge against their dollar dominated investment portfolio:

"...our country's trade practices are weighing down the dollar. The decline in its value has already been substantial, but it's nevertheless likely to continue. Without policy changes, currency markets could even become disorderly and generate spillover effects, both political and financial. No one knows whether these problems will materialize. But such a scenario is a far-from-remote possibility that policy makers should be considering now. Their bent, however, is to lean toward not-so-benign neglect: A 318-page Congressional study of the consequences of unremitting trade deficits was published in November 2002 and has been gathering dust ever since. The study was ordered after the deficit hit a then-alarming \$263 billion in 1999; by last year it had risen to \$618 billion."

"Should we continue to run current account deficits comparable to those now prevailing, the net ownership of the U.S. by other countries and their citizens a decade from now will amount to roughly \$11 trillion. And if foreign investors were to earn only 5% on that net holding, we would need to send a net of \$.55 trillion of goods and services abroad every year merely to service the U.S. investments then held by foreigners... Therefore, our U.S. "family" would then be delivering 3% of its annual output to the rest of the world simply as a tribute for the overindulgences of the past. In this case, unlike that involving deficits, the sons would truly pay for the sins of their fathers."

As such, we will continue to deploy client assets in non-dollar denominated investments as part of our asset allocation and ongoing portfolio compounding discipline. As we indicated in our last issue, we are not anticipating a stellar year for the domestic capital markets, nor do we see global economic growth expanding at the rate it did in 2004. We will patiently seek

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out investment opportunities that meet our valuation criteria, and will strive to keep our allocations both measured and consistent, without being swayed by short term emotion. One last quote from Mr. Buffett sums it up quite well, as he admonishes those investors whose actions are impacted by something other than rational, long term vision, thereby resulting in sub par experiences relative to the historical success of American business:

"There have been three primary causes (for the "public's" underperformance): first, high costs, usually because investors traded excessively or spent far too much on investment management; second, portfolio decisions based on tips and fads rather than thoughtful, quantified evaluation of businesses; and third, a start-and-stop approach to the market marked by untimely entries (after the advance has been long underway) and exists (after periods of stagnation or decline). Investors should remember that excitement and expenses are their enemies. And if they insist on trying to time their participation in equities, they should try to be fearful when others are greedy and greedy only when others are fearful."

WEALTH MANAGEMENT UPDATE

CHARLES W. DIBNER, CFP

The Financial Planning profession has well passed the twenty fifth anniversary of its formulation into a science. This simply means that it has survived a generation of discovery and a successive generation of acceptance. Now, well into its third generation, the science of Financial Planning is experiencing an intense degree of focus and attention that is dramatically altering the expectations and conduct of the financial lives of many American families. We'd like to begin to reexamine the makeup and structure of the science of Financial Planning, to proactively support IMCG's clients in formulating their expectations of this process and to assist them in the optimal use of the firm's full range of capabilities.

The term "Wealth Management" has become commonplace in the financial services vocabulary yet few people *feel* wealthy and "management" has a relatively generic tone. Perhaps, in the current idiom, "wealth" more closely means "a degree of financial success." The underlying question has been more one of "what, when and how" to effectively use, preserve, grow and pass-on that success. We must remind you that, as a publicly administered *profession*, "financial services" is, by far, the youngest of Medicine, Law, Banking or Education. Readily available financial services did not really exist until the birth of the Middle Class arguably in the first and second generations of the twentieth century. Then, until the later half of that century, financial services existed mostly in a product sales format. It is only in the most recent thirty years that financial counseling and independent (of sales) financial advisors have become an integral part of the public perspective.

There are, essentially, five components to the thorough, professional practice of Financial Planning as synonymous with Wealth Management. These parts are:

1. "Cash Flow" or the annual passage of income through a family. It is not to be confused with budgeting although this can be an area of focus for some. It simply identifies and charts the inflow of money and the outflow of money. Understanding this is essential to the ability to project "what if" scenarios, risk analyses, business analyses, retirement planning, education planning, tax planning, etc.
2. "Risk Management" or the evaluation of what would happen in the event of unforeseen family catastrophe. This includes awareness of the potential effects of financial incursions involving health, death, disability, legal, aging, property, assets, business, etc. The past decade has engaged health care, in particular long-term health

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care, in this agenda. As greater numbers of people live longer lives in more vulnerable states of health requiring greater frequencies and kinds of health care, this area will become the subject of increasing planning focus.

3. "Investments and Asset Growth" is the most commonly recognized aspect of financial planning. In fact, until the last decade, the two were frequently synonymous. Wealth Management science holds that investing and growing one's assets differs in goals, methods, risk and amounts for every family as well as for every individual within that family. IMCG's disciplined research process and portfolio management structure is a core focus of the firm and provides and outline of the opportunities that can used to meet the goals articulated in the financial planning process.
4. "Asset Erosion" examines those interactions with the Real World that lower, lessen or, worse yet, corrode the principal and potential growth of family assets. They are, for most, innocuous inevitabilities (for example: "nothing's sure except death and taxes.") that one must accept. We at IMCG beg to differ. One cannot immunize themselves from erosive forces such as taxes but there is a heck-of-a-lot one can do to dramatically lessen and control those forces. The principal forces of focus here are taxation, inflation, cost of living, and real-returns.
5. "Estate Planning" or the successful passage of your assets to your heirs. Past generations have known this to mean Inheritance Taxation but that is rapidly becoming a less frequently significant part of the planning charge. We closely examine preservation, future needs, function, limitations, taxation, appointees, family concerns and potential conflicts as well as privacy.

Our future quarterly commentaries will address each of these areas and, hopefully, open some new windows of service, support and availability for you.

CONSIDERATIONS WITH EMPLOYER RETIREMENT PLANS

TRACY W. ROGERS

IMCG takes a holistic approach to managing all aspects of our clients' financial assets so we can exploit critical interdependencies among portfolios we manage directly and those outside investments, such as 401(k)s and 403(b)s, where we provide advisory oversight. Our goal is to make sure that all of our clients' portfolios are integrated and coordinated to most effectively meet their stated goals and objectives.

By continually updating us with changes in your workplace retirement accounts, such as new fund additions or deletions, we can determine how any of the changes may affect you and your overall asset allocations. There are times where we can leverage what choices clients have in their workplace retirement plans and use them in conjunction with the portfolios we are managing at IMCG. For example, we might suggest using a participant's stable value fund to compliment a fixed income bond portfolio, or could consider using a fund that is sector specific like a real estate (REIT) or inflation linked foreign bond fund.

Over the past few years IMCG has been asked by its clients to help evaluate, and/or be a consultant to, their workplace retirement plans. The impetus for this has come from the collapse of Enron-esque retirement plans that were overly concentrated in employer stock, or found themselves offering duplicated asset class exposure, such as to the technology and dot

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com sectors. These issues raised ERISA concerns in that there could be employer fiduciary liability and have prompted a review of retirement plan structure and operation.

Below is a quick checklist for “food for thought” that business owners should be asking of their own retirement plan and its sponsors.

- Does the plan have an investment policy statement (IPS)? If so, is it based on the demographic analysis of the employees the plan is supposed to cover? Do the plan’s investment options meet the needs of the employees as they are outlined in the IPS?
- Has the employer/plan sponsor followed a consistent due diligence process in selecting investment managers? Is the process documented?
- Does the client receive, at least quarterly, a performance report? If so, does the report specify each money manager’s performance against stated objectives in the IPS, the manager’s peer group and the manager’s appropriate performance index?
- In the case of participant-directed defined contribution (401k) plans, has the client elected to follow the “safe harbor” provisions of the Sarbanes-Oxley Act of 2002? If so, has the client communicated to plan participants the intent to seek section 404c protection, providing at least three investment options, each with a different risk/return profile, providing education and training and enabling participants to change their investment allocation at least quarterly?

If you have questions about these, or any other, concerns relating to your workplace retirement plan, feel free to contact us, and we would be glad to provide an initial evaluation.

IMCG NEWS

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

W. DUGAL THOMAS – *DIRECTOR OF BUSINESS DEVELOPMENT & ASSISTANT PORTFOLIO MANAGER*; With 37 years of experience in the financial services industry, including tenure at Goldman Sachs, Wells Fargo and The Vanguard Group, Dugal joins us after spending 22 years with a Boston-based mutual fund and portfolio management firm. We look forward to his focus on the retirement plan and ERISA markets, given his knowledge of the pooled portfolio plans in which he specializes.

ANNE BACON – *ADMINISTRATIVE ASSISTANT & RECEPTIONIST*; Returning to IMCG after a hiatus with some of our colleagues, Anne reprises her original position with the firm. Given her experience with our operation, we feel Anne will be a seamless addition to our client support and operational activities.

OUR EXPANSION – Please excuse our office appearance over the next few months as we expand our space to accommodate the additional offices we need for the colleagues and staff that will be joining us – we’ll provide you with an update in our next issue!

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