

Dear Client:

June 2004

With the first 6 months of 2004 behind us we are left with a number of questions. Will summer ever arrive? How far can interest rates increase? If companies are making money, why are the markets going down? Who will lead the United States after the November elections? Will the high oil prices cripple the economic recovery? And will Martha Stewart ever go to jail?

As for the arrival of summer, it has arrived yet we haven't seen any signs of blue sky and sunshine. The same is true for the markets. Corporate earnings growth year over quarter to date is up 24% and this marks the fourth quarter in a row of over 20% earnings growth. To add to this positive sentiment, 70% of the companies have beaten expectations. So why is the market not happy right now? The main issue appears to be the fact that many of the companies that have reported these good numbers have at the same time been revising down their guidance numbers to the teens. In addition most of the net growth has come in the form of cost cutting not increased sales, which leads investors to question how far can companies continue to cut costs? Another issue could be the combination of solid 2003 growth combined with the global political uncertainties inducing money managers to take a more short-term approach.

Another hindrance to market growth is the concern of rising interest rates. While we all knew that an interest rate hike was inevitable there was the uncertainty of how much rates would increase. The Federal Reserve board has finally taken the initial steps to tighten their monetary policy with raising the overnight borrowing rate by 25 basis points. There is a general consensus that we are in for another rate hike before the year-end. The unknown is by how much. However, the chief economist for Merrill Lynch points out that the current economic environment is much like that of the 1950's when productivity growth was soaring, inflation averaged about 2% and capacity utilization remained stable. All this means is that the Federal Reserve board may not raise rates nearly as much as some seem to fear.

North American equities have not performed as well as many experts had hoped in 2004. One of the reasons has been the fact that we are in a year of a U.S. presidential election. The theory being that a significant change in power from the existing government will result in uncertainty to the economy and therefore the markets. Standard and Poor's has data on the performance of the S&P500 dating back to 1928 and recently examined all the presidential election years from that year to present. In election years that produced a significant change in government, the S&P500 posted an average gain of 7.3% in the postwar years.

The price of gasoline is not far from \$1 per litre in many parts of the country these days. It is small comfort, perhaps, to note that this is still a bargain compared to most countries. Nobody likes higher oil prices, but economists suggest that \$40 per barrel is not necessarily a disaster for growth. It will be a hindrance to a recovering economy and will result in delaying growth, not undermining growth in total. In fact, although oil prices are hitting prices last seen in 1991 prior to the invasion of Iraq by the U.S., if the 1991 prices were adjusted for inflation it would cost \$57 a barrel today.

As for the elusive Martha Stewart, she was sentenced to 5 months in jail, 2 years probation and a fine of \$30,000. Currently, Martha is still out of jail pending her appeal, although she may go to jail willingly to put this ordeal behind her. For me, the silver lining of all her nonsense is that the very stock she chose to sell in 2001 was worth considerably more the day of her sentencing. Once again it is proven that the markets aren't about timing, but rather time in.

Have a safe and enjoyable summer.

Regards,

*Don*

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