Rutherford Investment Management, LLC
Newsletter: 4th Quarter 2003

January 14, 2004 Turning the Corner

After three down years, the market was finally able to end its losing streak. This year saw the Dow up 25%, the S&P up 26% and the NASDAQ up 50%. All of this is refreshing after the beating of the last three years in which the market took one of its worst pummelings on record. But, while the champagne may be out, it may be awhile before it is time to drink it. Depending on the length of time an investor has been in the market, their perspective will differ. For those who got into the market after 1998, the market could not erase their losses. In fact, so much damage was done by the recent debacle that in order to reach their peaks the Dow will still have to increase another 12%, the S&P 37% and the NASDAQ a whopping 152%. It is good to remember the remark made by Alan Okum, cited in one of our recent newsletters, that "…we are still underwater."

Many market sectors are yet to recover to the 2000 highs. Only financials, energy, health care and consumer non-cyclicals are at or near their highs. Telecom and technology have the most to make up.

This past year saw several efforts at stimulation as the economy showed serious malaise. The Federal Reserve continued its round of interest rate cuts, but must have felt like it was shooting blanks for the most part. A massive stimulation of the money supply in midyear finally began to move the economy. The Fed went from constant worries about inflation to worries about deflation. The Bush tax cuts were also highly stimulative.

There were many negatives to overcome. A war, continued financial, accounting, analyst and mutual fund scandals. The price of oil remained high, and a weak dollar gave pause to many investors. The Federal Reserve in a repeat of its disastrous policies, which began the recent precipitous market decline, again reined in the supply of money while oil prices were high. But even the policies of the Fed were not enough to stifle the recovery.

Alan Greenspan has been forced to continue defending Federal Reserve Policies under his administration. In a speech to the American Economic Association in San Diego on January 3, 2004, he awarded himself an "A" for his stewardship of the economy over the last 20 years. He believes that a tentative conclusion can be drawn that the Fed's strategy has been successful. He described the recession of 2001 as "... exceptionally mild" which of course will come as a surprise to those who lost their jobs, their retirements, and their college savings. But he did admit that it would take a number of years for the "…trauma of the collapse to wear off." So apparently we are left with an "exceptionally mild collapse."

Attention shifts now to the next action of the Fed. The "Greenspan Promise" is that "…policy accommodation can be maintained for a considerable period", without defining what "policy accommodation", or "considerable period" means. Wall Street interprets this policy statement as a promise to maintain low rates into 2005. At the same conference in San Diego, Fed Governors took pains to reiterate this "Promise." Such a policy would be good for the markets. However,

even the bond markets are forecasting a rate increase by midyear, and how long can the Fed maintain interest rates at 1% when gross domestic product is growing at 4.5% per annum? The recent poor employment numbers should steel the Fed resolve to keep rates low.

Curiously, the Fed has recently been reducing the supply of money, even as they use low interest rates to boost the economy. The effect of this reduction in the money supply can already be seen in the economic numbers where the Non-manufacturing Business Activity Index came in well below expectations for the second straight month, and the first month since May that the index has failed to surpass the 60% mark. In addition, factory orders and durable goods orders have recently fallen, led by computers, which had their biggest drop in three years. Thus, one can expect further evidence of an economic slowdown.

We also expect the price of oil to remain high, but to moderate to some extent. We think that the signs of inflation are already apparent, and that we will begin to see evidence of that in the Consumer Price Index. We anticipate a rate increase sooner rather than later.

We are in the fourth year of the election cycle, and it is almost time to declare the election over. As of this writing, it appears that Howard Dean will be the Democratic nominee. George Bush has no challenger and is the certain Republican nominee. History shows that he is also the likely winner in November. With the exception of Jimmy Carter, every president since Franklin Roosevelt who ended his third year in office with job approval above 50% won re-election. (Job approval polling started with Roosevelt.) Every incumbent since Roosevelt who had at least a 50% approval rating in April of his election year, went on to win. President Bush currently has a job approval rating of 63%. The only Presidents who lost their bids for re-election (Carter and the elder Bush) were at a 39% rating in April of their election year. Both Harry Truman and Lyndon Johnson quit the presidential re-election race with their approval ratings at 24% and 36% respectively. History is definitely on the side of a Bush re-election.

With these factors in mind, we expect your portfolios to benefit in the consumer, finance, health care, technology, transportation and telecom space. We expect to add some manufacturing names, both heavy industry as well as technology. The weak dollar should benefit multi-national corporations. The growing Chinese economy provides markets for U.S. goods and services. The outsourcing of U.S. services also provides a growth area.

As always, we thank you for the opportunity to be your investment manager. Please do not hesitate to call us at any time with questions you might have.

Very Truly Yours,

Rutherford Investment Management, LLC.

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