Rutherford Investment Management Newsletter: Period Ending 12-31-2004

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TURNING A CORNER

Last quarter I wrote of the persistent headwinds facing the market. We had the continuing terrorism threat, high oil prices, Iraq war, presidential election and rising interest rates. Any one of these factors alone could be a problem for the market, but together they made progress very difficult. Some of these uncertainties have been resolved; that is why the markets made good progress after the presidential election. But other problems remain. Oil prices are rising again, and interest rates are almost certain to rise according to the Fed. Add to that, the rapidly approaching election in Iraq, and that this is the first year of the new presidential term and I think that 2005 will be a difficult year for equities. We know that bonds are likely to be soft because of the Fed course of raising interest rates.

The global markets are troubled by the U.S. twin deficits of the budget and balance of payments. As I have written before, the U.S. policy is to talk a strong dollar, but let the dollar fall. Treasury Secretary Snow appears on the talk shows and speaks of strengthening the dollar by doing "things" and you realize the administration policy, if it has one, is to let the dollar sink. And why not, we borrow money from foreign governments who are all too willing to lend to us so we will buy their products, and repay them with cheaper dollars. It's a great program as long as there is a buyer on the other end. But what happens if the other governments get tired of being taken? Then we could see a sharp drop in the dollar and a sharp rise in interest rates. We are seeing that now in slow motion as the dollar falls, and our interest rates rise. We are beginning to see inflation in commodity prices. Grocery shoppers have known this for months, but the Fed was late to get the memo.

We had a good year last year as equity markets have risen two years in a row after being down three consecutive years for the first time in sixty-one years. We beat the broad market, which is hard to do, for the second year in a row.

Looking forward we are very concerned about the dollar, so for those clients who allow us, we are moving some money into international investments. We will also be buying multinationals, energy, and commodity based companies, along with our usual broadly diversified portfolio. Diversification works well, not only because it lowers the risk for the overall portfolio, but cushions against downturns, and allows the opportunity for a breakout in sectors or stocks.

Information herein is believed to be reliable and has been obtained from sources believed to be reliable, but its accuracy and completeness cannot be guaranteed. Opinions, estimates, and projections constitute our judgment and are subject to change without notice. Not every investment decision or recommendation made by Advisor will be profitable. Investment involves risk and may result in losses.

The Fed is forecasting strong growth even as they raise rates, but the two are not compatible. If interest rates go over 5%, not only bonds, globally, but equities as well will have a very difficult year. I think we have inflation in the offing, which creates an adverse climate for both equities and bonds. Continued, or worse, problems in Iraq will disrupt the oil markets. If oil goes back over $50.00 a barrel, that will be negative for the economy. My feeling is that if 2005 ends where it began, it will have been a good year.

As you know, we tend to be fully invested with a well-diversified portfolio. The reason we are fully invested in the face of uncertainty is that we are unable to time the markets and since our economy is made up of a lot of more or less rational hard working people the bias of the market is to go up over time. So, if one remains fully invested in growing sectors and stocks, over time one should beat inflation and perhaps even the markets. Indeed, it often appears that it is the intervention of the government and especially the Federal Reserve that seems to throw a blanket on the economy, as they did in 2000. (For further information on this matter see: *"Who Shot Goldilocks"* by William D. Rutherford, available at www.whoshotgoldilocks.com).

We thank you all for the opportunity to manage your portfolios. We caution you that all investment involves risk and just because we have an up year doesn't mean we can't have a down year or years.

William D. Rutherford
Rutherford Investment Management, LLC.

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