CLARK CAPITAL MANAGEMENT GROUP, INC.

THIRD QUARTER 2003

Onward And?

In the last Navigator Report titled "Is this for Real" we discussed (to some confusion) the idea of "Cyclical" and "Secular" stock market movements. That discussion centered on the debate about whether the U.S. stock markets are in a cyclical (short term) up-trend within a secular (longer term) downtrend, or whether the October 9, 2002 market bottom was the beginning of a truly long term bull market. In this issue I want to again look at that question and expand our view into the rest of the decade.

> **"October. This is one of the peculiarly dangerous months to speculate in stocks in. The others are July, January, September, April, November, May, March, June, December, August, and February."**
>
> *- Mark Twain*

But first, we are in that month that investors are supposed to dread, October. By the time most of you get the chance to read this issue, October may well be on its' way into the history books. But anyway, lets take a look. The following statistics come courtesy of Gibbons Burke who is the editor of "Markethistory." There have been 108 Octobers since the Dow began in 1896. The market was closed during the October of 1914 due to WWI. Overall, 59.4% have been positive while 40.6% have been negative. The average positive return was 3.9% and the average loss was -4.9% with the overall result being 0.31%.

Investor perception is most likely influenced by the fact that many of the most memorable days in market history occurred in October. **Five of the ten stock market's *worst daily* declines occurred in October.** Interestingly, four of those five days, and six of the ten worst daily declines occurred on Mondays. The two most memorable market crashes in history, 1929 and 1987 occurred in October with the Monday, October 19, 1987 decline of 22.61% being the worst. Of the ten *worst months* in history, two were in October; again in 1929 and 1987.

On the other side of the equation, three of the ten best one-day advances occurred in October, all following the 1929 and 1987 incidents. Of the ten best *monthly* advances, none occurred during October.

The past five Octobers in a row have been positive. October 2002 was the second best October ever with a gain of 10.6% and that month established the low for the 2000-2002 bear market on Oct. 9th. Are we pushing the envelope by expecting this October to be a plus month? Probably, but we will just have to wait and see.

HARRY J. CLARK, CFP PRESIDENT / CHIEF EXECUTIVE OFFICER

An Overall View

Many have asked what we expect of the rest of this decade. Since we have no crystal ball (although there might be something just as good, demographics, as we will discuss later in this report) we always look back through history for clues as to what we might expect going forward. Here are three potential outcomes for the rest of this decade, **little or no return** for the remainder, **a 5% average return** for the decade as a whole, or a rate of return for the rest of the decade that would give the entire 10 years an **average rate of return of 11.22%.**

First, we will use little or no return for the rest of the decade because many market mavens insist that we will be in a sideways market with little upside progress. (This discussion will use the S&P 500 as the market proxy) If that were indeed to happen, it would give the entire decade a

return of -4.61% annually. Not so terrible you say! The worst ten-year period in the history of the U.S. stock market was from 1929 to 1938 when the return was -0.89% annually. Do you believe that the U.S. economy is worse than it was in that time period? Of course not! So the possibility of no return for the next seven years is probably not in the cards.

One of the World's great investors is Warren Buffet. He is expecting a return of 5% for this first decade of the new millennium. **If he is correct the market will have to appreciate by 14.7% annually for the next seven years (including 2003).** Three years of decline, -9.11%, -11.88%, and -22.10, and seven years of +14.7% equals an annual rate of 5% for the decade. This result seems a little more plausible but that would still make the decade the 10th worst 10-year rolling period in history. Are things that bad?

The average rate of return for all 10-year periods in U.S. history (again, this is using the S&P 500 index) is 11.22% annually. That includes all the best and all the worst periods. What return would be required over the next seven years (including 2003) to make this decade an average 10-year period? **The answer is a 24.52% annual return!** That rate of return would mean that the decade would close with the S&P 500 at **4000,** and the Dow Jones Average at **38,000.** Keep that number in your mind for later in this report. So it seems likely that the return for the next seven years, including this year, will be between 14.7% and 24.5%. The 14.7% return will give us the ninth worst decade in U.S. history while the 24.5% return will allow this decade to be just average. Could it be that this is a better than average decade? Or will the return be between the two and be about 19% for the seven year period. This would still make the decade lower than average but not in the bottom ten. I don't know about you, but I would not at all mind 19%/yr for a few years. **By the way, the market averaged 19.3% from 1991 to 2000 and an equivalent return would place the Dow Jones at 28,700 in 2010.**

A Short Term Look

As discussed in the last Report, the consensus is that the current market upswing is a cyclical bull market. There have been seventeen markets of this type since 1900. **The average cyclical bull market advance has been 50.6% and has lasted 371 days.** The current bull market began on October 9, 2002, and has only gained 28% through September 30th. The average gain for all bull market movements by the 11th month from the bottom is 44%. You can see how this advance compares to four previous advances in the prior issue of this Report. If this market advance is finished, it will be one of the most anemic on record so we probably have further to go. Reinforcing this outlook is the history of the Presidential Election Cycle study, which shows that the average gain from the low in the mid-term year to the high during the pre-election year is 51%. **Again, if this market stalled now it would make this election cycle rally the third smallest since the 30's.**

The chart on this page shows the S&P 500 Cycle Composite for 2003 as provided by Ned Davis Research. This chart combines several cycles including the Presidential Election Cycle, into one projection. The bottom line shows how this year compares to others in the same situation. Notice that, except for the larger dip in January, this year follows pretty closely to the historic projection. Also, notice that it now calls for a downward bias in the market until the end of

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November before a recovery begins. The chart also shows that the end of the year might not be any higher than the September peak. But this is not the purpose of the comparison. The trend of the projection is much more important than the level. The important point here is that this projection accurately forecasted a correction, or low in March, and a sharp rise during the spring and early summer. **It is now forecasting a correction during October and November before a year-end rally gets under way.**

Yes, there are some short-term negatives. Job formation in the economy has been anemic, to put it mildly. And while the economy as a whole seems to be perking up, most of the perk seems to be coming from cost cutting, job cuts, and inventory trimming and not from increased demand. Not a very positive sign. But, GDP grew at 3.3% for the second quarter compared to 1.4% for the previous quarter.

Commercial hedgers, usually a pretty astute bunch, have moved from being net positive to net negative; not a good sign. Extremely heavy Insider selling is also a warning flag. And margin debt, which reached a record on the Nasdaq at the peak in 2000, has just set another record high.

The bottom line, at least for the short term, is that the market will most likely experience a correction in the fall with a typical year-end rally following. We have been in a distinct sideways movement since mid-June, with the S&P

500 and Dow Jones Indices at almost the same levels on September 30th as they were on June 17th. This cannot go on much longer and we believe that a breakout from this flat movement will be to the downside, at least temporarily, and should provide some good buying opportunities.

Program Availability

Navigator Asset Management

The Navigator Asset Management Unit includes the Master Program, Premier Portfolios, and Option Enhancement programs.

The Master Program is a separate account program managed by world-class portfolio managers selected and monitored by us and protected by the Navigator Sentry Program. This program features nine structured portfolios with a minimum of two managers per structure.

Premier Portfolios are private equity accounts managed by Maira Thompson of CCMG, Walt Sokira of Walt Street Management, or Ed Baker of Baker 500. Each manager features a unique style of investment and protection. Tax-Free and Taxable bonds portfolios are managed by Steve Grant of CCMG.

The Option Enhancement program is managed by Jamie Mullen of CCMG and may be utilized to manage large blocks of stock, or to protect or generate income from individual portfolios of stocks or ETF's.

Navigator Asset Allocation

The Asset Allocation Unit of CCMG features three portfolio strategies; Traditional (tax managed), Strategic, and Dynamic allocation methods. The allocations in all three strategies are determined by proprietary allocation models which determine style allocations and sector weightings per portfolio.

Tradition Asset Allocation Strategy; also known as a tax-managed strategy with quarterly rebalancing and a fully invested mandate.

Strategic (World) Asset Allocation: features the same allocation models as above but with the addition of cash as an asset class for a maximum of 30% of the portfolio. More active than Traditional allocation methods.

Dynamic (STAR) Asset Allocation: same allocation models but with complete flexibility of 0% to 100% bonds, equities, cash or any combination. This is the most active strategy of the three.

All three strategies are also available with an allocation strategy provided by the H.S. Dent Foundation.

Program Notes

This section will be used to inform our readers of specific changes in allocations, portfolios, protection, or other items of interest.

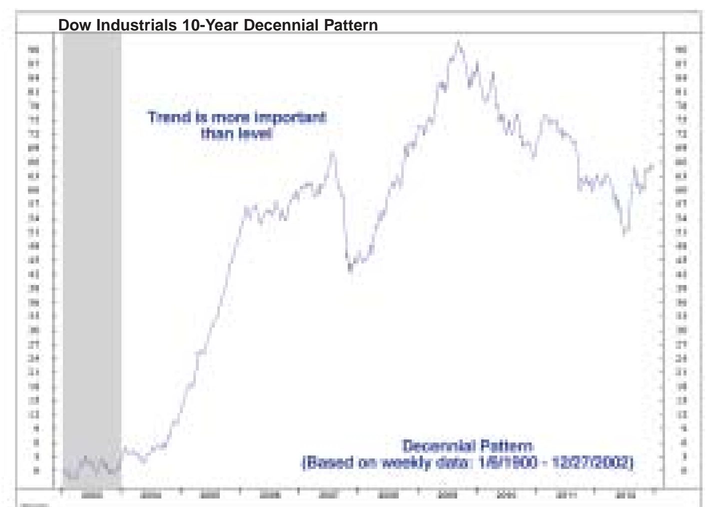
The Master Sentry Protection level was increased from 800 to 900 on the S&P 500 in late June. This was accomplished to lock in gains from earlier in the year and to protect the Master portfolios from a correction if it were to occur. This was accomplished by selling the December 750, 775, and 800 S&P 500 Puts and buying S&P 500 Puts at 900 expiring in June 2004. Our protection specialist, Rampart Investment Management, initiated this move.

The Strategic (World) and Dynamic (STAR) portfolios are, and have been, at their maximum cash allocation since June 16th. As of September 30, the S&P 500 is -1.46% lower and the Dow Jones is -0.47% lower than on June 16th. The Traditional Asset Allocation program remains fully invested.

Our Allocation models currently favor stocks over bonds, small-cap stocks over mid-cap stocks, and both over large-cap stocks. Growth and Value are about equally weighted. Sector allocations favor Technology, Health Care, Financial Services (diversified), Cyclicals, and Industrials.

The Longer Term Look

In an earlier paragraph I asked you to remember the Dow Jones level of 38,000, which would come about if this entire decade returned 11.22%, which is the average for all ten-year periods in U.S. stock market history. Harry Dent is a demographic economist that I have mentioned here before. Using demographics trends, the study of predictable spending habits, and how technological changes affect the economy, he has developed a very powerful thesis that would place the Dow Jones in the 35,000 range by 2009-2010. While not a crystal ball, demographic studies are a powerful projection tool. His result, as shown



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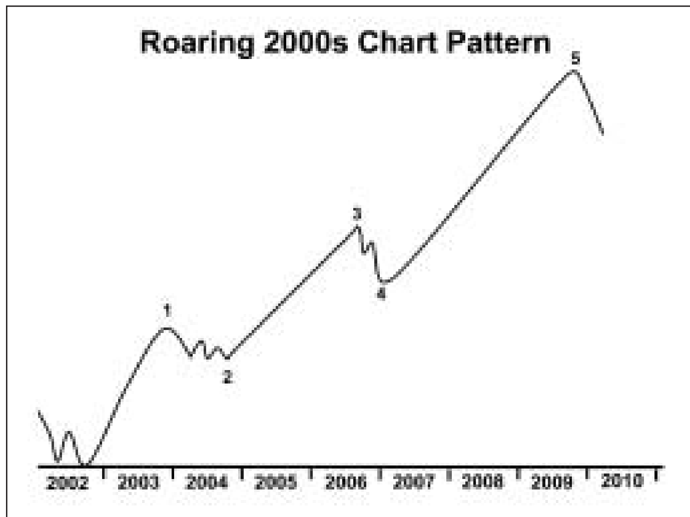
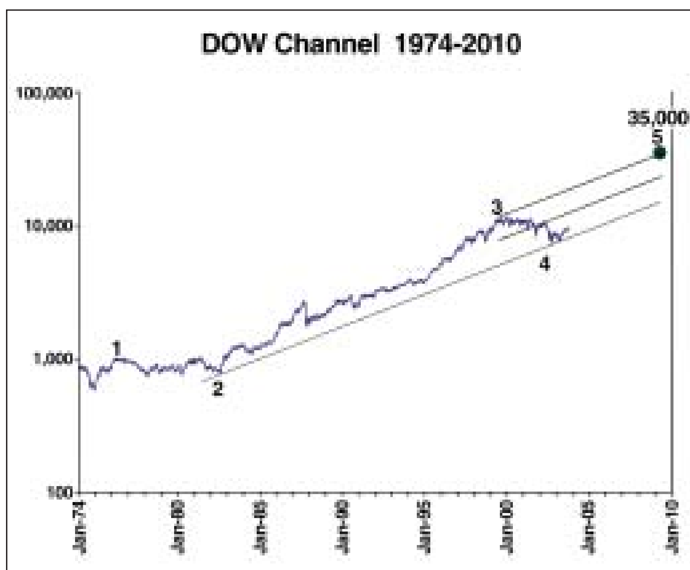


in the chart above, bares a striking similarity to a chart by Ned Davis on the previous page, showing the ten-year decennial pattern based on data from 1900 through 2002.

Both of these forecast portray the current bull trend easing in early 2004. A period of sideways movement would most likely follow as the economy catches up with the financial markets before the bull phase resumes before the 2004 elections. This bull market would continue through the first year of a new Presidential term and would most likely end in early 2006. This could possibly be the end of the present cyclical bull market. Of course, by then we might be calling the current bull market a secular trend. In any case, we would most likely expect a fairly severe correction to occur during the 2006 period and extend into 2007. That should be followed by the final phase of this decade's movement into the end of the decade. Sounds all too easy, doesn't it?



It is interesting how the same result can be gleaned from several methods. There is a high probability that this decade will be somewhat near normal or average. Mr. Dent's theories are the result of many years of demographic research while the cycle studies of Ned Davis show the same end point.

Summary

The market has been moving sideways since mid-June and cannot decide which way to jump. Markets can correct large upward movements, such as we saw earlier this year, by moving sideways or declining. Because this sideways movement has been so persistent I do not believe that we will have any kind of substantial correction from here. The market might test the 9000 level on the Dow Jones but I would be very surprised if it went below that level. November, December, and January are the most positive months of the year and this year should be no exception. The rally from the October 9, 2002 low has been a nice one but is still below expectations. It should catch up with a bang especially if some of the economic indicators, that are lagging, such as job creation, pick up. As always, patience will be rewarded.

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