CLARK CAPITAL MANAGEMENT GROUP, INC.

# THE NAVIGATOR REPORT

FOURTH QUARTER 2003

## Who Could Ask for Anything More

Wow, what a year! The first profitable year for the major indexes after three years of double-digit decline. Those three years being the worst since 1932.

In the third quarter Navigator Report we said that the U.S. equity market, as measured by the S&P 500, would have to average 24.52% during each remaining year of this decade to make the decade (2000 - 2009) only an average decade with an 11.2% per year return. We are off to a good start as the S&P 500 rose 26.4% during 2003. This rise was fueled by massive stimulus from the Federal Reserve, the lowest interest rates in forty years, tax cuts from the White House, low inflation, and accelerating productivity. And what a rise it was! *It was the broadest advance in over 23 years with 90% of S&P 500 stocks higher at year-end.* All 10 major industry groups advanced. **Who could ask for anything more to get the market soaring and the economy percolating?** Makes you wonder what would have happened in the absence of any of the above factors. Well, we're off to the races but the question of the day is whether the economic expansion, let alone the equity markets, can keep up the good work. We will examine some of the catalysts in this report and reach a conclusion as to current and future prospects for the equity markets.
I guess the immediate question

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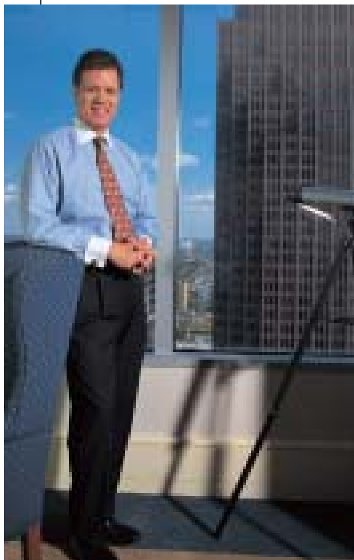


**HARRY J. CLARK, CFP** PRESIDENT / CHIEF EXECUTIVE OFFICER

**U.S. small business expectations have risen from a ten-year low to a twenty-year high**

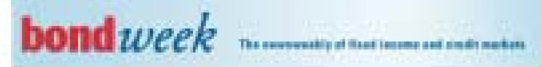
*- Economic Cycle Research Institute*

## CCMG in the News

It seems as though the media (CBS, CNBC, USA Today, Bloomberg, Reuters, Business Week) has developed an interest in what we are thinking and saying. Since we are not shy we thought we would share with you some of the stories that have been aired. A complete listing of all media interviews and appearances can be viewed on our website, **www.ccmg.com**. Just click on the tab "In the News."

*November 14, 2003*
**Harry Clark** appears as a live guest to discuss exchange traded funds.

*November 28, 2003*
**Sean Clark CFA,** chief investment officer, appears as a live guest to comment on the retail industry.




*November 20, 2003*
**Steve Grant,** senior portfolio manager bonds, comments on fixed-income strategies.

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is what happens now. We have had a stellar year in 2003 following the bummer in 2002. The fear remains that we may be experiencing a short-term bull market in the context of a longer-term bear market.

We discussed this in great (probably too great) detail in our second quarter 2003 report. Even I was having a hard time keeping "cyclical" and "secular" straight. If you recall, I showed that cyclical bull markets (seventeen over the past century) occur during longer-term bear markets (four over the same period) and average gains of 51% over a thirteen-month period. *The current bull was born in October 2002 and is now fourteen months old. The return to date has been a little shy of average with a gain of 43.1% from the bottom.* The Presidential election cycle was also discussed and that cycle also called for an average gain of 51% from the low of the mid-term election year (2002) to the high of the pre-election year (2003). So the return was also a little shy on that score. So are these statistics meaningful? Possibly! They show that, so far, as pleasant as things have been, the current bull market is not living up to expectations and is also getting a little long in tooth. **A correction may be in order and would be a healthy event.**

I came upon an interesting statistic from markethistory.com. This tidbit showed that there have been 11 times when the market was down over 10% in a given year and then was up over 10% in the next. **The following year saw gains in 9 of the 11 events. The gains averaged 18%** while the losses averaged 3.5%. The interesting part here is that the market was up only about 50% of the time during the first six months. The declines occurred mostly during the first quarter and averaged 7.1%. The second half, however, was up in all eleven cases. Good news! But that good news was almost always followed by a down move the next year out. Strangely enough, this scenario fits the Presidential election cycle almost perfectly.

## It's an Election Year (Yea!)

Why Yea? Because election years are, for the most part, predictable events as far as the equity markets are concerned. **And, unless something very unusual happens, 2004 will be a positive year.** Election year returns, over history, have only been slightly lower, on average, than the return in the pre-election year. As you know, the pre-election year is the strongest year of the cycle. Could that mean that we can expect a return of slightly less than 26% for 04? Well, that would be nice but I think that could be a stretch. On the other hand, if the stimulus continues, productivity keeps improving, and corporate profits keep rising, a pleasant surprise could be in the offing.

As you can see on the chart of the Presidential Election Cycle (provided by Ned Davis Research) on this page, election years usually start off with a whimper and end with a bang. **The first five months of the year normally results in a slight loss while the next seven months average about an 18% gain.**

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Another way to measure the possibilities is to look at the historical return from the pre-election year low to the election year high. In the prior seventeen election periods (1934 on) the average return has been 63.7% from the pre-election year low to the election year high. The smallest return was 20.8% in 1948 and the largest was 111.60% in 1936. The most recent two elections resulted in gains of 72.5% in 1996 and 64.7% in 2000. The table below shows each election since 1934 and the gain from low to high.

**S&P 500 Index Performance from Mid-Term Election Year Lows to Election Year Highs since 1934**

| Low S&P 500 | | High S&P 500 | | Gain over |
|---|---|---|---|---|
| Date | Value | Date | Value | Period |
| 07/26/1934 | 8.36 | 11/09/1936 | 17.69 | 111.60% |
| 03/31/1938 | 8.5 | 01/03/1940 | 12.77 | 50.20% |
| 04/28/1942 | 7.47 | 12/16/1944 | 13.29 | 77.90% |
| 10/09/1946 | 14.12 | 06/15/1948 | 17.06 | 20.80% |
| 01/14/1950 | 16.65 | 12/30/1952 | 26.59 | 59.70% |
| 01/11/1954 | 24.8 | 08/02/1956 | 49.74 | 100.60% |
| 01/02/1958 | 40.33 | 01/05/1960 | 60.39 | 49.70% |
| 06/26/1962 | 52.32 | 11/20/1964 | 86.28 | 64.90% |
| 10/07/1966 | 73.2 | 11/29/1968 | 108.37 | 48.00% |
| 05/26/1970 | 69.29 | 12/11/1972 | 119.12 | 71.90% |
| 10/03/1974 | 62.28 | 09/21/1976 | 107.83 | 73.10% |
| 03/06/1978 | 86.9 | 11/28/1980 | 140.52 | 61.70% |
| 08/12/1982 | 102.42 | 11/06/1984 | 170.41 | 66.40% |
| 01/22/1986 | 203.49 | 10/21/1988 | 283.66 | 39.40% |
| 10/11/1990 | 295.46 | 12/18/1992 | 441.28 | 49.40% |
| 04/04/1994 | 438.92 | 11/25/1996 | 757.03 | 72.50% |
| 01/09/1998 | 927.69 | 03/24/2000 | 1527.46 | 64.7% |
| 10/09/2002 | 776.76 | ? | ? | ? |

Mean gain: **63.7%**
Median gain: **64.7%**

*Since we have already reached a return of 43.1% from the pre-election year low, we should expect another 15% gain to reach the 63.7%* average from low to high. (I know that this does not seem to add-up, but do the math and it really is 15%, or actually 14.395%). Since the market usually stages the best part of the rally late in the year, we can expect the high for the year to be at about year-end. **Interestingly, the best returns for the election year have occurred when an incumbent Republican president is re-elected.** The average

gain when an incumbent wins is 15% but drops to 4.2% if the incumbent loses. Obviously a victory by Mr. Bush should, historically, have the most positive effect on the market.

## 2003 Results

We cannot detail returns for our various programs in this report because they are to numerous.

In the **Navigator Asset Allocation** unit of the firm, which utilizes mutual funds, ETF's, and variable annuity/life sub-accounts as the investment vehicles, we offer three portfolio strategies, Traditional, Strategic (World), and Dynamic (STAR), each with six to nine different parameters based on client suitability.

Our **Navigator Asset Management** unit utilizes individual stocks and bonds as the investment vehicles and offers programs in Premier Portfolios, Option Enhancement, and Master Portfolios. These offerings are highly customized to meet each client's particular needs.

Clients invested in Maximum growth strategies should expect a 2003 return in excess (some far in excess) of the S&P 500, which is our return benchmark. Returns for clients with a Moderate strategy should about equal the benchmark while those with a Conservative posture, which includes some bond exposure, performed at slightly less than the S&P 500.

Of note is that the Navigator Sentry strategy, employed in the Master Program, had the level of hedge, or downside protection, raised to 1050 on the S&P 500 at the end of the year.

## Whither The Dollar $$$$

Corporate profits are influenced in many ways; one way is by the value of the **dollar.** Many are worried by the recent decline in the U.S. dollar compared to the Japanese Yen and the European Euro. Many forget that the reason the dollar had been so strong in the late 90's was because Mr. Greenspan forced it higher to stabilize shaky currency markets worldwide. **The long slide of the dollar has been very positive for U.S. economic results.** Most all central banks have, so far, acquiesced to the lower dollar. It has helped the Fed fight inflation and it has helped U.S. multinational companies boost profits. **During the months of September and October, exports of goods and services posted their largest two-month gains in a decade.** The one worry is that a rapidly falling dollar might cause foreign investors to lose confidence in the US markets. This would cause the Fed to raise interest rates sooner than they otherwise might to stem the slide. As you know, interest rate increases do not sit well with the market.

In terms of market performance, there have been six prior times, since the inception of the dollar index in 1971, that the dollar has had significant losses against other currencies while the market has been advancing. **In every instance the market continued to move higher. By the end of the next quarter the S&P 500 was 8.99% higher and by the end of six months it was 13.76% higher on average.**

The year that looks most like 2003 was 1985. The Dow had advanced by 26% while the dollar index was falling 18.5%. Sound familiar? By the next month the Dow had risen another 13%, 20% over the next quarter and 25% over the next six months. The gains continued over the next eighteen months. Look at the chart of the Presidential cycle. It shows gains through 2004 and into the first half of 2005. A coincidence? We will see.

## Summary

"It's the economy," is a phrase that is uttered often when discussing the potential for the stock market. It is actually a pretty strange thing to say as time and again the stock market actually predicts the economic cycle. At the moment, however, the economy is going to play a very important part in how the markets perform going forward and that is largely tied to corporate profits. *Fourth quarter corporate profits are expected to come in at 22% to 28% above those of last year.* In addition, for the first time in twenty years, the IBES/First Call earnings estimates for the next two years have experienced dramatic upward revisions. And the ECRI (Economic Cycle Research Institute) says that U.S. small business expectations have risen from a ten-year low to a twenty-year high. So, it seems, the right medicine has been administered to the economy to give it the boost needed to accelerate at least through the next two years. While job growth has been slow to recover; this recovery has produced the fewest number of new jobs of any recovery in the past forty years, the growth will eventually come. Since the American electorate votes with their collective pocketbooks, and the consumer is feeling pretty good, it seems that there is a reasonable chance that President Bush will be re-elected.

Putting all this together; earnings growth, interest rates, tax-cuts, and the election cycle, leads one to believe that this could indeed be a year when the market approaches that return of 24%. **I, however, feel that a more realistic return could be 18% to 20%.**

Don Hayes, a noted market theoretician, feels that the markets move between despair and euphoria. At this time he believes that we are about 40% on the way to euphoria and is expecting a return of 31.4% this year. His only caveat is that interest rates must stay benign. On that score, several Federal Reserve Governors have recently stated that they believe they can hold rates at this level "for a considerable time." A dissenting opinion comes from Bernie Schaeffer,

also a noted market writer, who predicts a level of 850 for the S&P 500 by year-end. I hope he isn't serious!

Don't forget, in order to have the current decade (2000 through 2009) be an average decade in terms of return, we needed a 24.52% annual return for 2003 through 2009. Since we beat that by a smidgen in 2003, that number will go down a hair but it is still about 23%. Our target for the Dow Jones Industrial Average at the end of 2009 is 38,000. Don't laugh! That number is almost exactly the 35,000 target that Harry Dent, of the H.S. Dent Foundation, is predicting based on demographic trends, studies of spending habits, and how technological changes affect the economy. Will the market go straight to 38,000, definitely not? Will there be some major corrections along the way, definitely.

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*December 17, 2003*
**Maira Thompson,** senior portfolio manager equity, discusses Best Buy and Circuit City

*January 16, 2004*
**Sean Clark CFA,** chief investment officer, will be guest analyst

*December 24, 2003*
**Harry Clark** speaks about the 'Santa Claus' rally.

*December 29, 2003*
**Maira Thompson,** senior portfolio manager equity, comments on the basic materials sector's outlook for 2004.

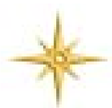
*November 27, 2003*
**Harry Clark** appears to discuss general market topics and issues

*November 28, 2003*
**Sean Clark CFA,** Chief Investment Officer, appears as a live guest to comment on the retail industry.

*November 19, 2003*
HP Income Up on Strong Printer, PC Sales
"I think since the merger was announced the market kind of gave her and Hewlett-Packard a grace period and that grace period was coming to an end with these numbers," **said Sean Clark CFA, chief investment officer at Clark Capital Management, which owns about 100,000 HP shares.**

*November 24, 2003*
**Harry Clark** discusses succession planning.

*December 31, 2003*
**Sean Clark CFA,** Chief Investment Officer, appears to give 2004 market outlook



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All CCMG performance figures in this Report are net of fees and expenses. Past performance is not a guarantee of comparable results in the future. The sited data have been prepared utilizing a methodology consistent with industry standards.

*Some CCMG allocation accounts are managed through the use of tactical and strategic asset allocation methods and utilize buy and sell indications produced by these methods to determine when clients should be invested in equity securities. When a buy allocation is generated clients' accounts are invested in equity securities, and, conversely, when a sell allocation is generated their accounts' equity positions are liquidated and invested in money market accounts and other cash equivalents. The performance data cited reflects the effects such buy and sell allocations would have had on an investment in the market indices discussed for the time periods indicated. The buy and sell allocations used in such information are actual allocations generated by CCMG's methods during the periods portrayed. Client accounts may or may not have been invested in the referenced indices during the periods portrayed. The cited performance data assumes the reinvestment of all dividends and capital gains distributions, and reflects the deduction of the maximum management fee charged by CCMG for the referenced program. Historical performance is available upon request.