



# THE NAVIGATOR REPORT

FIRST QUARTER 2004

## Perspective

After the sizzling year we had in 2003, investor's minds have been focused on when, or if, the next shoe will drop; meaning when will the next decline begin. We have had an ongoing discussion in these quarterly reports about whether the stock market is in a new long-term bull phase (secular) or just a rebound (cyclical) within a long-term decline (for that discussion please refer to the second quarter '03 issue). That question is still not answered but, in my opinion, the cards seem to be falling on the side of an extended new bull market. Bull markets, whether they be cyclical (short-term) or secular (longer-term) can be very profitable. You may remember from the previous discussion that there have been bull markets that returned in excess of 100% and were still referred to as "cyclical." We will concentrate on the positives and handle the next major market decline, whether short or long term, when it arrives.

To put the decline of 2000-2002 and the recovery to date into perspective we have to go back to the "irrational exuberance" speech given by our Federal Reserve Chairman Mr. Greenspan in 1996. When Mr. Greenspan pondered the question of irrational exuberance, the total stock market capitalization of the U.S. was somewhat under **\$8 trillion**. At the peak levels during 2000 the value was at **\$18 trillion**. You can see the tremendous increase in household wealth by referring to the chart on page two. Notice the rapid rise in household wealth from the slight dip to 27% in 1996 to the peak of

*continued on page 2*



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

## CCMG in the News



February 19, 2004

**Money Manager Profile: A Firm Makes Managing Money a Family Affair**

HARRY CLARK, PRESIDENT & CEO

**"Unless this is destined to be the shortest and least profitable bull market of the past 50 years, there is good historical reason to think more profits lie ahead"**

- James Stack, InvesTech Research



March 3, 2004

**Arms Companies Mull Higher Dividends, Share Buybacks Ban**

SEAN CLARK, CHIEF INVESTMENT OFFICER



March 3, 2004

**Defense Giants Shooting for Higher Dividends**

SEAN CLARK, CHIEF INVESTMENT OFFICER

## THE WALL STREET JOURNAL

March 13, 2004

**Taking Stock: More Pain May Be in Store But More Opportunity, Too**

HARRY CLARK, PRESIDENT & CEO



March 27, 2004

**Makers & Breakers**

MARIA THOMPSON, SENIOR PORTFOLIO MANAGER



February 26, 2004

**Market Correction?**

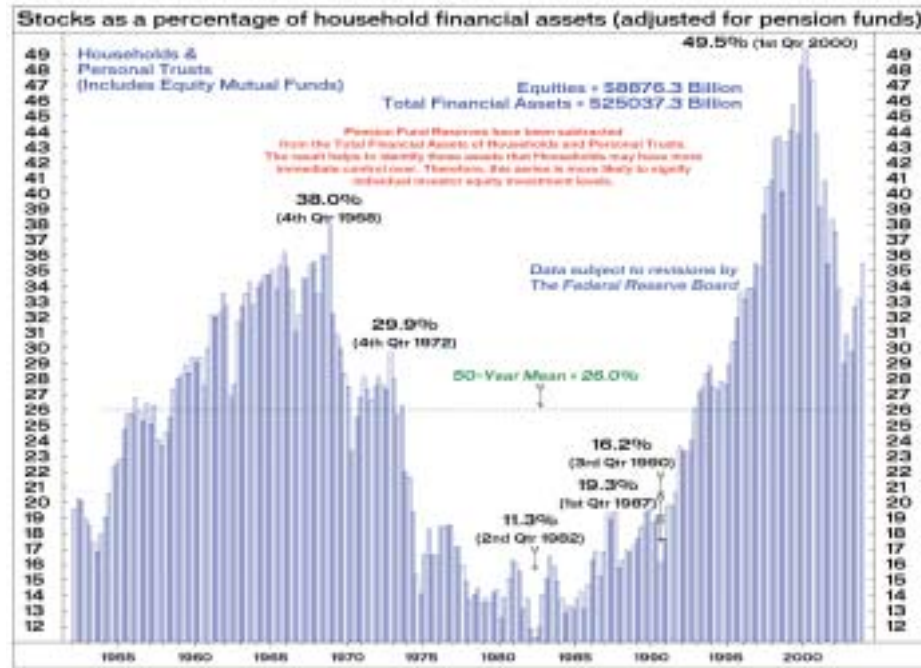
SEAN CLARK, CHIEF INVESTMENT OFFICER

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49.5% in 2000. It dropped to 29% during the bear market period and has now recovered to 35.2% (12/31). It seems to me that the increase of wealth from 1996 to 2000 was

ETF's are Exchange Traded Funds. They differ in many ways from traditional mutual funds. At this point they are all index based and cover a great many indexes including country indexes. The best known and oldest ETF is called a Spider and was launched in 1993. A Spider is a replication of the S&P 500 index. Other better-known ETF's are the QQQ's and the Diamonds. The QQQ is an index of the 100 largest non-financial companies on the Nasdaq and the Diamonds replicate the Dow Jones Industrial Average. Some of the benefits compared to traditional mutual funds are, lower cost, transparency, tradeability, and tax benefits. There are many other benefits and these have caused ETF's to become the fastest growing investment vehicle of the day.

A Core & Explore strategy is where a large portion of the account is in basic, or core, positions such as large-cap, mid-cap and small-cap indexes while the remainder is in potentially more profitable sectors such as emerging markets, technology, or biotechnology. Our present allocation is:



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indeed “irrational.” I don’t know what to call the ensuing decline in wealth from the **\$18 trillion** peak to the **\$10 trillion** bottom in October 2002 except “a tragedy.” And indeed it was a tragedy into those who had fallen for the speculative trap of low quality, no earnings stocks. Yes, we have seen a rebound of about \$3 trillion in capitalization but that rebound has occurred to a large extent in the lowest quality stocks. A recent Morningstar study of their 5,999 stock database revealed that 42%, or 2519, of those stocks had negative earnings (losses) during 2003. The average gain on those stocks was 117% during 2003! During 2003 the lowest quality stocks performed best while high quality languished. In the S&P 500, the lowest quality stocks gained 68% while the best blue chips only managed to gain 23%. At the end of the year the lowest quality stocks were trading at a 42% premium to value while the highest quality were priced at a 20% discount. This phenomenon is not unprecedented in the early stages of a new bull. If quality does not come to the forefront soon I believe that this indeed might only be the cyclical bull that some are predicting and not the true new long term uptrend we are looking for.

## Core & Explore ETF's with Sentry

During this first quarter CCMG launched a new program utilizing Exchange Traded Funds (ETF's) coupled with our Sentry protection program. We call this new program “Core & Explore”. To some of our readers, ETF's, Sentry, and the term Core & Explore are totally new.

### Core Portion:

- S&P 500 SPDR = 20%
- Mid Cap SPDR = 15%
- IShares Russell 2000 =15%
- MSCI EAFE = 10%

### Explore Portion:

- Financial Select SPDR = 5%
- Technology Select SPDR = 5%
- IShares Emerging Markets = 10%
- Navigator Sentry = 5%
- IShares Russell Mid-Cap Value= 10%
- Cash = 5%

As you see, the allocation is very diverse and includes both a “Core” and “Explore” position. The Navigator Sentry portion is our strategy designed to limit loss in the event of major market decline. It is derivative based and sub-advised to CCMG by Rampart Investment Management from Boston. Rampart is a firm that specializes in protection of assets utilizing derivatives. The allocation is adjusted as market conditions change.

## The Pause That Refreshes?

A pause? Who wants a pause? **Well; we need a pause.** Since 1900 there have been 350 stock market rallies of over 5% in the Dow Jones Average without a 5% correction. The rally that ended on February 11, 2004 was the longest rally since 1994-1996 and **the twelve longest since 1900** extending for 317 days. This extended rally left the market overbought and investor optimism excessive. In other words, a correction is in order. These corrections typically average about 9% and have the effect of quickly squashing investor enthusiasm. Couple that with the Election Year Cycle and you will see that this correction was to be expected. In last quarter's report we said, “A correction may be in order and

would be a healthy event." The S&P 500 and the Dow Jones peaked on February 11th and declined 5.7% and 6.4% respectively. The Nasdaq, which topped on January 26, declined 11.7%. As of this writing, the markets are recovering from the lows reached on March 24th but I expect at least a test, or partial test, of that low over the next few weeks.

I recently came across a poll from the Yale School of Management that showed 95% of individual investors and almost 92% of institutions believe that the U.S. Stock Market will rise over the next 12 months. I would feel much more sanguine about the stock markets prospects if these numbers were much lower.

## Election Effect

Few investors realize the effect that a presidential election has on the equity and bond markets. If I had to choose one word to describe the impact it would have to be "Dramatic." There are few other events in the life of the market that have the impact of the four-year Presidential Election cycle. In last quarters Report, we showed a chart of the Presidential Election Cycle beginning with the election year. That section was titled "It's and Election Year (Yeah!)." (If you want a copy of that report please call the office). Yeah! because the election year is second in average return only to the pre-election year. As you know, the pre-election year is always the strongest year in the four-year cycle. In that report I showed that the average gain from the low of the mid-term year to the high of the pre-election year has been 51%. During the most recent cycle (that began at the low of the mid-term year during October 2002) the market missed the average by returning 43% to the high at the end of 2003. The average return from the mid-year low to the high during the **election year is 63.7%**. That means that we have some room on the upside just to equal the average gains of the past. Of course the gain in this time frame could be lower or higher than the historic averages. My bet is with a higher return than average because everything is clicking just right with the economy. Fiscal, monetary and tax policies are favoring a rapidly expanding economy, which should be able to fuel a very good equity market.

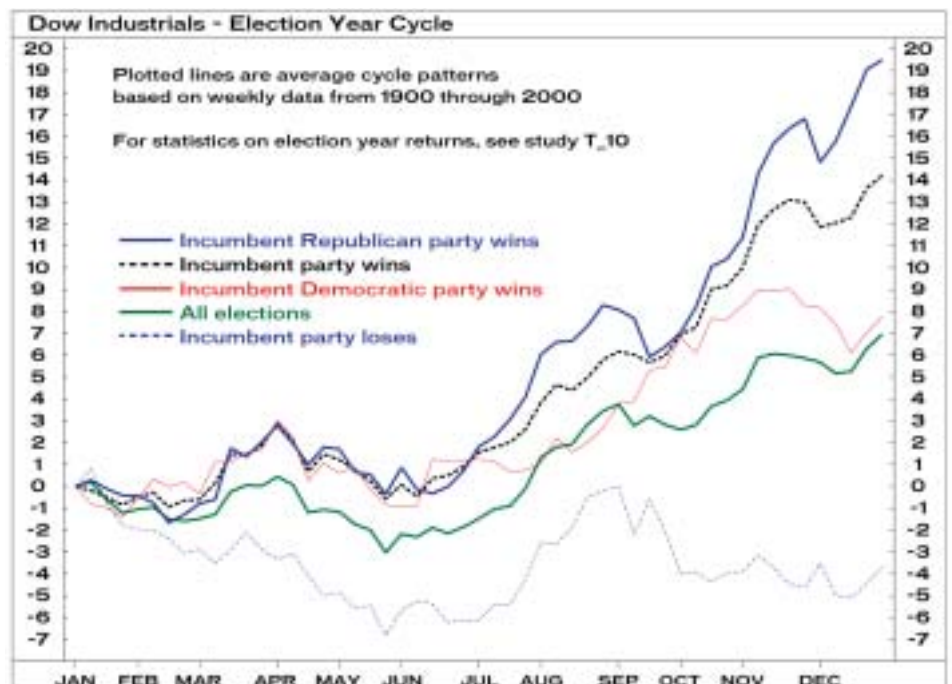
The election year is historically weak during the first five months and the return is normally slightly negative. A good market correction usually occurs in that time frame and has averaged about 9%. During the remainder of the year the **Dow Jones has rallied 82% of the time and is usually very positive**. The returns during this period can be very diverse based on who is expected to win the election. How does the market know what party will win the election? Of course it does not know. But, by the time the conventions are over during late summer, most elections are somewhat defined and the market acts accordingly.

The median gain for all elections years since 1900 has been 9.2%. That includes the correction early in the year and the rally during the rest of the year. There have been 26 Presidential elections since 1900. Republicans have won 14 times generating average gains of 13.1% while Democrats have won 12 times resulting in average gains of 4.6%. **An incumbent party has won 15 times and the market has responded with an average gain of 16.4%. The incumbent party has lost 10 times and market has declined on average 1.4%.**

The most intriguing aspect of this phenomenon is that when an incumbent **Republican wins, as has occurred on 8 occasions, the return soars to an average 23.5%**. An incumbent Democrat has won 7 times and the return has averaged 8.4%. These numbers may be easier to fathom while referring to the chart below from Ned Davis Research.

## Jobs, Economy, Interest Rates

You have undoubtedly heard reports about the "jobless recovery." In fact this recovery has produced the fewest new jobs of any recovery in the past forty years; at least up until now. I have stated before that the American public will vote with their pocketbooks. Case in point is the election where the Senior Bush lost his presidency. At that time the money supply was actually shrinking going into the



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election. I believe that that was the first time in Federal Reserve history that the money supply was in negative territory during an election and it cost Mr. Bush the election. You can bet that the current President Bush will not make that mistake. His friend, Chairman Greenspan is doing all in his power to generate jobs by flooding the system with money. The supply of money is like the supply of gasoline to an automobile. An automobile will not go without

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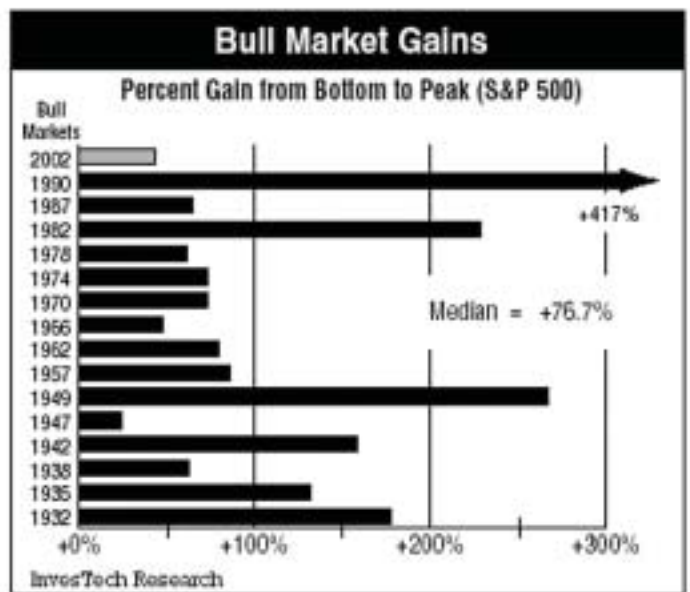
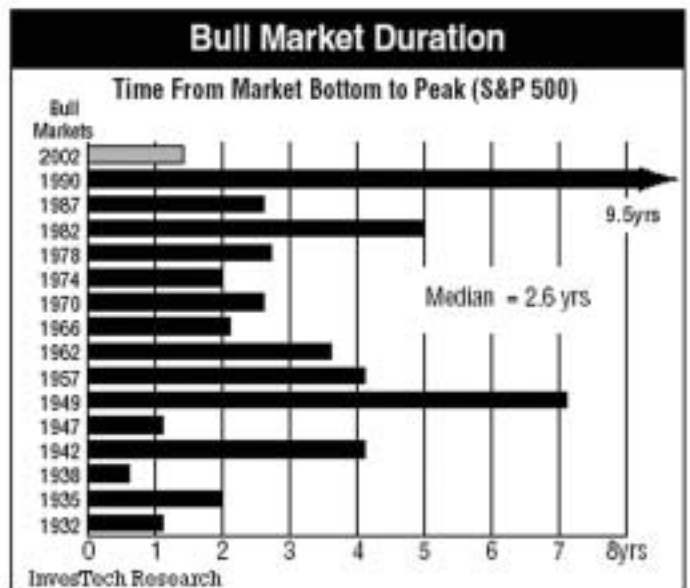
gasoline; the economy will not go without a supply of money. Yes, the cost of money is an important factor but even more important is the availability of money. Mr. Greenspan has created \$178 billion in new money supply since January 1st and it is beginning to take hold. That counteracts the strange decline in money supply during the second half of 2003. I believe that decline was an important reason why job creation was so lacking. The job report for March showed that 308,000 new jobs were created. January and February were also revised higher. This is tremendous news for the economy and the stock market. It might take a little while for all this to sink in, but when it does, the market will respond accordingly.

The other weak link in the economy had been manufacturing. The ISM (Institute of Supply Management) data is a way to track manufacturing activity and recently showed the best number in history at 62.5. Some say that a number this high translates into GDP growth of over 7%!

While all of the above is tremendously positive it will cause some concern by the Federal Reserve. Rapid growth in employment and manufacturing will undoubtedly make the Fed at least begin to talk tough. Rhetoric will probably be tougher in May and there could be a rate increase as early as June if the economy stays on course. That is not possible, you say! Well, yes it is! Since the inception of the Federal Reserve Board, there have been 88 interest rate increases and 22 have been during election years. The Fed, however, has never raised rates within two months of Election Day.

## Summary

So where are we today? The charts of Bull Market Duration and Gains are courtesy of the excellent publication "InvesTech Research" edited by James Stack (Investech.com). To quote Mr. Stack, "Unless this is destined to be the shortest and least profitable bull market of the past 50 years, there is good historical reason to think more profits lie ahead". That statement, and the accompanying charts well describe the current situation.



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