



# THE NAVIGATOR REPORT

FOURTH QUARTER 2004

## Another Year

Another year passes quickly into the history books and what a year it was. Of course we always say "what a year it was" about all passing years but it just seems to me that this year was a bit more contentious than normal. Many of us could not believe the vehement politicking that took place before the Presidential Election, became tired of watching the violence in Iraq, and were saddened by the terrible tragedy of the Tsunami in Asia. The question at hand is "What will this year bring?"

The purpose of this publication is to give clients of the firm a sense of what has happened in the investment markets in the past, where those markets stand today, and what might the potential be for profitability going forward. And, as you know, we believe that those who ignore investment market history do not stand a chance of having a successful investment experience in the future. Looking over one's shoulder (so to speak) only seems prudent since market patterns seem to be repeated time and time again. As Don

Hayes, from the Hayes Advisory LLC says, "While markets never repeat themselves exactly, they often rhyme." The rhyme sometimes gives us distinct clues as to what the future could bring.

Before looking ahead, let's take a look back at 2004. You might recall that we had been predicting a fairly normal Presidential Election year where the first several months were dull and down before the action began toward

*continued on page 2*

## CCMG in the News



December 2004

Sean Clark, Chief Investment Officer appeared on an hour long edition of Bloomberg's 'In Focus'. In a roundtable discussion with other experts, Sean discussed topics ranging from consumer confidence to the stock market outlook.

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December 2, 2004

Sean Clark, Chief Investment Officer recapped his predictions for 2004, and offered his outlook for 2005.

## The Washington Post

November 25, 2004

Harry Clark, Chief Executive Officer commented on how the drop in jobless claims is a reason for a year end rally.



July 2, 2004

Sean Clark, Chief Investment Officer discussed why he was optimistic that the stock market would rally in the final months of 2004.

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year's end. And what a dull year it was! The market peaked in February and proceeded to move sideways until a bottom developed in August for most indices and in late October for the Dow Jones. That period of indecision became the longest period in history with such low volatility. It was the longest period, since daily numbers have been available, that the market range was less than 10% from top to bottom. It was also only the second time in the 120-year history of the Dow that both the low and high were made in the fourth quarter. That indecision ended with a bang as most of the major indices achieved gains of between 10% and 24% from their respective bottoms by year-end. The chart of market breadth that we showed in the third quarter Report predicted that rally. The year played out exactly as we had expected in terms of movement although returns were lower than we had expected given a Republican victory in the election. The average return in an election year when a Republican has been re-elected had been 26% and returns fell far short of that in 2004.

In the third quarter Navigator Report we said that the stock market had predicted the election outcome 24 out of 26 times. When the Dow Jones rises from September 1<sup>st</sup> through October 31<sup>st</sup> the incumbent was re-elected 15 out of 16 times. When the Dow Jones fell over that period the incumbent was defeated 9 out of 10 times. Since the Dow Jones declined 1.5% during that time period this year, President Bush was supposed to be defeated! So much for almost infallible indicators! That prediction is now right 8 of 10 times when markets fall and 23 out of 26 overall.

President Bush also beat odds of another sort in the election. The Federal Reserve has only raised interest rates once before within two months of Election Day. The only other time was when President Carter was running for re-election. That increase is thought to be the reason President Carter was defeated. They (the Federal Reserve) raised rates again last year within 60 days of the election but this time the incumbent won!

## What Do We Expect In '05?

It is always interesting to see what others are projecting when it comes to trying to guess what lies ahead. Since no one has a crystal ball it really is guesswork. Of course guesswork can be founded to some degree in prior events and that is called "predicting." In any case here are a handful of predictions from some well-known seers;

*"We would expect that we test the all-time highs between March and April and then break through to new highs in the summer of 2005 with a stronger second half to follow with a Dow target as*

*high as 14,000 by year-end if we are right about the bubble beginning again in 2005"*  
**Harry Dent Jr.** from the H.S. Dent Foundation.

*"Market history and market valuations point to a year of robust performance,"*  
**Kenneth Fisher** of Fisher Investments, Inc.

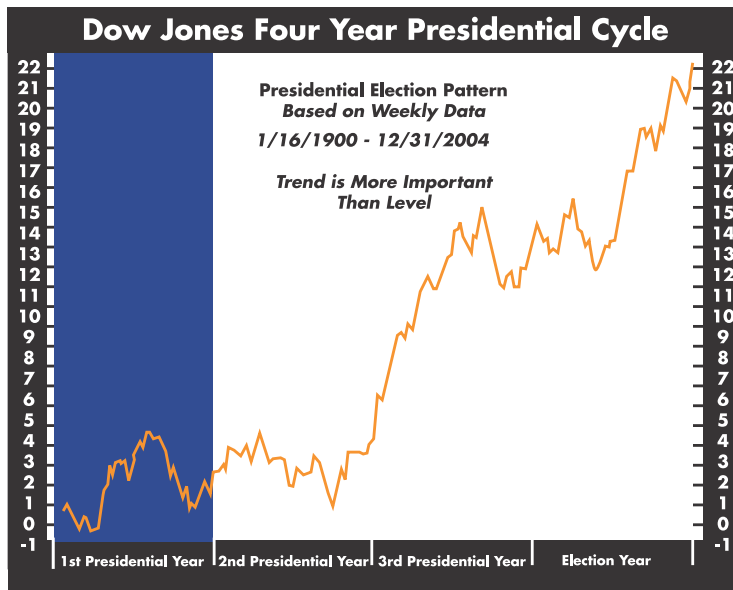
*"Nightmare time, going into next year, year one (of the election cycle), it's quite different. If you are in the overpriced half of the cycle, since 1932 two-thirds of those years have been down in real terms,"*  
**Jeremy Grantham** of Grantham, Mayo, Van Otterloo.

*"The mood on the street is much too giddy, bullishness and complacency much too pervasive. Such extremes in sentiment itself would call for a fair-sized correction,"*  
**Barron's.**

*"I think an interesting tracking chart to watch is shown above – the first year of a Presidential term (or post-election year). If the market did follow this pattern, it would be interesting because it would make all of the bears wrong in a good first half, and then when the bears were totally discredited, it would decline in the second half, frustrating the bulls. The market historically likes to prove the crowd wrong."*  
**Ned Davis** of Ned Davis Research Inc. (see chart above)

And finally *"A year of Increasing Uncertainty and Risk,"*  
**James Stack** of *Investech* and *"An exciting Year Ahead...But Great Caution Required,"*  
**Bert Dohmen's** Wellington Letter.

Are you sufficiently confused? Everyone has an opinion; some founded on more fact than others. The remainder of this report will discuss facts from other similar situations and we will see if we can discern a pattern for 2005.



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## Things We Know

We know that 2004 was characterized by one of the lowest volatility ranges ever. Low volatility is normally followed by increasing or higher volatility. We know that 2005 is the fifth year of the decade and there has not been a down year in an '05 year since 1875. We know that this is a post-election year or the first year of a new Presidential term so we can look at how that has played out during past years. We know (at least the estimates tell us) that corporate earnings comparisons will not fare well compared to '04. We believe that the GDP (Gross Domestic Product) will not compare favorably to the past two years. And we know, because Mr. Greenspan has told us, that interest rates will probably rise by quite a bit this year. **In short, there seems to be some heavy headwinds for the market to overcome in '05.**

## The '05 Phenomenon

We detailed this phenomenon in the last Report but it is useful to discuss this again. The fifth year of every decade, or of the decennial pattern, **has shown the greatest tendency of any other year of the decade to show a profit (see chart on page 4).** And, in fact an '05 year has not been down since 1875 when a predecessor index, the *Cowles Index* suffered a loss. Dividends were higher in those days so the total return was positive but the loss still goes in the record books. The last one in 130 years! It gets even better; the **average gain (S&P 500) is 26.4%**! Only two of those years showed gains in only single digits!

## First Presidential Year

This first year of the Presidential Cycle does not have nearly as sterling a record. **Since 1929 over half (10 of 19) of those years saw negative returns.** The returns were also all over the board ranging from a profit of 54% during FDR's first re-elected term in 1933 to a loss of 35% for his second re-elected term in 1937. Some distinction, same president, best and worst return! President Bush's first year saw a loss of 11.9%. The only President who was elected for more than one term since 1929 to show two positive years in the first year of their terms was President Clinton.

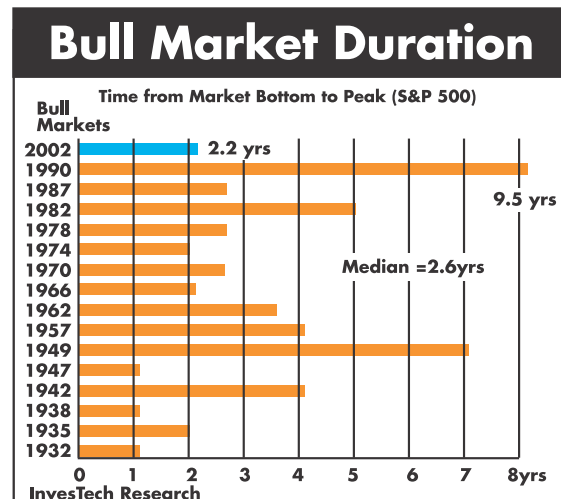
James Stack of *Investech* shows an interesting comparison of four investors. Each investor invested \$10,000 in a given year during the four year Presidential Cycle and only invested in that year of the cycle. In other words, investor one invested in 1945,55,65,75,85, and 95. Investor two only invested in 1946,56, etc., Investor three in 1947,57, etc., and Investor four in 1948, 58 etc. Investor one had \$30,000 at the end, investor two had \$24,179, investor three had \$193,942, and investor four had \$57,954. It just shows that the first two years of a term are the slimmest for investment returns while the third, or pre-election year is always the best and

election year is, on average, most favorable. The most recent pre-election year return was 28.9% while the election year returned 10.9%. A sobering thought is to remember that 9 out of the past 13 recessions began in the post-election year.

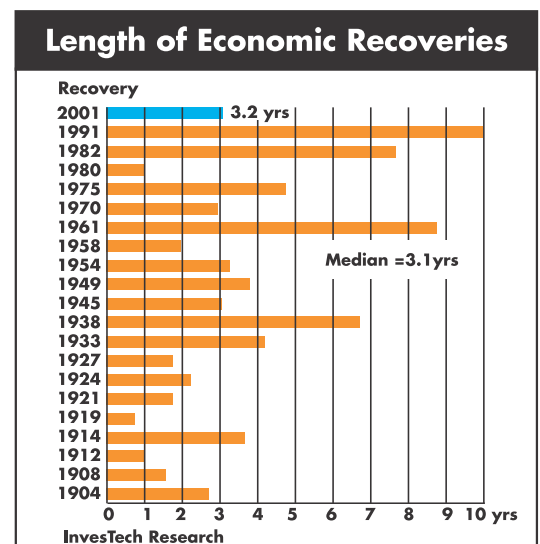
Interestingly enough, since 1929, every first year of a term that began in an '05 year was up; 1945=36.4%, 1965=12.5% and 1985=32.2%. Let's hope that '05 continues the streak!

## Long In Tooth

Both the present bull market, which began in October 2002, and the economic recovery, which began in November 2001, are ageing. The two charts below (*both from James Stack and Investech*) compare the present bull market and economic recoveries to others. As you can see, only three bull markets over the past 40 years have had a third birthday without a major correction.



The median length of an economic recovery is 3.1 years. Mr. Stack asks, "What are the odds this economic recovery will extend through 2005 and 2006 (reaching 5 years of age)?"



## So What Do We Really Expect?

Sean (our Chief Investment Officer and a Chartered Financial Analyst) and I (the Honorary Chief Investment Officer) are constantly called by CNBC, Bloomberg News, Fox News, and others to get our take on the upcoming year. **They think that just because we called 2004 accurately that we will be right in 2005.** Of course, only time will tell.

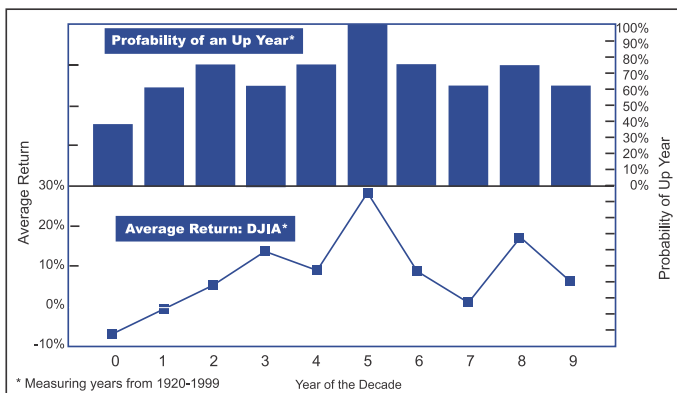
But in any case, **we believe that 2005 will be a tough year.** As mentioned in the last report, we are not sure that the bear market of 2000-2002 is really over or just taking a snooze. A typical bear market will, historically, last one-third the length of the time of the previous bull market. We count the previous bull from 1982; or an 18-year bull market. A six-year bear would end on 2006 or maybe late 2005. No matter what year it really ends, we also feel that the next true long-term bull market will be born from that point and continue for the rest of the decade.

Remember, Interest Rates will move higher this year and corporate profits will likely disappoint when compared to gains of the past two years. These two items alone should give investors pause for concern. Yet investors are more bullish now than they have been since just before the 2000 market top.

As Ned Davis mentioned in his quote earlier, *"The market historically likes to prove the crowd wrong."*

Since we have to guess a pattern for 2005, we believe that the market will have an early correction which will begin in January. That should be followed by a decent rally to almost new highs in the major averages. This is when those investors who were burned during 2000-2002 will decide to try the market again; and again just at the wrong time. We believe that a substantial correction will occur during late summer into early fall. By a substantial correction we mean 15% to 20%. This then might be the end of the 2000 bear market. The market will recover late in the year to post a gain of 10% to 12% on the S&P 500. If you refer to the chart on page two you will see this pattern in picture form! It will not be exact, but it will rhyme! Now last year, while our overall theme and market pattern were right on, our level of return was on the high side. We hope this year that our theme and pattern are again correct but that we are again wrong on the overall return of 10% to 12% and that it comes in much higher!

Either way we will deal with what the market gives us and make every effort to give you, our client, the best possible returns always being conscious of the risks involved.



FROM THE STAFF AT  
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