



THE NAVIGATOR REPORT

FIRST QUARTER 2005

Is It Over ???

Recent market action has prompted investors to wonder if the bull market that began in October 2002 has seen its day. You know, from reading prior Navigator Reports, that we have been saying that 2005 will be a difficult one for the stock *and* bond markets. The last report (fourth quarter 2004) stated that both the current bull market and the economic recovery were getting "long in tooth." Less than one third of bull markets reach their third birthdays and even then returns in the third year are almost always in single digits. Only three bull markets over the past 40 years have lasted three years before a major correction began. A major correction is defined as a decline of 20% or more, which we are expecting at some point this year.

The economic recovery is already over the hill and is older than the average recovery which lasts 3.1 years. This recovery is now 3.5 years old. Yes! The economy still looks good at the moment but a lot can happen quickly as we all know too well.

During several media appearances (which may be viewed on the CCMG website) my son, Sean (our Chief Investment Officer) and I, have said that there are five

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CCMG in the News

Bloomberg
TELEVISION

March 18, 2005

Bloomberg "On the Markets" President and Chief Executive Officer Harry Clark predicted an upcoming market correction citing the length of the current bull market and slowdowns in corporate earnings and GDP growth as some of the major causes.

The Fed's job is to "take away the punch bowl before the party gets really going."

- Former Federal Reserve

Chairman William McChesney

Bloomberg
TELEVISION

February 21, 2005

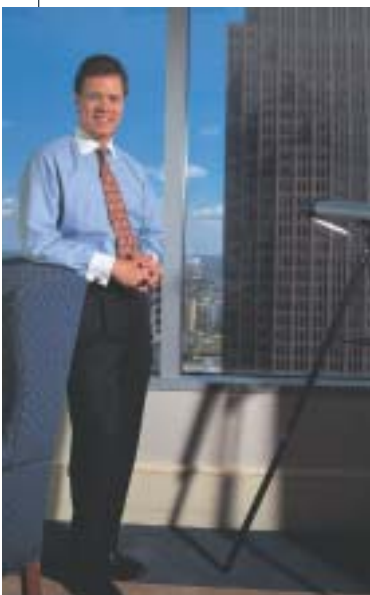
Bloomberg "On the Markets" Chief Investment Officer Sean Clark appeared as a live guest to discuss Separately Managed Accounts, the second fastest growing asset class on Wall Street.



CNBC

February 9, 2005

CNBC "Wake Up Call" President and Chief Investment Officer Harry Clark appeared as a live in-studio guest to offer his expectations for the market in 2005 and highlight those sectors that he expects to perform well.



HARRY J. CLARK, CFP PRESIDENT / CHIEF EXECUTIVE OFFICER

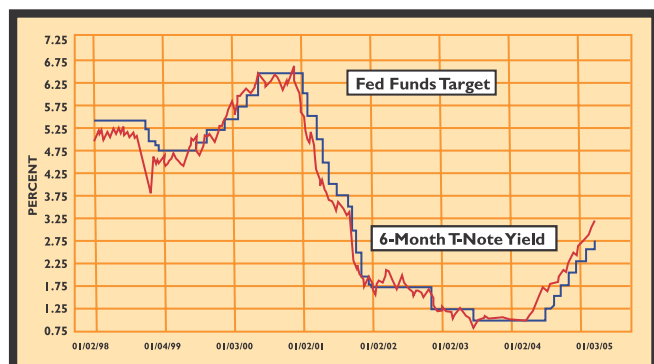
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reasons why the market will have a hard time this year. They are:

- 1. Earnings Comparisons:** Corporate earnings are the engine that pulls the market along. Earnings have been growing at an historic pace for five quarters and it will be extremely difficult for upcoming earnings to compare favorably with the prior year. Higher interest rates and a strengthening dollar will also cause earnings to falter. Earnings grew at a 28% annual rate last year while the most recent quarter produced an 18% rate of increase. The consensus for this year as a whole is in the 6% to 8% range; a tough comparison.
- 2. GDP Comparisons:** Similar to the earnings story, GDP cannot continue to rise as it has in recent quarters. This will give the impression that the economy is cooling off and you know that perception is reality.
- 3. Interest Rates:** We know that interest rates will continue to increase because Mr. Greenspan has told us they would in no uncertain terms. Another famous Federal Reserve Chairman from 1951 through 1970, William McChesney, tells us that the Fed's job is to "take away the punch bowl before the party gets really going." More on this later.
- 4. Oil Cost:** Even though the price of oil is lower in real dollar terms than during the early 80's, this commodity cost exerts a real influence on the equity markets. Oil is discussed in detail later.
- 5. Longevity:** As discussed above, the current bull market is past middle age and looks to be getting tired.

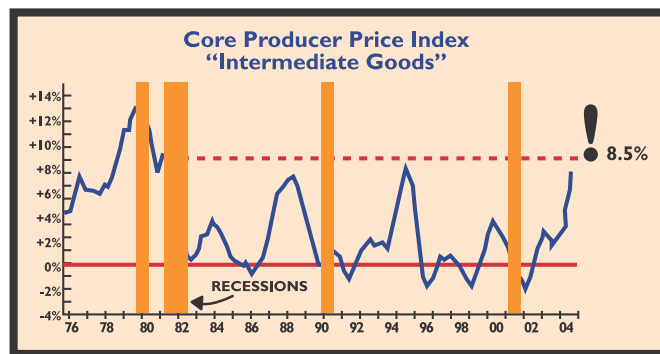
Inflation and Interest Rates

Many people ask us for our take on interest rates. Questions include "What do I do with my bonds?" or "Have I missed the best time to buy or refinance a house?" or "Should I wait until rates come back down before.....?" The answer to these questions will vary. The chart on this page should help understand where interest rates have been and maybe where they are going.



The chart is from the McClellan Market Report and shows that interest rates, at least short-term rates, are heading higher. I say short-term rates because the Fed, much to Mr. Greenspan's chagrin, does not control long-term rates. They are almost totally controlled by the bond investors' perception of inflation and what will happen to the principle when it is returned. This is a pretty graphic picture of the "punch bowl" referred to above. It has been said that the Fed "gives it and takes it away." Bert Dohmen's Wellington Letter says, "The Fed, has an almost perfect record of causing unnecessary market crashes and recessions. They may be on the way to keeping that record perfect." It is a fact that the Federal Reserve has an awful record when it comes to predicting the economy. I have seen it demonstrated that their record is less than one in four with economic predictions. I wonder how many economists would still have a job with those kinds of results. Of course to be kind to the Fed, not one recession in the past 40 years has been forecasted in advance by any major poll of economists.

Inflation, or the perception of inflation, is sure to guarantee that interest rates move higher. The chart below, from Jim Stacks' Investech, shows in graphic detail that inflation is indeed rearing its ugly head.



This chart pretty much guarantees that interest rates will continue a steady upward move. The best guess is that from the present level of 2.75%, rates should rise to a minimum of 3.5% during the year with the potential to move to 4.25% in early 2006. At 3.5% the rate is back to where it was before the 9/11 attack. Higher interest rates by themselves do not necessarily mean a falling stock market. Yes, higher rates eventually guarantee a falling bond market so bond investors should be very cautious and keep durations, or relative maturity levels, very short to avoid serious loss. A recent poll of 293 American CFOs by the Duke University CFO Magazine Business Outlook found that 35% of them felt that 3% was the highest rates

could go before impacting the economy. Could the Fed overshoot again and cause an economic slowdown into 2006? Stay tuned!

Oil

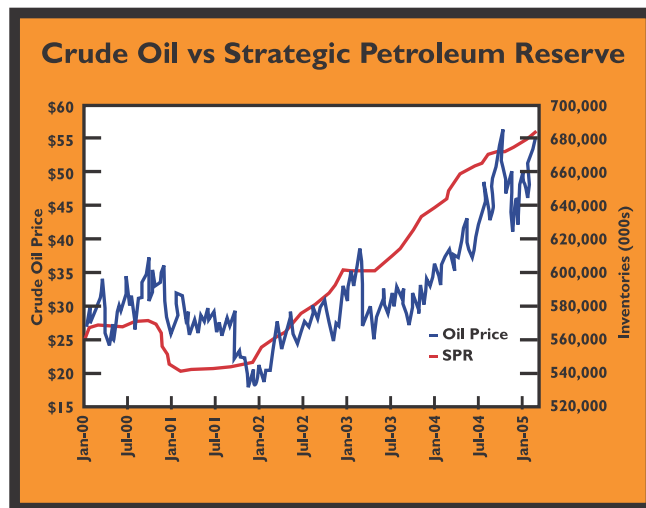
Another major concern to the public and the markets is the price of oil. Yes, the current price of crude oil, inflation adjusted, is no higher than it was in the early 80's but that is not much consolation to a country hungry for its SUVs. The recent price high of \$57.50 sent shivers down the spine of the markets and they reacted accordingly. Will this be the high point? Will oil move to \$60, \$70? Will Goldman Sachs' prediction of a "super spike" to \$105 be the final top? As you might expect, oil has become the hot topic, so to speak, and will continue to dominate the economic scene for a while longer. But, I believe, for only a little while longer. There are several factors coming into play that could very well cap the price of a barrel of crude for the foreseeable future; and not at the current price. Demand for oil has been heightened by China's bubble caused by the Fed's loose monetary policy. The momentum in the oil patch has also caught the attention of major speculators who, in many analysts opinion, have added \$15 to \$20 to the price of a barrel. Because a bubble in oil will impact inflation directly, we expect the Fed to keep on raising rates, which will have the effect of driving out the speculators. Speculation will most likely wind down as the price of oil falls below \$45/ bbl and short-term interest rates reach 3.5%.

There are, however, other reasons why the price of crude oil will be declining. A recent, and rare, interview with the Saudi oil minister recently confirmed his expectations that the price / bbl would fluctuate between \$40 and \$50/bbl. And, this is from a minister who has every intention of keeping oil as high as he can so that the sheiks of the Arab states can survive.

Bert Dohmen's Wellington Letter has a slightly more biased view of why the price of oil has risen to these levels. He says "For now, the price rise to \$58 has done its designated job, namely to get Congress to approve drilling in the ANWAR. It took a price scare to get these people to do what should have been done years ago. Now prices can be allowed to decline."

Another reason to expect an easing of oil price is because the Strategic Petroleum Reserve will be full by July. According to Harry Dent of the H.S. Dent foundation, who

supplied the chart below, the U.S. and other major oil importing nations have been building their reserves since the 9/11 attacks to prepare for the chance of terrorists causing a disruption in supply. The U. S. has added 140 million barrels to the reserve since 9/11, and 30 million barrels in just the past 5 months, or 6 million/bbl/month. The chart shows the very close correlation of the rise in price to the increase in the reserve.



Mr. Dent feels that the price, or oil bubble, will break in late summer or early fall. But there could be another surge in price to a final top in the \$60 to \$65 range before then. He believes that the long-term value of oil is in the \$25 to \$40 range and if things work correctly, the fundamentals only support an oil price of about \$30 long-term. Indeed, Lee Raymond, CEO of Exxon Mobil has stated that the recent price of oil has absolutely no relationship to fundamentals but is driven by speculative fever. He is not alone here because the oil industry in general has not stepped up to the plate to increase exploration. Why? Because the last time they did that in the early 80's their investment went down the drain as the price of oil declined. The major oil companies are so convinced that this price is not long term that they are hesitant to spend on exploration. They are using their huge new found earning for acquisitions and to buy back their own stock.

Oil production has not peaked, nor is it declining. Dozens of oil fields have been discovered in the past several years and none are in the mid-East. Any sane geologist will admit that there is plenty of oil to last until alternatives are in place. Some say that there are generations of oil reserves remaining.

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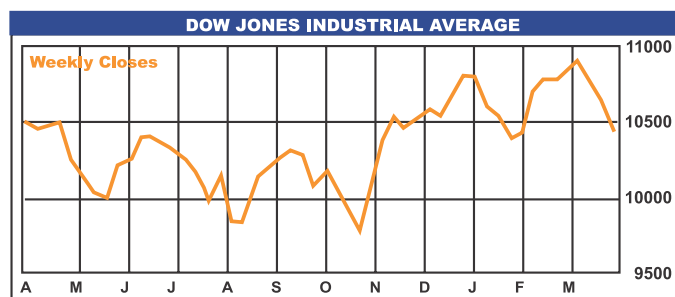
According to the International Energy Agency, increase in demand is running at 3 million barrels a day while increase in supply is running at 3.5 million barrels per day. Even with a mild slowdown in China's growth we would be up to our necks in oil. When the first Gulf war ended, oil fell 34% to \$26.40/bbl. A few weeks ago, oil fell 12% in two days. Let's see, a 34% decline in price now would put oil at about \$40!

What Is Happening Now?

You can see from the accompanying chart that the stock market recently made a new recovery high which was just slightly above the high set in late December. That event was widely watched, as many thought a breakthrough would indicate that the next phase of the bull market was beginning. Looks like a classic bear trap as the market quickly reversed and has been heading down ever since. The market recently peaked on March 7th with the Dow Jones Industrials at 10,936, the S&P 500 at 1225, and the Nasdaq at 2090. Interestingly, while the Dow and S&P 500 made new recovery highs on that day, the Nasdaq was 4% below the high it made in late December – not a good sign. Our market models, that measure internal market risk, turned negative on Friday, March 4th and any program that utilizes cash as an asset class was reallocated to their respective cash allocation percentages on the 7th. As of this date, April 2nd, the Dow has declined to 10,404, or by 4.85%, the S&P 500 has dropped to 1173, or 4.25%, and the Nasdaq has declined to 1985, or by 5%. The Nasdaq is now 8.85% below its recovery high of 2178 of late December.

Our original projections for this year were for a decline early in the year followed by a rebound to new recovery highs which would last into the late second quarter. That would be followed by a very stiff decline through the summer and into the fall. While it is possible that the

decline we are now seeing could continue and become the major decline we are expecting, it is more probable that we will now have a rally over the next several weeks before the market declines again into the fourth quarter of 2005. It is expected that oil could have a set back in price during the Spring lull, which would allow the market to rally for a while. For the reasons given above, oil could move higher into the summer to the \$60-\$70 range which could give the market the stiff correction we are expecting. If as we expect, oil peaks in late summer to early fall, the market could stage a big rally late in the year, as it usually does, and we would end the year on a slightly positive note. That could be the kickoff for the next major market move through 2006 and beyond.



If you are interested in the writings of Harry Dent, and his projections for the remainder of the decade, I suggest you read his new book "The Buy Opportunity of a Lifetime," available at www.hsdent.com or at 888-307-3368. Some say he is a sensationalist because in 1990 he predicted a Dow of 12,000 by 2000. Yes, he was wrong in 2001 and 2002 because the markets declined far more than he, or anyone else for that matter, expected. You will be interested to see what he has in store for us during the remainder of this decade. More on his outlook in the next quarterly newsletter.



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