NEWS

Wealth Builders Capital Management Program

4th Quarter 2004

Review and Outlook

If you're looking for the good news about the stock market in 2004, you need look no further than the fourth quarter. After struggling through the first three quarters, the major U.S. equity indexes rallied to finish the year with gains. An almost 7% return for the Dow Jones Industrial Average (DJIA) pulled that venerable index from a 3.57% loss at the beginning of the quarter to a 3.15% gain by year's end. The NASDAQ Composite surged 14.69% to turn a 5.32% loss into an 8.59% gain for the year, and the 8.99% rise in the S&P 500 was due almost entirely to the 8.73% it picked up in the fourth quarter.

The bond market showed remarkable resilience in the face of five consecutive interest rate hikes by the Federal Reserve since June. The benchmark 10 year Treasury bond rate finished the year at 4.22%, slightly lower than the 4.26% it sported entering the year.

Equity markets in Europe and Japan generally mirrored the U.S. experience, although the nearly 7% decline in the dollar during the year boosted foreign security returns for U.S investors. Stock markets in the emerging economies of Asia and Latin America did especially well, as their promise of robust growth attracted more investor interest - and capital [1].

Red hot commodity prices, such as for oil, steel, copper, and gold, cooled a bit in the fourth quarter. Nothing attracts supply like higher prices, and the arrival of new supplies of commodities took some of the pressure off prices, and probably sparked a bit of profit taking too.

Real Estate continued to sizzle, including Real Estate Investment Trusts (REITs). Still, at current prices even some avid fans of REITs are starting to get a bit nervous. As the year drew to a close, there were some signs that the galloping residential real estate market could finally be slowing to a trot.

All in all, 2004 may not have been the best year in recent memory, but it certainly wasn't the worst.

Through:	*12/31/2004*				One Month Change				
	Selected Indices	1Q04	2Q04	3Q04	October	November	December	4Q04	YTD 2004
US Equities	DJIA	-0.92%	0.75%	-3.40%	-0.52%	3.99%	3.40%	**6.97%**	3.15%
	S&P 500	1.29%	1.30%	-2.30%	1.40%	3.86%	3.25%	**8.73%**	8.99%
	NASDAQ	-0.46%	2.69%	-7.37%	4.12%	6.17%	3.75%	**14.69%**	8.59%
	NAREIT All Equities	12.56%	-6.56%	8.14%	4.54%	4.64%	4.82%	**14.67%**	30.41%
Global Equities	EAFE (International)	3.46%	0.44%	-1.65%	4.43%	6.75%	3.81%	**15.73%**	18.27%
	DAX (Germany)	-2.74%	5.08%	-3.94%	1.73%	4.19%	3.15%	**9.33%**	7.34%
	Nikkei (Japan)	9.72%	1.23%	-8.73%	-0.49%	1.19%	5.41%	**6.15%**	7.61%
	Bolsa (Mexico)	19.58%	-2.24%	6.79%	5.32%	4.65%	6.74%	**17.65%**	46.87%
Other	Dow Jones Corp Bond	2.90%	-3.16%	5.19%	0.31%	-0.52%	1.22%	**1.01%**	5.88%
	Shearson T-Bond Index	5.68%	-5.28%	6.57%	1.28%	-2.19%	2.17%	**1.21%**	7.97%
	CRB	11.16%	-6.28%	7.16%	-0.45%	2.55%	-2.41%	**-0.37%**	11.22%
	US $	0.84%	1.44%	-1.52%	-2.91%	-3.59%	-1.20%	**-7.52%**	-6.83%

[1] Additional risk is associated with international investing, such as currency fluctuation, political and economic stability, and differences in accounting standards.

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Source: Wealth Builders, Inc.

$ What's all the fuss about the dollar?

It seems just about every day lately there's a news story about the value of the dollar. Since January of 2002, the U.S. Dollar Index has fallen 30%. After starting the year with about a 5.5% gain through mid May, the dollar resumed its slide. It's fallen more than 12% from that point to finish about 7% lower for the year. But is a falling dollar a good thing or a bad thing?

There has been a fair amount of commentary recently highlighting the *advantages* of the dollar's decline. Certain industries could benefit in a meaningful way from a weaker dollar:

- ✓ Exporters stand to benefit as a weaker dollar makes U.S. products and services cheaper for foreign buyers,
- ✓ Domestic companies should have an edge as the falling dollar makes foreign alternatives more expensive for American purchasers,
- ✓ Travel and tourism within the U.S. should increase as visitors flock here to enjoy vacations at a discount,
- ✓ American businesses with significant foreign revenue should benefit as they convert their profits from the local foreign currency back into dollars at favorable exchange rates.

In addition to any benefits enjoyed by various sectors of the economy, a weaker dollar makes it easier to pay off large dollar denominated debts. Borrowers, including the U.S. Government, can use the devalued dollar to pay off debts incurred when the dollar was worth more, essentially getting a "discount" on the repayment of the value owed.

So, if a weak dollar can boost the economy and help ease the burden of huge deficits, what's the problem?

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Maybe there really can be too much of a good thing. For those of us who like chocolate, the occasional candy bar is a nice treat. It can quiet hunger, give a little energy boost, and even lift our spirits. But if feasting on candy every day replaces a balanced diet, the health effects could be serious, and the little lift we once enjoyed could be replaced by cravings and guilt.

A modest decline in the dollar may give the economy a little boost in the short term, but a steady diet of a declining dollar could threaten the economy's long term health - and leave the stock and bond markets with quite a bellyache.

From the summer of 1995 to January of 2002, the U.S. Dollar Index *gained* more than 47%. To get an understanding of what things might look like in a world of a steadily *weakening* dollar, we can look into the mirror of the second half of the 1990s. The major themes would likely be very much the same - but reversed:

- A strengthening dollar was credited with helping to produce a long period of low inflation, even in the face of robust economic growth. A strong dollar made imports cheaper, including cars, electronic equipment, and oil. With the exception of the periods immediately leading up to Gulf Wars I and II, oil spent most of the 1990s hovering around $20 per barrel - hitting $11.24 per barrel in November of 1998. From June of 1995 to January of 2001, the price of an ounce of gold fell 31.65% from $387 to $264.50. America was "importing disinflation" and domestic producers found it difficult to raise prices in the face of cheap imported competition. Since U.S. consumers got "more bang for the buck", their growing buying power was commonly cited as one of the reasons for a spending spree.

- A falling dollar puts pressure on prices of imports, including key imports like oil. $12 per barrel oil is a distant memory, and $50 per barrel oil has become so common it barely even makes the news anymore. Rising inflation hasn't been passed along in a serious way through to the Consumer Price Index yet, but the cost of raw materials has been steadily rising. Last year's fall in the value of the dollar means that even if the global price of something hasn't changed at all, it costs about 7% more than it used to in devalued dollars to buy it today. As import prices rise, domestic competitors have more freedom to match those hikes without losing any competitive edge. If "importing disinflation" can keep prices low in a roaring economy, can "importing inflation" drive them higher even as the economy slows and consumer spending dries up?

- Soaring financial markets and a rising dollar could have been part of a "virtuous cycle" in the 1990s. As stock prices in the U.S. rose, foreign investors who wanted a piece of the action needed to buy dollars to pay for their purchases. This demand for dollars drove the price of the dollar higher. As the dollar rose in value compared to other currencies, so did the value of dollar denominated stocks and bonds for foreign investors. This enhanced return from the rising dollar attracted even more foreign capital to U.S. markets, creating yet more demand for dollars, and so on.

- The dollar's recent slide pretty much wiped out the year's U.S. stock market gains for many European and Japanese investors when converted back into Euros or Yen. A continuing slide could create a "vicious cycle" of foreign investors abandoning U.S. markets to avoid further currency losses and selling their dollars as they go. If the rush for the exits accelerates, both the value

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of the dollar and the health of the U.S. financial markets could suffer.

- One of the ways international investors hold dollars is in the form of dollar denominated bonds. Some of the strong demand for dollars almost certainly helped increase the demand for American bonds during the 1990s, helping to keep interest rates low. Foreign investors could afford to put up with low rates on their bond investments as long as they were compensated by the soaring value of the dollar. The rising dollar helped to encourage continuing flows of capital to our shores despite low and falling interest rates.
- To entice foreign capital to keep flowing here, American borrowers - including the U.S. Government - may have to offer foreign lenders ever higher interest rates to compensate them for their losses as the dollar falls. If the dollar falls by 5% to 7% or more every year, how high will rates have to go before foreign investors not only break even, but feel they're getting a fair deal for their money?

Of course, just because the dollar has been falling lately doesn't mean it will keep on falling. Foreign central banks, especially in Japan and China, continue to be massive dollar buyers. As huge exporters to the U.S., it's in their interest to keep the dollar as strong as possible so their products don't become too expensive for American consumers to buy.

Still, in November alone, the U.S. imported in excess of $60 billion more than it exported. $60 billion more dollars went abroad than were needed to pay for the goods and services we sold internationally. And that was just one month.

$60 billion here and $60 billion there, and pretty soon it may start to add up to some real money. Can we keep feeding the rest of the world a steady diet of extra dollars and deficits, or is there a limit to how many of our dollar backed IOUs they'll be willing to consume?

Just in case, we'll continue to look toward those areas that tend to benefit from a falling dollar, including gold and other commodities, foreign bonds, and other international opportunities as they arise.

Maybe some nice Swiss chocolate...

- Gary E. Stroik

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Index Definitions

The Dow Jones Industrial Average (DJIA or "The Dow") is a price-weighted average of 30 of the largest blue chip issues traded on the New York Stock Exchange.

The S&P 500 Index includes a representative sample of large-cap U.S. companies in leading industries.

The Nasdaq Composite Index (NASDAQ) is a market-value weighted index of all common stocks listed on Nasdaq.

The Dow Jones Utility Average tracks 15 large geographically representative gas and electric utilities.

The NYSE Financial Index includes all the finance stocks traded on the New York Stock Exchange.

The Russell 2000 Index includes the smallest 2,000 stocks in the Russell 3000 Index (approximately 8% of the total market capitalization of the Russell 3000 Index) of the Russell data series. **The Russell 3000 Index** represents approximately 98% of the investable U.S. equity market**.**

The NAREIT Index includes all Real Estate Investment Trusts (REITs) currently trading on the New York Stock Exchange, the NASDAQ National Market System and the American Stock Exchange.

The MSCI EAFE Index (EAFE) is an unmanaged index based on share prices of approximately 1,470 companies listed on stock exchanges around the world. The stocks of twenty countries are included in the index.

The CAC 40 Index is a capitalization-weighted index of 40 companies listed on the Paris Bourse.

The Dax Index is a total return index of 30 selected German blue chip stocks that trade on the Frankfurt Stock Exchange.

The FTSE 100 Index is a capitalization-weighted index of the 100 most highly capitalized companies traded on the London Stock Exchange.

Nikkei-225 Stock Average (Nikkei) is a price-weighted index of 225 blue chip Japanese companies listed in the First Section of the Tokyo Stock Exchange.

The Hang Seng Index is a capitalization-weighted index of 33 companies that represent approximately 70% of the total market capitalization of the Stock Exchange of Hong Kong.

The Bolsa (Mexico) is an index of 40 actively traded companies listed on The Mexican Stock Exchange (Bolsa Mexicana de Valores).

The Dow Jones Corporate Bond Index is an index of 96 bonds issued by leading U.S. companies designed to represent the market performance, on a total-return basis, of investment-grade bonds.

The Shearson T-Bond Index measures the performance of U.S. Government Treasury Bonds of a wide range of maturities.

The U.S. Dollar Index is computed using a trade-weighted geometric average of six currencies. The six currencies and their trade weights are: Euro 57.6%; Japanese Yen 13.6%; UK Pound 11.9%; Canadian Dollar 9.1%; Swedish Krona 4.2%; Swiss Franc 3.6%. These specifications are subject to change.

The Philadelphia Semiconductor Index (SOX) is a price-weighted index of 17 U.S. companies involved in the design, manufacture, sale and/or distribution of semiconductors.

The Philadelphia Gold & Silver Sector (XAU) is a capitalization-weighted index composed of 12 companies involved in the gold and silver mining industry.