



Investment Insights

Kevin Kennedy

In the spirit of the season, it's the time of year when we take a look at who was naughty and who was nice in the investing world in 2004. In keeping with my "glass is half full" optimistic bent, we'll start with the positives, those who should expect a stocking full of rewards.

Nice:

The investment markets. Another solid year for investors of all persuasions, as gains were felt through a variety of investment vehicles. In the stock market, US stocks posted gains of 7.4% through December 17, 2004, as measured by the S&P 500 Index. Over that same timeframe, the EAFE index, which measures foreign stocks, rose over 15%. Bonds were up, too, with the Lehman Composite Bond Index showing a 4% increase. Finally, real estate, the brightest star in investments this year, rose about 18%, according to DataQuick Inc. Coming on the heels of an even better 2003, it was certainly a case of good tidings for all in 2004.

The return of normalcy. After three years of chaos and uncertainty in the financial markets, 2004 turned out to be relatively "boring". The stock markets turned in one of the least-volatile years in recent memory. Most investors would agree that this was a welcome change, almost like a vacation from the stressful period experienced in recent years. My own informal poll indicates the old stalwarts politics and sports have replaced stocks as the cocktail party-discussion subject of preference.

The economy. The economy once again posted a strong year on many fronts. Inflation remained relatively low, while growth as measured by Gross Domestic Product is expected to show a 3.9% gain for the year. Although job growth remains low, many companies shell-shocked by the decline in business in 2001 and 2002 may finally start to rehire workers now that business has shown two years of modest recovery.

Now on to the naughty for 2004, items that caused investors grief and definitely deserve lumps of coal this holiday season.

Naughty:

The US Dollar. The US dollar continued a disturbing trend begun in 2003 by sliding to all-time lows against the Euro this year. Although this helps US companies by making

their goods cheaper to European buyers, it hurts most of us by making imports more expensive. And forget that European vacation: with the dollar down nearly 50% over the past two years against the Euro, you'd better bring a wheelbarrow of cash on your next trip overseas.

The Federal Reserve. After three years of keeping short-term interest rates low, the Fed reversed course this year, raising rates five times since June 2004. According to the financial handicappers, they may not be done yet, with another hike expected in the first quarter of 2005. This will have the biggest impact on consumers who used low-rate short-term loans to buy homes and other big-ticket items.

Oil. Woe to those whose daily routine includes a stop at the gas station. We nearly saw the elusive \$3 per gallon hit this summer, and in the Bay Area, we've consistently suffered from gas prices \$0.20-\$0.30 per gallon above the National average. High oil prices have also dealt a crippling blow to the airline industry, forcing major carriers like United and US Airways into bankruptcy.

Major brokerage firms and mutual fund companies. New York Attorney General Elliot Spitzer stripped the sheep's clothing off the major brokerage firms and mutual fund companies in 2003, but the distrust among the investing public is still present. Recent studies have shown that high net-worth investors are increasingly moving away from the major financial service providers, and seeking independent advice. Until meaningful structural changes happen to the conflict-ridden business models of these institutions, investors are justified in being skeptical. In an industry entrusted with the financial future of millions of families, this reform is not only vital; it's imperative to the financial well being of our country.

Best wishes for good health and happiness in 2005!

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