



## Economic and Market Commentary from CMC

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### The Economy

The fourth quarter was gift wrapped in a greenback-ribbon for investors. All the major stock market indices finished the year higher than they started, but the dollar was significantly lower. The Dow Jones Industrial Average finished up 3.8% for the year, the S&P 500 was up 9.1%, and the NASDAQ composite closed up 8.7%.

Last quarter the media focused on the rising price of oil, which is 33% more expensive than it was in January 2004, but now the attention is on the dollar. One euro will buy you \$1.36, which is 60% more than this time in 2002. How does this explain returns this past quarter, and what does this suggest for the period just ahead?

For U.S. investors, this has been a great time to own international equities. In dollar terms, in 2004 the Nikkei 225 (a measure of Japanese stock market performance) was up 10.7%, the FTSE Eurotop 300 (a measure of Europe-wide performance) was up 16.8%, but even more impressive was the ATX (a measure of Austrian stock market performance), which was up 68.7%!

These returns are impressive, no doubt, but a significant portion of these returns came from a depreciating dollar.

Here is how it works: when U.S. investors purchase foreign (non-U.S.) traded securities (e.g. in an international mutual fund, or directly through a brokerage account) not only are they exposed to the action of those stock markets, but they are also exposed to foreign exchange fluctuations.

dollar. When foreign investors buy U.S. assets demand for the dollar is created, which tends to cause the dollar to appreciate in value. There are also speculators who like to bet that currencies will move one way or another, adding demand or supply to the markets.

### Economy

- Improving performance
- Interest rate outlook: continued, measured increases
- Foreign exchange: the dollar continues to decline

**Growth Style Investing:** may fair well, particularly companies with significant overseas sales

**International Diversification:** should pay off in the short term

**Coming attraction:** mild inflation

It just so happens that the dollar's decline in 2004 meant that returns in foreign markets were amplified for U.S. investors.

There are a number of things that determine rates of exchange between currencies: expectations for inflation in each country, interest rate differences between countries, national incomes, preference for foreign versus domestic goods in each country, etc. In the end, exchange rates are determined by supply of and demand for currencies in the foreign exchange market. When domestic consumers buy foreign goods, demand for foreign currency is created, which tends to depreciate the

Inflation is creeping northward in the United States as the rate of consumer-price inflation rose to 3.5% in the year thru November, compared to 3.2% in October and almost twice what it was a year ago. In spite of this inflation consumers remain confident that the future will be prosperous; the Conference Board's index of American consumer confidence is at its highest level since July.

Europe-wide, there is also accelerating inflation, but they have been able to keep a cap on it. In Japan, they experienced their second month in a row of inflation—a whopping 0.8% annualized!



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Clearly, inflation will be higher in the U.S. than in Europe or Asia, so this may explain part of the decline in the value of the dollar.

Even with inflation the U.S. economy by comparison is expanding more rapidly than countries in Europe or Asia. Japan's economy expanded 2.6% as measured by gross domestic product, Europe expanded by 1.8%, while the U.S. grew by 4%. Along with this growth in the U.S. came increased industrial production, higher retail sales, and lower unemployment (5.4% in November).

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## What's New

**New Clients** We are pleased to welcome G&K Advisory Services and Northwestern Mutual Financial Network as new clients of the firm.

### Redevelopment of Our Website

In November of 2004 we launched our new website after months of design, writing and engineering effort. We are delighted by the reception we have received and are particularly proud of the ease of navigation, our investment

manager search section and our new on-line research subscription services.

Many thanks are due to Michael Bailey our web site engineer and founder of Metech Designs.

By the end of February we will have launched the first of our three on-line research subscription services. CMC EResearch™ is a robust chart library designed to keep the advisor commu-

nity updated monthly with timely and developing economic and market changes.

It is available with a one-month free trial subscription. The other two on-line services are currently under construction and will be available in the months ahead.

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