CENTURION
COUNSEL, INCORPORATED
Investment Management

365 S. Rancho Santa Fe Road, Suite 300
San Marcos, CA 92069-2338
(760) 471-8536 Fax (760) 471-0399
e-mail: info@centurioncounsel.com

Q2 2003 Market Review 7/15/03

There's an old cliché that says from 1929 to 1930, the amateurs lost their money in the markets; the smart money lost their money in 1931; and the very smart money lost theirs in 1932. The point was that bear markets eventually find a way to beat every single strategy. Fortunately for Centurion investors, the bear has had a tougher time beating every asset class. Our investment philosophy focusing on portfolio diversification and asset allocation has performed admirably and ensured that our clients have survived the worst bear market since the great depression. Now, investors of all intellects are having difficulty answering the same question, has the bear finally gone into hibernation?

The recent gush of stock-market gains has felt like a soaking rain after a long drought, hasn't it? Since its March lows, coinciding with the U.S. deciding to invade Iraq, both the Nasdaq and the S&P 500 have gained nearly 20%. The month of May itself was like roses blooming to investors with stocks, bonds, real estate, oil and even gold all up at the same time. An investment panacea best explained by market capitulation and a rapidly plunging U.S. dollar that has forced asset prices to naturally adjust to this fundamental shift in value. Still, investors remain in disaccord whether the run-up signals it's time to jump back completely into the stock market basin.

Several trends have converged to power the rally: healthier-than- expected first-quarter earnings, a quick resolution to the Iraq war, and continued interest-rate easing by the Federal Reserve. Tax cuts on capital gains from 20% to 15% and dividends from 35% to 15% have spurred the more recent gains. Indeed, there rarely has been such a potent policy mix as the one now emanating from Washington with U.S. fiscal, monetary, currency and tax policies all are favorable for equities. It's almost as if political and monetary authorities are conspiring to lift the stock market.

The most important aspect by far of the tax bill is the cut to 15% on dividends, which greatly raises the attractiveness of those assets. Investors already have a higher probability associated with receiving the dividend component from stock investments as opposed to capital appreciation and now are taxed over 60% less on dividends received. In fact, many strategists think companies will increase dividends thanks to the tax-law changes since corporations no longer have a tax incentive to buy back stock rather than pay dividends. As Warren Buffett once said: "If you can eliminate the government as a 39.6% partner, then you will be much better off."

Meanwhile, the economy has started to show signs of picking up steam. Capital spending seems to have stopped falling, and business cash flow is improving. Add

CENTURION
COUNSEL, INCORPORATED
Investment Management

365 S. Rancho Santa Fe Road, Suite 300
San Marcos, CA 92069-2338
(760) 471-8536 Fax (760) 471-0399
e-mail: info@centurioncounsel.com

to that the tax cuts and easy money pouring out from Washington that will probably pump both stocks and the economy in the runup to next year's elections and the combination of positive supports for stronger growth is the most powerful since the boom turned to bust three years ago.

All of this has egged on investors. They've poured an estimated $22 billion into U.S. equity funds since the beginning of April. That's after yanking out more than $11 billion from January through March. That's not to say all investors are true believers in stocks again. Some $5 trillion remains stashed in money market accounts that are now yielding less than 1% and can barely cover costs. Clearly three years of bruising tends to leave some psychological scars.

Indeed, there are reasons for investors to be cautious. Stocks remain expensive with a P/E ratio of 20 for the S&P 500 well above historic averages of around 15. Unemployment and very weak inflation continue to be problems as unemployed workers struggle through one of the toughest job markets in 20 years while slow demand and excess production capacity make it difficult for companies to raise prices and take on new workers. Meanwhile, losses in pension funds (a total of $462 billion over the past 4 years) will slow the recovery of the economy by forcing companies to divert funds from investment and hiring to rebuild their pension funds. Another grim sign: In May executives sold $3.1 billion worth of their companies' shares, the most insider selling in two years.

The stock market, to paraphrase Winston Churchill's comment about democracy, may not be perfect, but it looks better than the unattractive alternatives. After 13 interest-rate cuts by the Federal Reserve since the start of 2001, short-term rates are the lowest they've been since the Eisenhower administration and have reduced the shine of fixed income securities at current levels. The benchmark Treasury 10-year note recently tested 45-year lows and the after-tax yield on most Treasuries is 2% or less, (money-market funds average 0.6%) meaning that investors are consigning themselves to low or no after-tax returns over the next decade barring the unlikely event of outright price deflation. So as Churchill might have said, stocks may be the least attractive form of investment -- except for all the others.

So enjoy the run-up but don't inhale too deeply. Following three years of portfolio losses, investors have slowly started returning to the stock infested waters, even though questions remain whether the recent bull rally is still running in bear country. Centurion's diversification strategies have allowed our investors to sustain their assets during a period where other investors have lost the majority of their portfolios and we feel we are well positioned to capture value in all of our asset classes over the next quarter and into the future. Admittedly that's not a glamorous approach but your investments are supposed to build wealth, not keep you on the edge of your seat. In the end, that's what smart money is supposed to do.