



## 2004 Predictions

### UNDERVALUED SECTORS (CONSIDER!)

- LARGE CAP VALUE
- DIVIDEND STOCKS
- OIL DRILLERS

### OVERVALUED SECTORS (AVOID!)

- HOME BUILDERS
- CALIFORNIA  
MUNICIPAL BONDS
- CHINA

With 2004 being an election year, we will start out with our prediction of the presidential race. We believe that President Bush will be re-elected but in another close race. As we write this, Kerry looks like a shoo-in for the nod of the Democrats, but we would not be surprised if the fight for the nomination lasts longer than most pundits are predicting.

The Fed will keep the foot on the gas until near election time. Low interest rates and increasing money supply are normally good for the equity markets, and the last 12 months have been no exception. We believe the markets will rally early this year with the high hit in the first half. Since the markets almost always attempt to anticipate the future, we anticipate they will see a close election and rising interest rates in 2005. At this time, bond yields will likely begin to move higher and the environment for equities will

become more challenging. Even with the weakness late in the year, we believe that the Dow will be up 7 to 10% in 2004.

Oil prices will drop below \$25. Prices have stubbornly remained above the \$30 level since the war in Iraq not because of tight supply or OPEC, but the weak U.S. Dollar. Oil is priced in dollars so as the value of the dollar shrinks, the price of oil goes up. The dollar will regain some of its strength this year as the Fed slowly increases short-term interest rates and this rise in the dollar with increased supplies from Iraq will be the drivers of the softening oil price.

## Our 2003 Scorecard

In the January 2003 issue, we made our predictions for the year. Now we can review those predictions to see how we fared. Lets first start with our winners. We correctly predicted that: the Dow would hit 10,000; International Bonds would be strong; inflation would have a small increase; the economy would be strong and corporate profits would grow.

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Our losers fortunately only numbered two. We incorrectly believed that interest rates would increase slightly, instead they held steady. In addition, we believed that Internet companies such as Yahoo would struggle. This one was not close as Yahoo had a great year rising 175%. Fortunately, this only affected us in terms of opportunity cost. We still had a very successful year with investments in other industries and assets that performed well. Overall we believe that we earned an "A-" on our 2003 predictions.

**Our newly designed website is out! Please visit us at  
[www.centurioncounsel.com](http://www.centurioncounsel.com)!**

## **It's not what you make—It's what you keep**

We like to stress consistency in investing. The chart on the following page (Chart 2) shows that a return as low as 6% a year on a steady basis handily outperforms a portfolio that returns 30% a year for two years then loses 30% the third year. The reason a lowly 6% return trumps a larger inconsistent return is the amount needed to recover from a loss. (Chart 1) shows a loss of 30% needs a gain of 42.9% just to break even.

We mention what may seem obvious but the volume of stocks traded on the Bulletin Board is twice the level achieved in the great bubble year of 2000. The Bulletin Board is the haunt of penny stocks and stock promoters.

A recent example of the irrationality of this market occurred in the first week of January of this year. SpaceDev Inc. (SPDV:BB) a denizen of this market underworld that to quote the company "offers commercial missions and spacecraft for lunar orbiters, Mars orbiters and probe carriers and asteroid rendezvous and landers for sale." No doubt they also offer missions to Uranus to search for Klingons. Prior to last week, the company's biggest claim to fame was the first auction of an exclusive private space mission on E-Bay. However, as word leaked to the press that President Bush was going to set the goal of man going to Mars the stock of this company took off like a rocket. From under \$1.00 a share to over \$2.00 in the span of 2 days as volume blasted up from several thousand shares a day to over 600,000. Of course once the details of the space mission were learned (that it would not take place for 15 years) the stock crashed back to earth leaving all of the get rich quick investors who jumped on for the ride.

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Chart 1	
Percent Loss	Gain Needed to Break Even
-10.0%	11.1%
-20.0%	25.0%
-30.0%	42.9%
-40.0%	66.7%
-50.0%	100.0%
-60.0%	150.0%
-70.0%	233.3%
-80.0%	400.0%
-90.0%	900.0%

Chart 2				
Year	% Gain/Loss	Account Value	% Gain	Account Value
		\$100		\$100
1	30.0%	\$130	6.0%	\$106
2	30.0%	\$169	6.0%	\$112
3	-30.0%	\$118	6.0%	\$119
4	30.0%	\$154	6.0%	\$126
5	30.0%	\$200	6.0%	\$134
6	-30.0%	\$140	6.0%	\$142
7	30.0%	\$182	6.0%	\$150
8	30.0%	\$237	6.0%	\$159
9	-30.0%	\$166	6.0%	\$169

We do not believe investors should chase fads but should have a consistent investment plan that uses a number of different asset classes, as this serves to reduce risk in the long run.

## The Wrong Solution

The current mutual fund scandal has created its own cottage industry of blame and political opportunity. We believe that the wrongdoers should be punished and barred from the industry for life. The Pete Rose case in baseball is ample precedent in our opinion; if you mess with the integrity of the industry, you should be banned for life.

That being said, we think that is it important to put into perspective what really happened and the danger of some of the proposed cures. In most of the cases to date, the damage to investors will amount to less than 1/2 of 1% of their holdings. In other words an investor with a \$10,000 account may have suffered \$50 of losses due to improper trading. In most cases, this type of trading only occurred with international equity funds.

The solution being proposed by some in Congress and by Elliot Spitzer, the Attorney General of New York, would be to take the free market out of Mutual Funds and have it substituted by government controlled prices. This solution did not work for President Nixon when he tried wage and price controls in the early 70's. We believe that all fees should be clearly disclosed and the investor should be able to shop not only for performance but also for price.

## Why we use closed end Mutual Funds

A closed-end fund (CEF) is a publicly traded investment company. It collects money from investors through an initial public offering (IPO) and uses this money to invest in securities. The shares of a CEF trade on market exchanges like the New York Stock Exchange (NYSE) and the American Stock Exchange (AMEX). The difference between a closed-end fund and a traditional mutual fund (open-end) is that the open-end fund is continually offering shares at its net asset value. Simply put, the net asset value (NAV) is the current worth of a share. It is computed by deducting the total assets of the fund (the current market value of the securities held by the fund plus cash) from the total liabilities, and dividing the result by the total number of outstanding shares.

CEFs, on the other hand, change hands in the stock market at what is called the market price. The market price of a CEF will fluctuate with the demand and supply principles of the market. When demand exceeds supply, the market price at which the shares of a CEF trade may be at a premium to the NAV. That is, the shares of the CEF cost more than its NAV. Likewise, when supply exceeds demand, the shares of the CEF may trade at a discount to its NAV, that is, the shares of the CEF cost less than its NAV. For example, if the NAV of a CEF is \$10 and its market price is \$12, the CEF is trading at a premium of 20%. If the NAV is \$10 and its market price is \$8, the CEF is trading at a discount of 20%. The premium/discount may be computed using the following formula:

Though some funds trade at a premium, the majority of CEFs trade at a discount. The premium or discount is not constant, but usually fluctuates with market conditions. Often a fund that is trading at a discount may shoot up to a steep premium or vice versa, as investors' perceptions of the market changes.

Perhaps the most important factor why most CEFs trade at a discount is that CEFs operate in relative obscurity, and hence demand for the shares of the CEFs is low. While most investors have heard about mutual funds, very few have heard about closed-end funds. The reason is obvious: mutual funds advertise extensively to attract investment money, since the management is paid a percentage of the assets managed. However, CEFs, except under very rare circumstances, operate with a stable pool of investment money. Advertising will not increase the asset base; instead, the cost of advertising erodes the assets of the fund.

At Centurion we like to buy a dollar for ninety cents whenever we can. We often use CEFs when they fit an asset class such as International Bonds. We will purchase these CEFs when trading at a discount to NAV and will sell those positions when they trade at a premium. This happened recently when we sold the Templeton Global Income and the Aberdeen Global Income Funds which appreciated substantially above NAV from our discount purchase price. We very much like these funds and will look to buy them back again when the market price is less than the NAV.

**Centurion Counsel Wishes You  
Continued Prosperity in 2004!**