

SELECTOR[®] Money Management

2004 Fourth Quarter Review

The fourth quarter of 2004 was worth the wait. The first three quarters of the year were held hostage in a rather tight trading range. As of the end of the third quarter, the S&P 500 had risen a scant 0.2% for the year. The Presidential Election in November proved to be the catalyst for a rally that broke the 'glass ceiling' that had been restraining equity prices. In the fourth quarter the S&P 500 added another 8.7%, giving it a gain for the year of 8.9%. The NASDAQ had been down almost 6% at the end of the third quarter, but also rallied in the fourth quarter to end up 8.6% for the year. The Russell 2000, an index of small cap stocks, was the best-performing index of 2004. At the end of the third quarter it was up 2.9%, and had also been contained by its own trading range during the year. But in the fourth quarter the Russell 2000 advanced by another 14% to end the year up 17%.

International equities performed significantly better than domestic equities in 2004. In addition to favorable economic conditions that existed in Europe and the Far East, their equity markets were able to take advantage of the weakness of the U.S. Dollar versus foreign currencies. The Europe, Australia, and Far East Index, also known as the EAFE Index, is an unmanaged, market-value weighted index used to measure the overall condition of overseas markets. In 2004, the EAFE Index gained just over 19%.

The Federal Reserve lifted federal funds rates and discount rates in 2004, but the longer-term bond market was relatively unaffected. Longer-term bonds are primarily driven by more traditional supply and demand factors, as well as inflationary outlooks. The demand for these bonds remains strong, and the inflation levels continue to be stable, despite the spike in oil prices. The yield on the CBOE 10-year Treasury Yield Index at year-end was 4.21%, down from 4.25% at the start of the year. These numbers do disguise the mid-year volatility that occurred when the Federal Reserve Board announced their rate increases. Over an eight-week period, yields jumped from 3.65% to 4.78% before settling down. High yield bonds continued to be the best-performing bond sector, capitalizing on both stable longer-term interest rates and a stable equity market. Foreign bonds also performed well as they were able to take advantage of the currency weakness in the U.S. Dollar.

2004 will go into the history books as another Bull Market Year for equities. While all of the major market indexes remain under their 2000 highs, there has been significant progress as measured by both time and price. The S&P 500 is now approximately 50% above its most recent Bear Market lows, and within 25% of its most recent Bull Market highs. Far more importantly, the economy continues to be strong, and although 2005 corporate earnings will be compared to extremely strong 2004 numbers, earnings are expected to grow. Should interest rates and inflation rates remain stable, one would expect that equity markets would continue to reward investors in 2005.

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