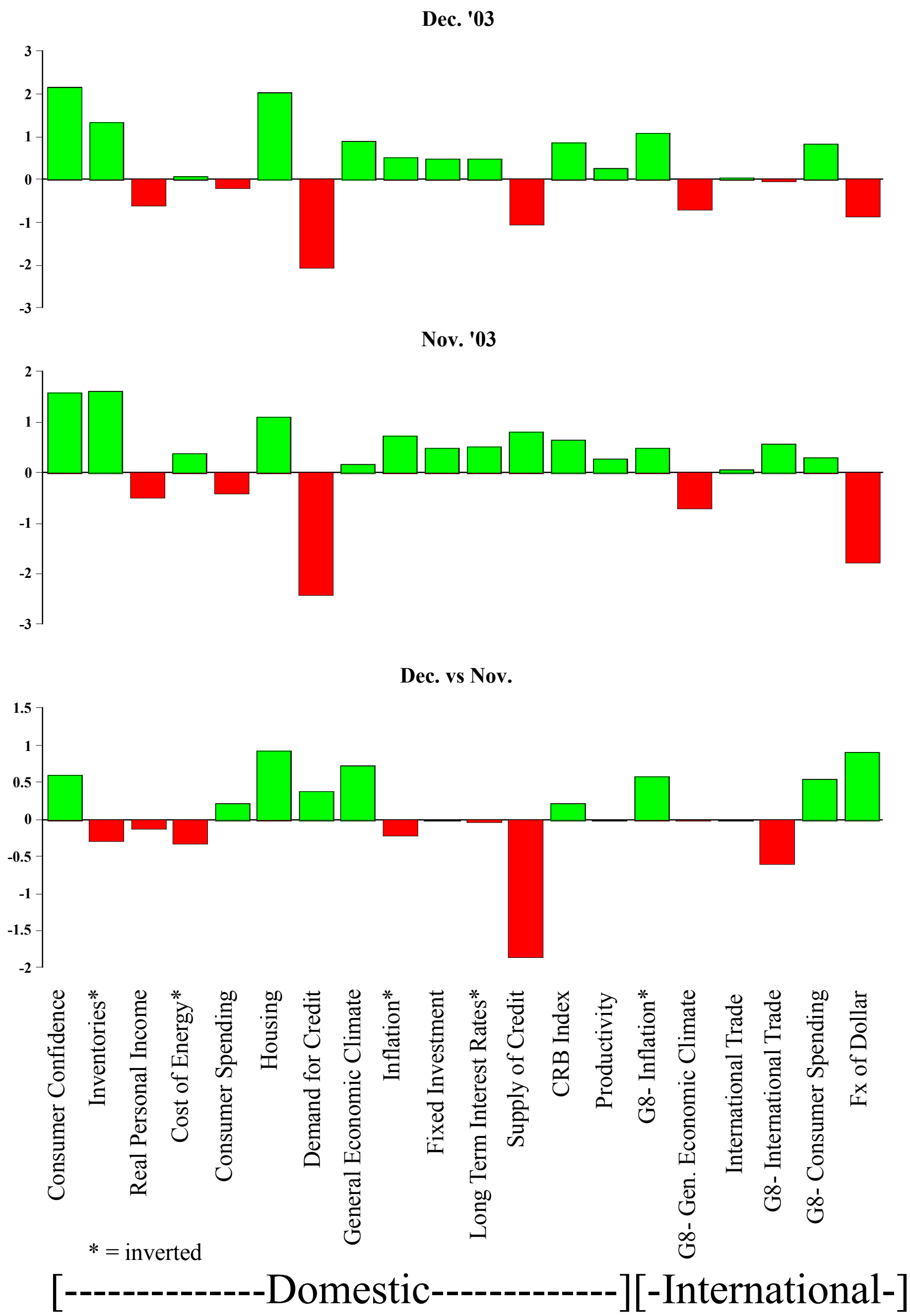
Adding to Defensive Groups Appears Warranted December 17, 2003

The following charts show fact based trends in ASC Economic factors as of December 2003 as compared to November 2003 and changes expressed in standard deviations around the norm, hereinafter referred to as "units".



ASC Factor indicators of future activity show that the US economy continued strong again last month. Following are significant changes in trends last month expressed in standard deviations around the average rate of change or "units". Initial Unemployment Claims fell by .59 units. Housing rose by .93 units. General Economic Climate rose by .72 units. Supply of Credit fell by 1.84 units. G8 Inflation fell by .58 units. G8 Exports rose by .59 units. G8 Consumption rose by .55 units. The Foreign Value of the US Dollar rose by .91 units. The US economy is still going strong; there has been little deceleration in the latest month. The large negative change in Supply of Credit of 1.84 units is a warning flag in what is otherwise a picture of healthy trends.

It appears that there may be another "soft patch" after the current trend of strong growth subsides, as the belated response in the labor markets is coming too late to help reliquify the consumer. With the "exported multiplier" that we discussed in December 1994 and August '03, there appear to be structural impediments to job growth in the US. The jobs are being created all right, in China and India. As a result, a hollowing out process is hurting middle income consumers. With the less than normal job growth this US consumer, already overly indebted and experiencing a high level of bankruptcies, cannot be relied on to remain the world's locomotive indefinitely. Job growth is needed in the very near term to boost real income and allow the consumer to continue spending to keep the recovery on a smooth growth trajectory. Without job growth there may be a gap in which growth falls off significantly. The uncertainty about how far and how long the US economy decelerates represents another storm cloud on the horizon that should not be ignored.

This "hollowing out" process can be confirmed by less than robust same store sales at Wal-Mart and Target, stores which sell to the middle income segment. Stores that sell to the upper income brackets such as Neiman Marcus and Saks are doing comparatively well. Although Democratic critics are citing the cause of this as the administration's tax cuts for the rich at the expense of the poor, the more likely reason is the result of globalization effects. Spending power of the middle class is more sensitive to employment. It is no secret that American workers are being displaced by foreign sources as US companies outsource. They either outsource or they lose competitive position. Since short term relief with subsidies have been counter productive, the only way a balance is going to be achieved in a free market is a realignment of currency values which is now happening. As a start, the weakening US dollar should start providing some relief to US exporters in '04. The other areas of US jobs that have still not recovered are those that participated in the telecom and Internet bubble of 2000. The unemployment rate among highly paid computer science professionals is still very high.

In assessing likely conditions over the next six to nine months, one should consider current trends as to their intensity and magnitude. In some cases, trends as a mix are configured to indicate stability and that future conditions are likely to remain largely unchanged in which case there should not be a great deal of uncertainty. The current condition consists of sharp trends with a great deal of disparity that may indicate instability. For example, very high growth of the industrial economy is being accompanied by very low interest rates which is keeping housing robust. The coincidence of strength in industrial and interest sensitive areas suggests that a "boomlet" may be underway. A very weak US dollar, accompanied by very low inflation, indicates that once short rates start rising they are likely to accelerate.

While the Fed is being accommodative with a low federal funds rate, Supply of Credit has slowed markedly in the most recent trend. The ASC factor Supply of Credit had a negative 1.8 unit change last month. The latest three month changes in M2 and M3 were **-4.8%, -4.3%,** respectively on an annualized basis. It is highly unusual in a recovering economy to have a contraction in these broad monetary aggregates. While the Fed has one foot on the accelerator on short rates, it appears to have its other foot on the brakes with the Supply of Credit.

Another defensive group, ASC's hospital supply group, made up primarily of pharmaceuticals perked up last month; it increased to 5 from 12 last month. The precursor conditions leading to the increase in rank of the pharmaceuticals as a defensive group bear some similarity to those of August 2000. At that time, unsustainable strength was being exhibited. For example, it is inconsistent for an economy to be growing at a real rate of 8% and for supply of credit to be showing decreases. Another factor helping the drugs is the weakness in the foreign value of the US dollar. The other defensive groups, the phones and energy, held up well, ranked second and sixth respectively.

Investment Strategy

Equities:

Groups that are well positioned are weak dollar cyclicals such as papers and chemicals, as well as regional phones, pharmaceuticals and energy. Over weights in S&P groups are advised in Health Care, Materials, Industrials, Telecom Services and Energy. Market weights are advised in Utilities. Underweighted are Financials, Consumer Discretionary, Capital Good Technology and Consumer Staples. The Capital Goods Technology Group was downgraded to an underweight this month after a neutral weighting in October '03. Health Care was upgraded to an overweight from a market weight.

Fixed Income:

With a strengthening economy, a weaker US dollar, and somewhat higher inflation, a cautious stance on long bonds appears warranted. Over the intermediate to longer term, the yield on the long bond is likely to be heading higher. Regarding the issue of duration, on a scale of 1 to 10, with 10 representing a maximum position in shorter term debt and 1 representing a maximum position in Long Treasuries, we would rate the current environment as a 9, the same as last month, suggesting an average maturity of 2-3 years.

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