

The economic picture during the second quarter of 2004 continued to clear as employment reports suggested that jobs are being added and that GDP growth is continuing. The US Department of Labor reported that the domestic labor market gained 324,000 jobs in April, followed by 235,000 and 112,000 jobs in May and June, respectively. Despite the gain of these jobs, the unemployment rate remained steady at 5.6% throughout the quarter. Revisions to first quarter GDP growth were 0.5% lower than previously estimated, suggesting annualized growth of a more modest 3.9%. This is slightly lower than the 4.1% growth that GDP saw in the fourth quarter of 2003. The big economic news of the quarter was the Federal Reserve's decision to raise short term interest rates by 0.25%, the first increase since May 16<sup>th</sup>, 2000.

The financial markets showed gains across all market caps and most sectors. Smaller companies continued to outperform their larger peers with the S&P Small Cap 600 returning 3.6% and the S&P 500 Large Cap index returning 1.72%. The technology-oriented Nasdaq Composite increased 2.8%. In large caps, growth stocks as measured by the S&P/Barra Growth Index increased 2.69%, while value stocks as represented by the S&P/Barra Value Index increased only 0.80%. Sector-wise, Industrials and Energy were the outperformers, returning 7.97% and 6.98%, respectively, while Financials and Utilities were underperformers, losing 2.94% and 2.27%, respectively.

Our portfolios are currently positioned to continue to take advantage of strengths in the technology and energy sectors, weakness in consumer discretionary and communication services, and to be defensive against rising interest rates. We benefited from strong stock selection in numerous sectors during this last quarter.

We believe that our technology investment thesis still stands. We have been at a slight overweight in this sector, anticipating a return to technology spending by businesses during this economic cycle. We have started to see this return to spending and expect to see it continue. A recent *Business Week Online* article cites a number of factors that suggest technology stocks should do well going forward. The author refers to a study by Standard & Poor's credit rating service indicating that the technology sector outperforms the rest of the market during periods of rising interest rates. Historically, the technology sector has increased 2% on average during these periods while other sectors fell 5%. In addition, many companies have delayed technology spending over the last few years and, now that the economic picture is brighter, they are updating their capacity in this area to keep their operations up to date and remain competitive. (Olga Kharif "A Tech Shelter from Rate Hikes?" *Business Week Online*. June 30, 2004.)

As always, we plan to continue our diligence in analyzing stocks that present good value in terms of cash flow and have positive earnings and sales surprise momentum.