Park Piedmont Advisors LLC

Registered Investment Advisor

VICTOR LEVINSON **NICK LEVINSON**

DECEMBER 2004 COMMENTS

IMPORTANT NOTICES: BEST WISHES for the NEW YEAR!!!

TAX COST BASIS INFORMATION for 2004 SALES:

For all clients who have had sales in their taxable accounts during 2004, you will receive Form 1099s from our current broker/dealer and custodian, LaSalle Street Securities (LSS) and National Financial Services (NFS), and possibly from our previous broker/dealer and custodian, Balis Lewittes Coleman (BLC) and Bear Stearns (BS). You will receive 1099s from BLC-BS only if sales were made early in 2004 prior to your accounts transferring to LSS-NFS. When you receive these 1099s, if you fax or mail a copy to Lynette at our NY administrative office, we will supply all the necessary cost basis information to you and/or the person who prepares your tax return. This process should only be needed for the transition year 2004, as we expect to be fully integrated into the LSS/NFS tax reporting system by the end of 2005.

SEC DISCLOSURE DOCUMENTS: ADV PART II

As a Registered Investment Advisor with the SEC, Park Piedmont Advisors LLC (PPA) has provided each client with a copy of its required SEC Disclosure Document, ADV Part II. Among other matters, the ADV Part II describes PPA's advisory services, fees, and the business and educational backgrounds of its advisors. This is our continuing Notice, required by the SEC, that you can request a copy of PPA's ADV Part II, which we will send to you by return mail. To receive a copy, please contact Lynette Carmelli at 212-391-2323, or lynettec@parkpiedmont.com. This same notice will appear on each client's quarterly billing and investment results report, mailed in October, November, and December 2004.

You can also access our ADV at any time from our website, at www.parkpiedmont.com.

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Any recommendation contained in these Comments may not be suitable for all investors. Moreover, although the information contained herein has been obtained from sources believed to be reliable, its accuracy and completeness cannot be guaranteed.

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COMMENTS: INDEX RESULTS, period ending DECEMBER 31, 2004

STOCKS	YEAR 1999	YEAR 2000	YEAR 2001	YEAR 2002	YEAR 2003	YTD 2004	CURRENT MONTH
Vanguard Total Stock Market Index Fund (1)	23.8%	(10.6)%	(11.0)%	(21.0)%	28.4%	12.5%	3.9%
S&P 500 Index (2)	19.6%	(10.1)%	(13.0)%	(23.4)%	26.4%	9.0%	3.4%
Vanguard S&P 500 Growth Index Fund (1)	28.8%	(22.2)%	(13.0)%	(23.7)%	25.9%	7.2%	3.9%
Vanguard S&P 500 Value Index Fund (1)	12.6%	6.1%	(12.0)%	(20.9)%	32.2%	15.3%	3.9%
Dow Jones Industrial Average Index (2)	25.2%	(6.2)%	(7.1)%	(16.8)%	25.3%	3.2%	3.5%
NASDAQ Composite Index (2)	85.6%	(39.3)%	(21.0)%	(31.5)%	50.0%	8.6%	3.9%
Vanguard Mid Cap US Index Fund (1)	25.0%	2.6%	(4.8)%	(16.3)%	34.1%	20.4%	4.9%
Vanguard Small Cap US Index Fund (1)	19.6%	(4.2)%	1.0%	(21.6)%	45.6%	19.9%	4.2%
Vanguard International (EAFE) Index Fund (1)	25.3%	(15.2)%	(22.6)%	(17.5)%	40.3%	20.8%	5.1%
BONDS:							
Vanguard Total Bond Market Index (1)	(0.8)%	11.3%	8.3%	8.2%	4.0%	4.2%	0.9%
Vanguard Interm. Tax-Exempt Bond Index (1)	(2.9)%	9.2%	5.0%	7.9%	4.4%	3.2%	1.1%
Vanguard High Yield Taxable Bond Fund (1)	NA	NA	NA	1.7%	17.2%	8.5%	1.2%

%	1999 1Q	1999 2Q	1999 3Q	1999 4Q	2000 1Q	2000 2Q	2000 3Q	2000 4Q	2001 1Q	2001 2Q	2001 3Q	2001 4Q
S&P 500	4.1	7.6	(7.7)	15.6	2.0	(3.0)	(1.3)	(7.8)	(12.1)	4.8	(13.8)	8.1
NASDAQ COMP	14.6	10.0	0.0	61.0	12.4	(14.8)	(7.2)	(29.6)	(25.5)	12.9	(26.7)	18.3
BONDS Interm. Taxable	0.0	(0.5)	0.4	(0.7)	2.4	1.5	3.1	4.3	3.2	0.8	4.3	0.0

%	2002 1Q	2002 2Q	2002 3Q	2002 4Q	2003 1Q	2003 2Q	2003 3Q	2003 4Q	2004 1Q	2004 2Q	2004 3Q	2004 4Q
S&P 500	0.0	(13.8)	(14.1)	4.5	(1.8)	12.8	2.2	13.2	1.3	1.3	(2.4)	8.8
NASDAQ COMP	(5.5)	(19.5)	(13.5)	7.0	2.5	19.2	12.1	16.2	(0.5)	2.7	(7.5)	13.9
BONDS Interm. Taxable	0.0	2.8	3.6	1.8	0.9	2.7	0.2	0.2	2.7	(2.6)	3.1	1.0

1) Results for Vanguard funds include dividends and fund expenses but do not reflect PPA's advisory fee.
2) Results for S&P 500, Dow Jones, and NASDAQ indexes do not reflect dividends or PPA's advisory fee.

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DECEMBER 2004 COMMENTS

STOCK index prices for December were significantly higher, for the second consecutive month, as Largecap, Midcap, and Smallcap all posted similar gains. For the month, the S&P 500 gained 3.4%, the Dow Industrials 3.5%, and the NASDAQ Composite 3.9%. YTD, the S&P 500 finished up 9.0%, the Dow up 3.2%, and the NASDAQ up 8.6%. By contrast, both the Midcap and Smallcap indexes finished up approx 20%, and the Total Stock Market Index, which includes Midcap and Smallcap stocks, was up 3.9 % for the month and 12.5 % for the year. Within the Large Cap S&P 500, Value continued to outperform Growth, by 15.3% to 7.2% for the year. The International Index, which hedges currency impacts, was up 20.8% for the year, and the best performer of all was the REIT index, up 30.7%. After the fact, it appears there was no significant new financial news to alter the market's uptrend that began during November.

BOND returns (price change plus interest), in a reversal of November's declines, posted gains for December. However, for the full year 2004, most stock returns outperformed bonds for the second consecutive year. The importance of a balanced and diversified portfolio is highlighted by the fact that **"for the seven years ending August 31, 2004, U.S. taxable bonds as measured by the Lehman Aggregate Bond Index had an annualized total gain of 7.1%, compared to 4.5% for the S&P 500." (Cited in WSJ article, "Bonds Tortoise Outruns Stocks Hare in 7 Years," dated 10/1/04, pg. C3.)**

By year-end, the benchmark 10-year US Treasury yield was 4.22%, down from November's 4.36%, which in turn was a significant increase from October's 4.03%. The high yield for the year was reached in mid-May, at 4.85%. The current interest rate environment, and its effect on bond prices, is discussed in detail on pages 7-10. Monthly and full year total returns (including interest) were as follows: High quality intermediate-term taxable bonds, gains of 0.9% and 4.2%, respectively; and high quality intermediate-term municipal bonds, gains of 1.1% and 3.2%, respectively. High Yield ("Junk") taxable bonds continued to outperform high credit quality bonds, up 1.2% for the month and 8.5% for the year.

Stock and bond investment results for December, for the year 2004, and for the five years from 1999 to 2003 are set out on page 2. The stock market rally that began decisively in March, 2003 has now raised the S&P 500 by 56% from the October 2002 low. While these gains have made investors believe again that stocks do not go down in perpetuity (a view that was widely held during the depths of the 2000-2002 bear market), the question of whether this recovery will continue is, as always, dependent on unknown future events. (Note also that after a price decline of 50%, it takes a gain of 100% to return to the previous price level. Example: the S&P 500 reached its high of 1,527 in Q1 2000, then declined to 777 during Q4 2002, a drop of approximately 50%. From 777 to the S&P 500's current level of 1,212, there has been a gain of approx 56%, but the index is still another 315 points, or an additional 40%, from its prior high.)

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In order to keep the current recovery in perspective, we continue to show the chart below, which sets out the extent of the declines measured from the highs of Q1 2000. The chart also puts these declines in the context of results since the end of 1994 (also see the figures on page 10). Note that the three indexes have positive average annual returns ranging from 10.2% to 11.2% for the full ten-year period from the end of 1994 through year-end 2004, very much in line with long-term stock returns going back to 1926. Further, as these returns converge more and more, the idea of "regression to the mean" seems quite applicable.

The long-term investor therefore has a very different view of the stock market's returns than those measuring returns from the highest levels.

	S&P 500 (1)		DOW (1)		NASDAQ (1)	
1st Qtr 2000 High	1,527		11,723		5,048	
Year End 2000	1,320	(13)%	10,785	(8)%	2,470	(51)%
April 10, 2001 Low	1,103	(28)%	9,390	(20)%	1,684	(67)%
September 21, 2001 Low	965	(37)%	8,235	(30)%	1,425	(72)%
Year End 2001	1,148	(25)%	10,020	(17)%	1,950	(61)%
October 9, 2002 Low	777	(49)%	7,286	(38)%	1,114	(78)%
Year End 2002	880	(42)%	8,342	(29)%	1,336	(73)%
Year End 2003	1,112	(27)%	10,454	(11)%	2,003	(60)%
December 31, 2004	1,212	(21)%	10,783	(8)%	2,175	(57)%

Context: Prior Five-Year Gains in Bull Market of 1995 - 1999:

	S&P 500 (1)	DOW (1)	NASDAQ (1)
End 1994	459	3,834	752
End 1999	1,470	11,500	4,070
Gain	1,011	7,666	3,318
Avg. Ann. % Gain, '95-'99; 5 years	26.2%	24.6%	40.2%
December 2004	1,212	10,783	2,175
Gain	753	6,949	1,423
Avg. Ann %Gain, '95-12/04; 10 yrs	10.2%	10.9%	11.2%

1) Results for S&P 500, Dow Jones, and NASDAQ indexes do not reflect dividends or PPA's advisory fee.

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I. UPDATE OF KEY ECONOMIC INDICATORS

The strength of the overall U.S. and world economies is one of a number of factors likely to influence the future direction of both stock and bond prices. (Note: We, along with many market observers and academics who write about the markets, believe stock and bond prices already reflect consensus expectations of economic growth. Further, we believe that even if you could accurately predict any number of actual economic figures, the market's reaction to those figures is essentially unpredictable). In any event, an understanding of the direction of current economic trends may at times be useful as a context to help understand market conditions. This section of the Comments provides an update of key economic indicators.

(1) Gross Domestic Product (GDP) is the broadest measure of goods and services produced in the U.S. economy. (GDP figures are inflation-adjusted, annualized growth rates). The initial estimate for Q304 GDP was 3.7%. The final figure was reported at 4.0% (Wall Street Journal [WSJ], 12/23/04, pg. A2).

(2) Employment for November grew by 112,000, following October's downward revised gain of 303,000 jobs. The November figure was "disappointing…about half what economists had been expecting" (Vanguard Economic Week in Review [VEWR], 11/29-12/3/04). "The modest pace of job creation…reinforced the image of an economy that is expanding more slowly….Three years after the last recession officially ended in November 2001, the rebound in jobs remains slower than in any previous economic recovery since World War II" (NYTimes, 12/4/04, pg. C1).

(3) Interest Rates were little changed. The benchmark 10-year U.S. Treasury interest rate, which is set by buyers and sellers in the bond market, closed December at 4.22%, following November's sharp advance to 4.36% from October's closing level of 4.03%. During the month of December, the Federal Reserve raised short term rates for the fifth time since June, to 2.25%

(4) Inflation, as measured by the Consumer Price Index (CPI) "core" rate, which excludes the volatile food and energy sectors, rose 0.2% in November. For the last twelve months, this core rate was up 2.2%. With food and energy included, the CPI was also up 0.2% for November, and was 3.5% higher for the previous twelve months (VEWR, 12/13-17/04). Further, the Producer Price Index (PPI) core rate increased 0.2% in November, but again was higher with food and energy included, at 0.5%. The changes for the last twelve months were 1.9% for the core rate and a much higher 5.0% with food and energy included (VEWR, 12/6-10/04).

An extensive discussion of Interest Rates, Inflation and Bond Prices appears on pgs 7-10

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(5) Sector Economic Activity Continued Mixed

(a) Durable goods orders (industrial and consumer) gained 1.6% in November, following October's revised decline of 0.9%. Excluding transportation, however, the November figures showed a decline of 0.8% (VEWR, 12/20-24/04; WSJ, 12/24/04, pg. A2).

(b) Industrial production gained 0.3% in November (VEWR, 12/13-17/04).

(c) Retail Sales, excluding autos, rose 0.5% in November, but only 0.1% with auto sales included. Overall sales (which include gasoline sales) were 7.2% higher year over year (not adjusted for inflation) (VEWR, 12/13-17/04).

(d) Housing sales for existing homes increased 2.7% in November to a record rate, and prices were 10% higher than a year earlier (WSJ,12/30/04,A2). On the other hand, sales of new homes declined 12% for the month, the largest one month decline since 1994, but were still 3.6% higher than a year earlier (VEWR, 12/20-24/04).

(e) Personal Income for November rose 0.3%, following an October gain of 0.6%. Personal spending increased by 0.2%, after an October increase of 0.8%, while personal savings as a percentage of after-tax income rose 0.3%. Note that personal savings excludes capital gains from stocks and homes (WSJ, 12/24/04, pg A2).

(6) Consumer Confidence, as measured by the Conference Board's Index, "jumped sharply in December to its best level since the summer, reversing most of the slide in the prior four months and leaving the index at its second highest reading of the year." Factors cited in the WSJ article were an improving job outlook, declining oil prices and rising stock prices (WSJ, 12/29/04, A2).

(7) Corporate Profits for the S&P 500 companies during Q3 2004 are estimated to be up 16.8%, "a healthy gain, but the first time in five quarters that the quarterly increase has fallen below 20%" (NY Times Sunday Financial Market Week, 11/21/04, pg. 7). In the WSJ's December 22nd front page article on the stock market (also cited on pg. 11 of these Comments), there is discussion of corporate earnings forecast for 2005 in the 7-10% range, "close to the historic average."

Overall, the economic news for December was mixed. As for market prices, what we know is that the many factors that influence prices gave rise to a second consecutive strong month for stocks and a mildly positive month for bonds. The following pages 7 through 11 discuss a wide variety of the factors that are likely to affect bond and stock prices going forward. What we don't know, as always, is how the unpredictable, unknowable future will impact these factors, which in turn move the market prices for stocks and bonds.

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II. BOND INVESTMENTS in a TIME of RISING INTEREST RATES

Since June 2004, the Federal Reserve has raised the Federal Funds rate, the short-term interest rates it controls, five times, from 1% to 2.25%. Despite this rise in short-term rates, the yield on the benchmark ten-year U.S. Treasury bond, which is set by buyers and sellers trading bonds every day, has actually declined from its yearly high of 4.85% reached in mid-May to as low as 4.0% during October, and back to 4.2% at the end of December. Since bond prices, and the investment returns from bonds, are directly related to interest rates, this divergence between the direction of short term rates (up) and longer-term rates (level to down), has created much uncertainty for bond investors.

Short-term rates most directly affect the yields of short term fixed income investments, including money market investments and all maturities of one year or less. But the recent increase in short-term rates does not always cause increases in the longer term rates set by market participants (which is the case currently). This means there can be periods during which yields on intermediate-term bond maturities (three to ten years) actually decline, and the prices of these bonds increase, even as the yields on short-term maturities increase and the prices decline. The key element in this bond pricing is the spread between the short term rate, now 2.25%, and the longer term rate, now 4.22%. The spread is 2%, and conceptually reflects a rate of inflation expectation; that is, if investors collectively believe the future rate of inflation will be 2%, then a 2% spread between short and intermediate rates would be reasonable, since inflation reduces the purchasing power of a fixed amount of dollars received in the future. Whether this current pricing is reasonable therefore depends in large part on the future rate of inflation.

This moves the bond investment discussion to inflation. Inflation is impacted by a host of factors, including the rate of growth of the broad economy, the pace of employment growth, the budget deficit, the price of oil, the exchange rate value of the dollar (all factors that have been discussed in previous Comments). In its December 15th article (pg. A2) reporting on the Federal Reserve's most recent rate increase, the WSJ reported that "the Fed said the economy is growing at a 'moderate pace' despite high energy prices, the job market continues 'to improve gradually,' and both inflation and longer-term inflation expectations remain 'well contained.' The Fed also reaffirmed its intention to raise rates at a 'measured' pace, interpreted as no more than a quarter point per meeting." The article continued that "the Fed said, as it has since March, that there are 'roughly equal' risks of the economy growing faster or slower than its ideal rate, and of inflation going too high or too low," and that "the Fed is torn between data that show the economy to be strong, and expectations that a widening trade deficit, high energy prices and less fuel from tax cuts will weigh on growth in the coming year." The article also stated that "the Fed's first rate increases were driven primarily by the need to lift the rate from extraordinary lows appropriate only when the economy faced the risk of deflation. With yesterday's increase, the rate is firmly above the underlying inflation rate - 1.5%, according to the Fed's preferred measure – and the Fed is keying its moves more to the ebb and flow of data on growth and inflation."

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Prior to the Federal Reserve's most recent rate rise, the December 2nd WSJ carried a front page article titled "Fed View Shifting on Inflation; Rate Rises Likely," in which it stated that "a growing number of Federal Reserve officials believe inflation risks are on the rise – a shift in sentiment that will likely keep the central bank raising interest rates at its next few meetings. Officials cite several reasons for their newfound concern: slowing productivity growth, the lower dollar, high energy and commodity prices, recent inflation data, and anecdotal evidence of businesses raising prices." The article mentions that the first four quarter-point rate increases since June "were motivated by a universally held view among Fed policy makers that, with the three-year-old expansion apparently well-established and the threat of deflation gone, a 1% interest rate was far too low and eventually would fuel inflation." The article observed "that the 'core' consumer-price index, which excludes the volatile food and energy categories, rose a more-than-expected 0.3% in September and 0.2% in October, lifting the annual increase to 2% from 1.7%." Further, in its December 13th article (pg. A3) on November's Producer Price Index (PPI), the WSJ reported that the PPI had risen 1.9% over the past year, compared with 0.5% in the previous 12 months.

In an interesting counter to the "inflation-is-increasing" sentiment, Bruce Johnston, Senior Marketing Investment Strategist for Fidelity Investments, in a December 1st lecture to the New York City Chapter of the American Association of Individual Investors (AAII), took the position that technology, and global competition and overcapacity, would likely minimize upward price pressure on many important products and services. (Note that this does not include products and services not generally subject to international competition, such as education and health care).

William Gross, who manages the largest bond fund in the U.S., with approximately $77 billion in assets, believes that inflation adjusted interest rates are likely to stay low even though he believes the inflation rate is reported as lower than it really is. Gross is quoted in the December 2004 edition of Investment Advisor magazine (pages 62-63) as follows: (a) "yields have to rise because the government cannot afford to pop the ballooning deficit because it is the necessary evil that is keeping the economy growing;" (b) "deficits are being supported by the 'kindness of strangers,' the Chinese, Japanese, etc., and as long as the strangers are willing to finance the budget level at these low interest rates, we can look forward to a relatively placid period. But when – not 'if,' but 'when' – they decide to not go along with the program, that's when the real danger exists for higher yields and substantially lower prices in Treasuries;" (c) "year after year, the CPI (Consumer Price Index) inaccurately adjusts prices downward to reflect better quality" since individuals do not actually pay less for these products in terms of the cost of living; therefore "CPI is really a percent higher than what the governments says it is;" (d) his 'most certain idea' is that "real interest rates in the U.S. will have to be kept low. Too much debt in a finance-based economy precludes raising interest rates like we have in the past. While that keeps the patient/economy breathing, it leads to asset bubbles, potential inflation, and a declining currency over time….The low rates mentioned earlier speak to really low real short-term rates. If inflation continues upwards it would be logical for the Fed to raise nominal short rates just enough to contain prices, but not kill the economy. We have suggested one-half percent real as a future Fed target, but no one really knows. We will just have to find out. With so much debt in our economy, a subjective analysis would caution against raising real rates too high. We believe that higher rates will be a long time coming."

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The New York Times (NYT) featured this issue, and its many facets, in a December 22nd article on the first page of its Financial section. The author starts with the fact that, with only a few days left to the year, long-term interest rates are likely to finish the year right around where they started, and that "this has to rank as the biggest financial-markets surprise of 2004. Given the fundamentals, rates should be higher. The U.S. economy's growth rate is relatively strong. The fed has been raising short-term interest rates. The dollar has fallen….The labor market, while still feeble, is in better shape than at the beginning of the year. The budget deficit is still with us. The trade deficit is wider than it was last December. The personal-savings rate has fallen further." The article then states that at least in the short term, heavy buying of U.S. Treasuries by Asian central banks has kept prices higher than they should be, and rates lower. But what of the longer term? Here the author writes of a "fairy-tale ending…inflation is the bogey-man that doesn't appear because global deflationary pressures act as a counterweight. (Our note: remember this same point made by Fidelity's Bruce Johnston.) U.S. companies, more competitive abroad thanks to the weak dollar, become confident enough to hire and raise wages here. A rise in exports overcomes the American consumer slowdown. Rates rise at a safely moderate pace because investors become less obsessed with the fragility of the expansion." The author then discusses the other side, which contends that "rates rise when the economy is strong and investors anticipate continued strength"… and that "if rates remain artificially low too long, and inflation reappears, that's the ultimate risk."

With all these opinions and ideas on the subject, let's look at some actual historical data from Ibbotson Associates 2004 Yearbook, "Stocks, Bonds, Bills and Inflation," 1926-2003 Market Results, pages 38-39 (note: a detailed presentation of this data was included in our May 2004 Comments, page 9). For purposes of these Comments, the data will focus on the unusual occurrences rather than the normal. The purpose of this analysis is to try and understand the extent of the risks involved in owning intermediate-term bonds compared to short term money markets. (The third liquid asset alternative, stocks, the returns for which have been far more volatile but which also have been historically far more rewarding than either intermediate bonds or money markets, is not the subject of this discussion. And remember, in evaluating liquid asset alternatives, there are only the three choices, namely stocks, bonds and cash equivalents. International investing, small company investing, growth and value, are all subdivisions of the three basic categories.)

From 1926 through 2003, Intermediate-term Government Bonds have had an average annual return of 5.4%, with a range (two-thirds of the time) of plus/minus 5.7% around that average return (pg 33). The return consists of interest earned, plus/minus the price changes of the bonds. Therefore, at least for two-thirds of the time, there were essentially no years of negative returns from intermediate-term bonds. In the other one-third of the 78 years, there have actually been eight years that have been negative, with the worst performance in 1994, at minus 5.1%. The next worst year was 1931, at minus 2.3%. The other six down years were all below 2%. By contrast, U.S. Treasury Bills, as a proxy for ultra short-term rates that today are represented by money markets, have had a 78-year history of a 3.7% average return, with a plus/minus 3.1%, and only one fractional down year out of the 78 years. As for inflation, its average annual rate has been 3%, with a plus/minus range of 4.3% and ten negative years. The last negative year for inflation was 1954, and the largest declines occurred during the depression years of 1930-1932.

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During recent years, the expected correlation between intermediate-term bond results, and short-term rates and inflation has NOT been present. For example, in 1994, the worst one-year period for bonds, inflation was under 3%, well within its most recent 13 year range, and T Bill rates were just under 4%, also well within their recent 13 year range.

What concerns most investors, however, is the fact that short term rates have fallen so low that they appear to have nowhere else to go but up. Indeed, we know that those rates have already gone from 1% in June to 2.25% in December. We also know that during these six months, the yields on intermediate-term bonds have remained essentially the same. But is this performance likely to continue if short rates continue to rise? The key to the potential price declines for intermediate bonds is really the PACE at which short-term rates rise. Assuming the actual short-term interest rate reflects the rate of inflation, and that the spread between short-term rates and intermediate-term bond yields also reflects the rate of inflation, a gradual increase in short term rates, even if accompanied by an increase in the yields for intermediate bonds, should not present too great a problem for intermediate-term bond returns. This is particularly likely since those higher interest rates eventually accrue to the benefit of the bond owners as their longer maturity bonds mature. A modest price decline, coupled with higher interest rates, could well provide a total bond return greater than the still lower returns provided by the money markets. And ultimately, this is the key TRADEOFF: To opt for the certainty of no negative return you need to accept the lower interest rates that come from the short-term investments. By owning bonds with maturities that have higher interest rates, those bond prices need to fall by more than the favorable interest rate spread for the bond result to be worse than the money market result. Higher yielding adjustable rate debt securities, and inflation protected debt securities, provide certain benefits, but also carry their own risks. Owning bonds denominated in foreign currencies clearly have their own risk-reward characteristics. Once again, after all the analysis of the past price data, all the scrutiny of the investment choices, and all the differing opinions on the direction of the many factors that influence interest and inflation rates, we are left with the same fundamental questions that impact all investment decisions: What is the degree of downside risk the investor wishes to take on in the hopes of gaining an incremental investment return, in a world filled with unknowns?

As a final note to this section, Ibbotson Associates, which publishes recommended asset allocations for a range of investment objectives it labels Conservative, Moderate Conservative, Moderate, Moderate Aggressive and Aggressive, has Cash Equivalent allocations of 30% and 20% respectively for the Conservative and Moderate Conservative accounts, along with an allocation of 47% and 38%, respectively, to Fixed Income. The balance of those two portfolios, which Ibbotson divides between U.S. Equity and Non U.S. Equity, amounts to 23% and 42% respectively. (Source: Select Sector SPDR Advertising Supplement, page 5, in Financial Planning Magazine, December 2004).

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III. STOCK INVESTMENTS: Factors that influence prices in the Long-Term

The context for this section of our Comments is the issue of whether portions of future Social Security money should be invested in private accounts, some of which would be invested in the stock market. An article in the Financial Section of the New York Times (December 26th, pg. 6), titled "The Risky Assumption in Social Security Change," discussed this issue, along with key factors that impact stock prices. The article noted the basic investment proposition that "past performance is no guarantee of future returns," and then stated that the commission set up to review the alternatives for strengthening Social Security "chose to assume that stocks would offer an average annual return of 6.5% after adjusting for inflation, and that bonds would pay about 3%. The assumptions about returns came mainly from historical averages." It is this use of historical averages, and the likelihood of their continuing into the future, that was brought into question.

One commentator, the chief investment strategist at Prudential Equity, cited two huge boosts to equity returns over the past 20 to 25 years, namely "the Federal Reserve's successful war against inflation and an upward trend in companies' profitability." He also mentioned a third factor at work for the past seventy five years, namely "the doubling of the average valuations of companies, as measured by price-to-earnings ratios. Back in 1926, the price-earnings ratio was roughly half what it is today. Putting aside whether you think this change of valuation is sustainable, no one thinks it's going to double again." The same commentator also observed that "when profitability is high it tends to fall, when it's low it tends to rise." Further, with inflation and interest rates near historical lows, it is clear that declines from current levels, if any, cannot possibly match the declines that occurred from the double digit rates of the mid and late 1970s. Taken together, these factors suggest future stock returns are unlikely to match their historical rates.

The chief quantitative strategist at Merrill Lynch added yet another reason why future stock returns are likely to fall short of past returns. "Our view has been that the No. 1 rule of investing is that returns on capital are highest when capital is scarce. Right now, courtesy of the Fed's liquidity and their encouragement of investors to take more risk, there is no asset class that is starved for capital. That's why asset returns, across the board, will be muted relative to current expectations for perhaps quite some time."

In the WSJ's December 22nd front page article discussing the short term direction of stock prices, the optimistic case for continuing gains was dependent on "an economy not too hot and not too cold, generating neither inflation nor recession." The negative case stressed, among other issues, "the prospect of more increases in interest rates, the continued decline of the dollar, and the already historically high valuations of some stocks." The article pointed out that at current price levels, the S&P 500 stocks are trading at 20 times their past 12 months' earnings, and 18 times forecast earnings for the next 12 months, with profit growth forecasts for 2005 in the 7-10% range, "close to the historic average."

We have included this discussion of stock prices, their past returns, and some of the long and short term factors that influence them, to once again stress that the future is inherently uncertain, that risk is extremely difficult to avoid, and that sensible investing involves choosing amongst a variety of alternatives, developing a broadly diversified mix of investments designed to meet specific personal objectives, rather than trying to time the markets by predicting future price movements.

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S&P 500 (1) DOW JONES (1) NASDAQ (1)

1) Results for S&P 500, Dow Jones, and NASDAQ indexes do not reflect dividends or PPA's advisory fee.

I. Figures From Period Starting 2000 (% Figures Are Cumulative Declines From 1/01/00)

	S&P 500 (1)		DOW JONES (1)		NASDAQ (1)	
Start of 2000	1,470		11,500		4,070	
End of 2000	1,320	(10.1)%	10,785	(6.2)%	2,470	(39.3)%
Sept. 21, 2001 Low	965	(34.3)%	8,235	(28.4)%	1,425	(65.0)%
End of 2001	1,148	(21.9)%	10,020	(12.9)%	1,950	(52.0)%
Oct. 9, 2002 Low	777	(47.1)%	7,286	(36.6)%	1,114	(72.6)%
End of 2002	880	(40.1)%	8,342	(27.5)%	1,336	(67.2)%
End of 2003	1,112	(24.3)%	10,454	(9.1)%	2,003	(50.8)%
End of 2004	1,212	(17.5)%	10,783	(6.2)%	2,175	(46.5)%

II. Figures From Period Starting 1995 (% Figures Are Gains From 1/01/95)

	S&P 500 (1)		DOW JONES (1)		NASDAQ (1)	
Start of 1995	459		3,834		752	
End of 1999	1,470		11,500		4,070	
5 Year Gain; Annualized %	1,011	26.1%	7,666	24.6%	3,318	40.2%
End of 2001	1,148		10,020		1,950	
7 Year Gain; Annualized %	689	14.0%	6,186	14.7%	1,198	14.6%
End of 2002	880		8,342		1,336	
8 Year Gain; Annualized %	421	8.5%	4,508	10.2%	584	7.5%
End of 2003	1,112		10,454		2,003	
9 Year Gain; Annualized %	653	10.3%	6,620	11.8%	1,251	11.5.%
End of 2004	1,212		10,783		2,175	
10.0 Year Gain; Annualized %	753	10.2%	6,949	10.9%	1,423	11.2%

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