Chartwell Consulting

ADVISORY SCORECARD

Early each year, we try to provide some perspective on the upcoming period. Here's an update on how our thoughts from January 2005 have worked out, together with our current thinking on selected issues

In January 2005, we said	*This is what happened . . . .*	*Our current position . . . .*
We think GDP growth rates are moderating from those of 2002-04. "Employment growth remains slow, and real wage growth remains low."	2005 GDP increased 3.5%, vs. 4.2% in 2004. Employment increased 2.0mm; Rate of unemployment dropped from 5.2%, to 4.9%. Real wages *declined* 0.4%.	Our pessimism is increasing. Although Q1 '06 will be strong, we expect GDP growth to slow in latter part of year, as consumers start to rebuild their woeful savings accounts.
We believe even more strongly that downside price risk of long-term Treasury bonds is not being compensated for by current yields.	Downside price risk was not much of an issue. The 10-year yield rose from 4.22% to 4.39%, producing just a 2.1% total return. But, the 30-year bond actually *rallied* in price.	This is the first Fed tightening cycle **ever** when long-term yields declined. Go figure. We think the current flat yield curve suggests downward pressure on long-term bond prices.
We continue to favor strategic exposure to the emerging market bond sector, as we did in 2004, but expect future *excess* returns to be considerably lower than in 2004.	JPM Emerging Market Bond index was up 12% in 2005, after rising 20% in 2004. Excess return versus U.S. Investment Grade Bonds was +9% (vs. +16% during 2004).	We expect emerging markets stocks and bonds will be increasingly volatile in 2006, as hot money rushes in/out. But, we still favor a strategic overweight to this area.
Equity price volatility remains a fact of life. 2004 was actually much less volatile than prior years. We expect greater up/down moves in 2005.	Equity market volatility was *lower* in 2005. The number of ±1% market days was very low, as was the Hi/Lo monthly return differential (6.2%).	Market volatility can't go much lower. Investors have become complacent (feeling less buy/sell pressure). We expect volatility to increase in 2006.
Earnings growth was better than expected in 2004, and long-bond rates didn't rise. We expect modest single digit (4-7%) domestic equity returns in 2005.	Broad market Russell 3000 index returned 6.1%; small/mid Russell 2500 index advanced 8.1%, and large cap S&P 500 index returned 4.9%. We got this right.	Separating out energy sector earnings growth from the rest of the market's, the latter is expected rise a little over 10% in 2006. We think domestic stock returns will be a little less than that.
Our tactical recommendation to overweight international equity and debt allocations remains in place. We're just not pounding the table as hard as 1-2 years ago.	International Developed Market stocks returned 14% in 2005; Emerging Markets stocks were up 34%. **Hedged** global bonds returned 5%, but un**hedged** global bonds lost 7%. The Dollar was strong in 2005.	We still prefer our clients overweight international stocks and bonds. We think these markets remain well-priced versus U.S. counterparts, with the Dollar's potential for weakness adding to the opportunity.
Risk potential in the credit bond area has increased; spreads are very narrow and issuance has been rising rapidly. So has the risk of a general hike in market rates. Cash equivalents are looking good to us, as are foreign bonds.	Credit bond issuance set records last year. But, returns from credit sectors were a bit *higher* than the broad U.S. market. The T-bill index narrowly beat the broad bond index. **Currency hedged** foreign bonds did do better.	Credit bond default fears shouldn't rise in 2006, suggesting credit returns will remain modestly above-market. With an almost purely flat U.S. yield curve, why invest heavily at the long-end unless you expect a recession soon?

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