Chartwell Consulting

ADVISORY SCORECARD

In each January edition of *Chartwell Review*, we try to provide some perspective on the upcoming year. Here's an update of how our thoughts last January are working out.

In January 2004, we said	*This is what happened . . . .*	*Our current position . . . .*
What bothers economists is the anemic growth in real wages/salaries.	This trend continued in 2004, with real disposable personal income up 2.4%	We think GDP growth rates are moderating from those of 2002-04. "Employment growth remains slow, and real wage growth remains low."
Business spending continues growing at a double-digit pace throughout 2004	It has	Lower growth in this area in 2005. Dollars spent will be higher than 2004. Contribution to GDP growth will be less.
The 10-year Treasury was unusually volatile in 2003. Its current price risk hardly seems compensated for by its meager 4.25% current coupon.	10-year Treasury yields rose in first half of 2004, then fell in second half. 10-year yields ended 2004 almost exactly where they started.	We believe even more strongly in our position of one year ago. Current long-term U.S. bond yields are low relative to their downside price risk.
We think the most intriguing fixed income sector is that of emerging market bonds. The sector has performed extraordinarily well, but still retains very positive characteristics.	JPM Emerging Market Bond index was up 20.0% in 2004, versus a 4.2% return for U.S. Investment Grade Bondss.	We still favor strategic exposure to the emerging market bond sector, but expect future excess returns to be considerably lower.
The U.S. equity market has advanced in 9 of last 10 months. Investors shouldn't be surprised or dismayed if there is a short-term break in this upward advance.	S&P 500 fell 3% from March-July, then rose 11% August-December. Small-cap sector declined 6%, then rose 19%.	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.
Modest single digit appreciation from current (Feb. 1, 2004) levels seems a reasonable assumption for 2004.	Total S&P return for Feb-December was 9%. For small-cap it was 13%. Our forecast was too low, but it didn't look that way until the end of November.	Earnings growth was better than expected in 2004, and long-bond rates didn't rise. We expect modest single digit (4-7%) equity returns in 2005.
As a tactical matter, we continue to recommend investors keep **above** their international equity and debt allocation targets, and establish or increase emerging market allocations.	Developed Market international equity returned 21% in 2004; Emerging Markets were up 26%. **Unhedged** global bonds returned 10%, **hedged** global bonds returned 5%.	Our tactical recommendation remains in place. We're just not pounding the table as hard as 1-2 years ago. Non-U.S. equity and debt markets are fundamentally well-priced vs. U.S., but not "stupid" cheap.
Domestic Treasury bond yields will be flat to rising. Our general "long credit risk, short interest rate risk" fixed income recommendation remains.	Shorter term Treasuries rose, in lockstep with Fed Funds, but longer-term Treasury yields fell 0.2%. Credit bonds continued to outperform Treasuries in each maturity bucket.	Risk potential in the credit bond area has increased, as spreads are very narrow and issuance has been rising rapidly. But, so has the risk of a general hike in market rates. Cash equivalents are looking better and better to us, as are foreign bonds.

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