Market Brief

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The views and opinions contained in this market brief are those of Capital Allocation & Management, Inc. and have been researched and analyzed by Robert Kennedy, CIO, Capital Allocation & Management.

	30-Sep-05	23-Sep-05	Weekly % Change	YTD % Change	12 month % Change
Nasdaq Composite	2,151.69	2,116.84	1.65%	-1.09%	10.79%
S&P 500 Index	1,228.81	1,215.29	1.11%	1.39%	8.60%
Dow Jones Industrial Average	10,568.70	10,419.59	1.43%	-1.99%	3.69%
MSCI EAFE (Intl.)	1,618.84	1,584.26	2.18%	6.82%	22.82%
Wilshire 5000	12,289.26	12,126.92	1.34%	2.66%	11.13%
10 Year U. S. Treasury Yield	4.33%	4.25%	1.88%	NA	NA
30 year U.S. Treasury Yield	4.57%	4.53%	0.88%	NA	NA

The phrase "dodging a bullet" was heard many times last month, as the financial markets managed to ignore a myriad of simply horrific news events. The bears expected that the combined effects of the two hurricanes, rising energy prices, continuing problems in Iraq and omni-present political problems would punish equity prices towards the end of the month. Yet, most of the major indices actually managed to finish the month with positive gains. We suspect that "climbing the wall of worry" will be a phrase that is repeated often as we move into the year's last quarter.

Market bears seem to be ignoring the fact that if the energy components are taken out of the S&P 500, that index would be down approximately 10% year to date. Obviously, just as with the inflation stats, it is ridiculous to take out key components of market valuations. The reality, however, is that many areas of the equity markets are significantly oversold/undervalued and, consequently, the necessary ingredients for a market "meltdown" simply were not available. This does not mean that we still can't suffer a severe sell-off over the coming weeks, given the potential for another hurricane or a terrorist event. But, *IF* we begin to see the gulf's decimated energy "patch" experience a quicker than expected recovery, the ingredients will be in place for a pullback in energy prices and a solid rally in the overall equity markets.

The third quarter earnings season will begin in earnest in a couple of weeks. So far, earnings warnings have been relatively muted, albeit the hurricanes' effects are just now being computed by many companies. For the most part, this quarter's earnings warnings have been "average" as compared to previous quarters. Market analysts seem to expect earnings to rise approximately 15%, albeit the majority of that rise may be attributed to energy stocks where earnings are expected to pop more than 45%. If energy gains are ignored, however, the markets should still see earnings gains of 11%, which will be the 14th consecutive quarter of double digit profit gains. Furthermore, for the past year and a half or so, analysts have underestimated earnings gains by approximately 25%, so the potential for better than expected overall reports is real. We are, consequently, cautiously optimistic that the equity markets' relative strength will continue over the coming weeks.

Alan Greenspan continued his series of "swan song" speeches last week by warning investors that to expect central bankers to continually buffer market exuberance is "simply not realistic." Most market watchers assume this to mean that the Fed will continue to raise rates over the coming months. Not surprisingly, the Treasury markets experienced some selling pressure after Mr. Greenspan's remarks, causing a further flattening of the yield curve. Of note, however, is the continuing relative strength of the corporate bond markets. The "canary in the coal mine" remains positive.

Economic Reports: On Tuesday, August factory orders are expected to have increased 2% after a 1.9% decline in July. On Friday, the September unemployment report should post a 5.1% reading versus August's level of 4.9%. It is expected that the economy lost 150,000 jobs in September, primarily due to Hurricane Katrina.

"All Indices are unmanaged and are not available for direct investment by the public. Past performance is not indicative of future results. The NASDAQ Composite Index measures the performance of all issues listed in the NASDAQ Stock Market, except for rights, warrants, units, and convertible debentures. The S & P 500 is based on the average performance of the 500 industrial stocks monitored by Standard & Poor's. The Dow Jones is computed by summing the prices of the stocks of 30 large companies. The Morgan Stanley Capital International (MSCI) Europe, Australia and Far East (EAFE) Index is a broad-based index composed of non U.S. stocks traded on the major exchanges around the globe. The Wilshire 5000 Total Market Index represents the broadest index for the U.S. equity market, measuring the performance of all U.S. headquartered equity securities with readily available price data."

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