Market Brief

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Capital Allocation & MANAGEMENT, INC.

VISION DIRECTION LEADERSHIP

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.

	28-Oct-05	21-Oct-05	Weekly % Change	YTD % Change	12 month % Change
Nasdaq Composite	2,089.88	2,082.21	0.37%	-3.93%	5.82%
S&P 500 Index	1,198.41	1,179.59	1.60%	-1.11%	6.04%
Dow Jones Industrial Average	10,402.77	10,215.22	1.84%	-3.53%	3.74%
MSCI EAFE (Intl.)	1,552.13	1,536.94	0.99%	2.42%	13.51%
Wilshire 5000	11,947.36	11,792.57	1.31%	-0.20%	7.94%
10 Year U. S. Treasury Yield	4.57%	4.39%	4.10%	NA	NA
30 year U.S. Treasury Yield	4.80%	4.60%	4.35%	NA	NA

Muhammed Ali and Joe Frazier would have enjoyed October's bulls versus bears fight. Like the two-punch drunk fighters from the *Thrilla in Manila*, the camps bobbed, weaved and counter punched right into October's final bell (or the 14th round, with regard to Smokin' Joe). Just when it appeared one side had the upper hand, the other would mount a charge seemingly out of nowhere. While statistically the bears may have won the month, we think the bulls may win the year; as the bears have enjoyed a myriad of bad news over the past several months which, sadly for them, have not resulted in a severe market break. Nevertheless, the bulls should not become overconfident, as the bears have proven to be exceptionally resilient.

Earnings reports continue to meet/exceed expectations, on an overall basis. To be sure, there have been some misses, but with almost 70% of the S&P 500 companies reporting, nearly all of them have exceeded forecasts, while only 19% of them failed to beat estimates. Interestingly, we have read that some of the year's best performing hedge funds have experienced big losses in October, some as much as 5%-10%. For the most part, they have been stung by reversals in the energy sector and overseas investments. We can not say we are unhappy to hear this, as we believe this year's dramatic rise in energy prices was primarily caused by the hedge fund community. Now that energy prices seem to have peaked, perhaps we will see some panic selling in that sector over the next few weeks. This should benefit overall equity prices as we move into the strong holiday season. We are not counting on it, but that development would be welcome.

The FOMC meets tomorrow and it is widely expected to raise interest rates another 25 basis points, which will place the Fed Funds Rate at 4%. For the moment, the Fed Funds Futures market tentatively suggests that the Fed may raise rates to 4.5% by the end of the year (4.75% is another possibility). Looking into 2006, a growing chorus of Fed watchers believes that Mr. Bernanke will continue to raise rates through March, as they think he will want to "prove his mettle" to the financial markets. As such, a 5%+ Fed Funds rate would not be out of the question. Speaking of Mr. Bernanke, it is widely expected that as Fed Chairman, he will be much more transparent than Mr. Greenspan. He has made it known that he believes inflation targeting is the way to go, with a target in the core rate between 1% and 2%. If this is the case, interpreting Fed moves may become much easier as there will be less guessing as to what the Fed will need to do as the core inflation rate changes over time. Furthermore, we suspect Mr. Bernanke will be unable to obfuscate nearly as well as Mr. Greenspan has over the years which, at a minimum, will result in much less head scratching.

Treasury investors were not nearly as enthused about Mr. Bernanke's appointment as were equity investors. Perhaps it is because of Mr. Bernanke's statement from a couple of years ago that the Fed could drop "dollars from helicopters" in order to offset deflation was not something that one would want to hear from the future chairman of the Federal Reserve. More importantly, we think the recent troubles in the White House may be giving foreign investors pause with regard to holding significant amounts of Treasury issues. Indeed, if it appears that the US political situation is deteriorating; foreign investors may decide to place their dollars elsewhere. For the moment, this is not something that appears to be happening, but it is something to monitor as we move into 2006.

"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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