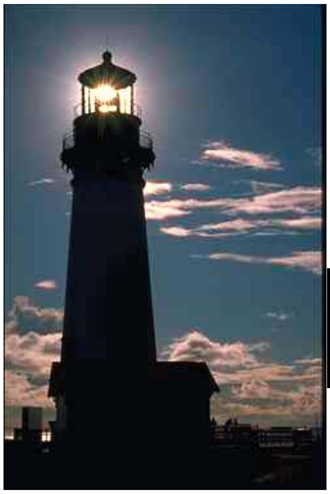

HODGE FINANCIAL SERVICES, LLC

Registered Investment Advisors

A VOICE OF FINANCIAL REASON

By Robert H. Hodge, CPA/PFS

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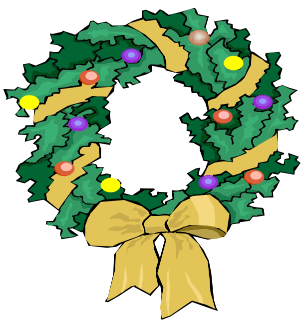
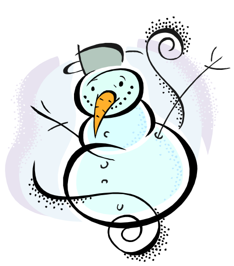


Important Reminder

As we announced last month our website is nearing completion. Beginning next month we will be communicating our stock recommendations via e-mail. In order to take advantage of getting our stock recommendations on a timely basis we need your e-mail address. Please e-mail your address to me at bob@voiceoffinancialreason.com.

Inside this issue:

The US Dollar - Is It in a Crisis? (cont.)	**2**
The Economy	**2-3**
Asset Allocation	**3**
Stock Recommendation of the Month	**Insert**
Stocks	**4**
Bonds	**4**



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The US Dollar - Is It in a Crisis?

Last week the US dollar hit a new low against the euro dollar and the Japanese yen. The euro traded at $1.22 and the Japanese yen touched 107. The drop in the US dollar has been occurring for the past 2 years but the drop has been accelerating over the past 2 months. While it is generally recognized that the dollar had been too strong in recent years and needed to fall, the rate of decline has sparked a debate as to whether the drop could spark a currency crisis. In analyzing whether a dollar crisis is emerging it is helpful to look at our currency from a historical perspective.

The euro was introduced in 1999 as a common currency for most of the European countries. The actual currency was first issued in early 2000 replacing the various currencies of the member countries. The euro was first proposed to facilitate trading among the various members. It was also felt that the block of nations represented by the euro zone would be a stronger competitor to the US. When the euro began trading, the initial exchange rate was $1.16 per US dollar. Within a short time the euro began to drop as currency traders doubted whether the euro zone experiment would be viable. By November 2001 the euro had dropped to $0.85 to the US dollar, a decline of nearly 30%. Over the last 2 years the euro has recovered all of its losses and at the current level of $1.22, it is about 5% above its initial exchange rate. While the rise in the euro has been significant over the last two years, it has more to do with correcting a previous oversold condition than a current crisis in the dollar.

The drop in the dollar as it relates to the Japanese yen is a similar story. The relationship of the yen to the dollar is expressed in the opposite way that the euro versus the dollar is expressed. This means that when the yen versus the dollar is falling the Japanese currency is actually strengthening. At its current level of about 107 the Japanese yen is only about 5% higher than it was at the start of the century. Again, not what you would classify as a crisis.

"...the rate of decline has sparked a debate as to whether the drop could spark a currency crisis."

Why does a country's currency fluctuate in value? The answer is based on the country's need for foreign capital versus the willingness of foreign investors to supply the

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The US Dollar - Is It in a Crisis? (cont.)

(Continued from page 1)

needed capital. It is well known that the United States runs a large trade deficit (nearly $500 billion per year) which must be funded for the most part by foreign investment. In the 1990's the US was viewed by most foreign investors as the market of choice. The US was experiencing solid growth and an improving fiscal picture. The willingness of foreign investors to invest in our markets was in excess of our capital needs thus causing the US dollar to strengthen. Now with the US dollar in decline we need to ask what has changed to cause the demand for our dollar to be reduced.

There are several reasons why our currency is being devalued. The major reason is that we require a large amount of foreign investment each year in order to fund our ever increasing current account deficit. Europeans, who in the past had been large investors in our markets, are generally unhappy with our current political policies. The war with Iraq was not popular with much of Europe. In addition, the rapidly expanding markets in India and China are attracting a large amount of capital which is competing with the US dollar. In effect the US is no longer the market of choice.

The strengthening of the Japanese yen has been brought about by the improvement in Japan's economy. Over the last year, Japan has made significant strides in improving its economic situation. They have finally begun to deal with their insolvent bank problems and there is a sense that the deflation they have been suffering with for nearly a decade is over. The Japanese have begun to reinvest in their economy and as such our markets in the US are no longer as attractive as they once were.

"The decline in the US dollar that has occurred in the last two years has made our exports more competitive but they have not yet led to a reduction in our trade deficit."

I expect that the US dollar will continue to decline over the coming year. The decline in the US dollar that has occurred in the last two years has made our exports more competitive but they have not yet led to a reduction in our trade deficit. Our need for foreign capital must begin to decrease before we will see our currency stabilize. In order for this to happen, we need to close our trade deficit with Asia. So far, there is no evidence that our trade imbalance is improving.

Over the last year investors have not reacted to the decline in our currency. There is an underlying concern however, that if the decline was precipitous it could cause foreign investors to liquidate their holdings in our markets. If this were to occur, it would have a material effect on our stock and bond markets. I continue to believe the decline in our dollar will maintain a gradual pace and as such, we will avoid a crisis. The dollar story merits watching, but at this point the decline is a logical response to the normal flow of funds around the globe.

The Economy

In early December, the first revision to the 3rd quarter Gross Domestic Product was released. It showed that the US economy grew at an annual rate of 8.2% in the 3rd quarter, the fastest pace in more than 20 years. The upward revision surprised most economists causing them to increase their estimates for 4th quarter growth from 4% to 5%. In addition, economists have increased their estimates for next year. The report also revised the measure of worker productivity upward. In short, the 3rd quarter was a WOW performance for the US economy.

Consumer confidence rebounded sharply in November. The ISM surveys of the manufacturing and service sectors showed robust growth. The housing numbers remain strong and auto sales rebounded sharply in November. Overall retail sales for November showed an increase of 0.9% which was stronger than expected.

The only report that was disappointing was the monthly employment report. The US economy added 57,000 net new jobs in November which was less than half of what economists were predicting. The jobs growth was less than what had occurred in September and October. The one thing that was confusing about the employment report is that the unemployment rate dropped from 6.0% to 5.9%. It is generally recognized that the US economy needs to create about 150,000 net new jobs each month in order to keep the unemployment rate stable. There appears to be a disconnect between the household survey that is used to calculate the unemployment rate and the business survey that is used to calculate net new jobs. The disconnect in the two surveys has been going on for much of this year and has yet to be explained.

The Federal Open Market Committee met to discuss changes to interest rate policy on December 9th. In their policy statement following the meeting, they left interest rates unchanged. While the language of the statement was similar to the past few meetings, it differed in their characterization of the risks of deflation. The new statement expressed the view that the risks of inflation versus deflation were now in balance. This change in language could be the beginning of a shift in interest rate policy that may occur next year. The statement however, still contained language indicating the Fed expects to keep interest

(Continued on page 3)

Asset Allocation

This month we are recommending a change to the dividend oriented fund in your portfolio. We recommend switching the 10% allocated in the dividend sector from the Vanguard Dividend Growth Fund to the Vanguard Windsor II Fund. Although the investment returns of the two funds have been almost identical so far this year, we favor the positions held in the Windsor II Fund over those held currently in the Dividend Growth Fund.

We continue to recommend an overall allocation of 70% to stocks and 30% to high yield corporate bond funds. We believe that the fundamentals continue to support being fully invested at this time.

The year 2003 is stacking up to be an excellent year for both stocks and high yield corporate bond funds. Those investors who remained with much of their portfolio in US Government bonds or money markets lost out on an opportunity to recoup much of the losses incurred in the 3 year bear market. While we believe that the stock markets in both the US and international remain poised for further gains in the next 6 months, the easy money has probably already been earned. Hopefully our individual stock picks will continue to outperform the general market, thus enhancing our overall investment returns.

The following is a recap of our current recommended asset allocation. Please note the Vanguard High Yield Corporate Fund has now reopened for new investment.

Asset Class	Recommended Vanguard Fund	Percent Allocation
Stock & Stock Funds:		
US Large Cap Funds	500 Index Fund	20%
Dividend Oriented Funds	Windsor II Fund	10%
Individual US Stocks		20%
International Stock Funds	International Growth Fund	15%
International Stock Funds	Pacific Stock Index	5%
Bonds:		
US Treasury Bonds		0%
High Grade Corp. Bond Funds	Inter-Term Corp. Fund	0%
High Yield Corp. Bond Funds	High Yield Corp. Fund	30%
Cash Equivalents:		
Money Market	Prime Money Market	0%

* The Vanguard High Yield Fund has been reopened to new investors. In previous newsletters, we recommended T. Rowe Price High Yield Fund as an alternative to this fund.

The Economy (cont.)

(Continued from page 2)

rates accommodative for a considerable period of time. This has left Federal Reserve watchers pondering over how long is a considerable length of time. My best estimation at this time is that the Federal Reserve will probably remain on hold for the next six months unless conditions change.

In my view, the Federal Reserve will keep interest rates at present levels until it is convinced that the risks of deflation have been eliminated. I don't think the average American appreciates how close we came to the type of deflation that has plagued the Japanese economy for a decade. Once deflation gets entrenched it is very difficult to stop and its effects can be devastating on an economy built on credit. The Federal Reserve, together with Congress and the Treasury Department, has done an extraordinary job to prime the economic pump and avoid the onset of deflation. While none of us are pleased that we are again running large budget deficits, I am convinced that the actions were absolutely necessary. The threat of deflation was simply that great.

"The tremendous stimulus that has been added to the economy courtesy of our government will not come without a cost."

It now appears that corporations are beginning to expand capital spending while the consumer remains robust. Capital spending was the missing ingredient in establishing a sustainable economic recovery. The US economy is poised for solid growth in 2004 and as such, corporate profits should be strong. This will provide a strong backdrop for stock prices in 2004.

The tremendous stimulus that has been added to the economy courtesy of our government will not come without a cost. A rapidly expanding money supply, along with extremely low interest rates, will ultimately prove to be inflationary. This is apparent by looking at the rise in commodity prices and the rise in real estate values which clearly indicate the early signs of coming inflation. It is my belief that our government has made a conscious decision to accept an increased inflation rate over the next few years. Hopefully, they will be able to keep inflation within a reasonable range of between 3% and 4%.

Stocks

US stocks advanced modestly in November, continuing the rally that began on October 1st. Large cap stocks slightly outperformed small cap stocks for the first time in many months. US stocks continue to be fueled by strong economic growth and improving corporate profits. Analysts are expecting that corporate profits will increase by more than 20% in the 4th Quarter. The strong profit growth is allowing stocks to move higher without expanding the price to earnings ratio (P/E ratio). This is in stark contrast to the markets in the late 1990's where the P/E ratio was expanding to unprecedented levels. While the market is not cheap at current levels, Mike and I believe it is fairly valued in light of the economic outlook. Further gains in the first half of 2004 are likely, if the profit picture continues to improve. We believe that the S&P 500 will begin to outperform the NASDAQ market next year.

International markets also moved moderately higher in November although, most of the gains were the result of the falling US dollar. As discussed previously in this newsletter, we believe that the dollar will continue to decline for the foreseeable future. This gives investors in international funds an opportunity to earn both market and currency gains.

Bonds

US Treasury bonds as measured by the 10 year note remain in a range of between 4% and 4.5%. Given the strong economic growth and continued low inflation there remains no news to move Treasury bonds out of their current range. Ultimately, if we are right about a pickup in inflation, Treasury bonds will incur capital losses as interest rates move higher.

High yield corporate bond funds continued to move higher in price during November. Year to date the typical high yield bond fund is up between 13% and 18%, far outpacing the returns on Treasuries. With current income yields of between 7% and 8%, high yield bond funds remain an attractive investment.

"I believe the recipe for happiness to be just enough money to pay the monthly bills you acquire, a little surplus to give you confidence, a little too much work each day, enthusiasm for your work, a substantial share of good health, a couple of real friends and a wife and children to share life's beauty with you."

- J. Kenfield Morley

Happy Holidays!

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