C Y P R E S S

Asset Management, Inc.

MARKET COMMENTARY **July, 2004**

Thus far in 2004 we have seen a tug of war between robust economic fundamentals on the one hand and fears of higher interest rates, higher oil prices and geopolitical instability on the other hand. While it has been a spirited contest, neither the bulls nor the bears have made much progress. As a result, stock market performance has been lackluster despite a strong economic recovery and even stronger growth in corporate profits. In fact, as we write this letter the S&P 500 is at exactly the same price level (1112 as of June 9, 2004) as it began the year. Our market balance sheet, however, remains weighted to the positive side and supports our view that continued strong economic fundamentals and earnings growth will lead the equity markets higher during the second half of the year.

Concerns over fed tightening, $40 crude oil, and the turmoil in Iraq are widely known and discussed in the media and, consequently are largely reflected in current stock prices. Perhaps less widely publicized is the positive momentum in the U.S. economy, a broad global economic expansion that looks both durable and far from mature, and robust 20% plus growth in corporate earnings. Solid economic fundamentals are reflected in 10 consecutive months of jobs growth, strong consumer confidence (which rose in June to its highest level in two years), and surging corporate cash flows and liquidity. Moreover, equity valuations have become increasingly attractive as earnings are up 25% through the first half of the year while stock prices remain essentially unchanged. The S&P 500 currently trades at 17 times 2004 consensus earnings, making stocks far cheaper than bonds where the bellwether 10 year U.S. Treasury Bond yields only 4.5% and trades at 22.2 times earnings (its coupon).

Lending further support to our outlook for a better second half is the presidential election year cycle. Historically the second half of election years has produced significantly better returns than the first half. On average, over the last 17 presidential elections, stocks have performed better by more than 30% in the second half as compared to the first half of that year. Typically, the anticipation of a change in administration is worse than the change itself. Moreover, this time, election year uncertainties and concerns have been further complicated by fears of a terrorist attack that could disrupt our elections. There can be little doubt that what looks to be a close and contentious national election has impacted the market, but as that event comes into closer focus and the uncertainty is resolved, we could well see a decent rally in the market.

To summarize, while stocks have largely marked time during the first half of the year as the market waits for more clarity on some of the issues we have cited – Iraq, the Presidential election, Fed tightening, and the duration of the current economic expansion – your portfolio is well positioned for a better equity market and continued global economic expansion in the second half of 2004.

Market Balance Sheet

POSITIVE	NEUTRAL	NEGATIVE
Interest Rates →		
Economic Growth/Industrial Production	Liquidity (Monetary Growth)	Budget Surplus/Deficit
Fiscal Policy	Dollar	Geopolitical Stability
Economic Growth/Consumer Spending		Energy Prices
Profit Growth/Margins	Free Trade/Protectionism →	
	← Valuation	
Productivity	Inflation →	
Demographics		← Employment

POSITIVE

Interest Rates	Still historically low and very favorable to equity valuations; while the Fed Funds rate is likely to at least double from the current 1.25% over the next 12-18 months, we still see an accommodative Fed. A gradual rise in rates is actually a positive signal confirming an ongoing economic expansion.
Economic Growth	Should remain around 4% for the next few quarters. ➢ Business Confidence and Profits are surging, providing the foundation for the next stage of the recovery: increased business investment and higher employment; and, for shareholders, a period of rapid dividend growth and share repurchase. ➢ We see the economic growth driver shifting from the consumer to capital spending and industrial production, and toward innovation, small business, and more entrepreneurial activity.
Fiscal Policy	Taxes on dividends and capital gains at lowest levels in over 60 years, not in jeopardy of change prior to 2009 unless we have a change in control of Congress.
Productivity	Continues to drive profit growth and keep the U.S. economy the most competitive in the world; will moderate somewhat as economic expansion lengthens and employment picks up.
Demographics	Baby boomers in the sweet spot of wealth and investing cycle, hungry for growth and income.

NEUTRAL

Inflation	Remains low but over the last year we have seen significant increases in the price of global commodities and industrial materials – worth monitoring.
Dollar	The dollar has stabilized during 1H 2004 after a decline of some 20% during 2002-2003. The weaker dollar helps U.S. multinationals, and we should start to see improving trade balances in the second half. We look for the dollar to remain around current levels, supported by higher interest rates.

Liquidity (Monetary Growth)	Money growth back above levels of nominal GDP.
Free Trade/ Protectionism	Muddled state of affairs; a more concerted free trade policy out of both U.S. and Europe would be positive for global growth; "outsourcing" issue a political red herring (remember the U.S. economy is the primary beneficiary of global growth).
Valuation	Reasonable at 17 times estimated 2004 S&P 500 operating earnings, leaves some cushion for a moderate rise in rates.

NEGATIVE

Budget Deficit	A concern at 4% of GDP, would like to see more spending restraint in 2004-2005. Bigger issue is the persistent growth of medical care costs and the long term liability of retirement in our aging society.
Employment	Finally starting to turn up, classic lagging economic indicator.
Energy Prices	Oil and gas prices remain stubbornly high, acting as a drag on the global economy (also hurting our trade deficit); we do find the sector attractive from an investment standpoint.
Geopolitical Stability	Reconstruction of Iraq is proving challenging and costly; terrorism threat will be with us for some time.