

LARGE-CAP CORE GROWTH COMMENTARY LETTER SECOND QUARTER 2004

It's Deadlock and Gridlock Despite a Bumpy Second Quarter

Market Performance

The end of the second quarter heralds the midway point of 2004 and many are describing the stock market as “plodding along, muddling through, and offering meager returns.” Those lethargic metaphors, while they belie the ups and downs of the past quarter, are perfectly fitting when telling of the small changes in stock market indices. However, the low returns we have seen of late are likely the result of self-canceling but important influences during this most recent period.

Witness the economy's solid profit reports and job creation figures, which were offset by fears of slowing economic growth when, for the first time in four years, the long anticipated interest rate increases by the Federal Reserve were finally realized.

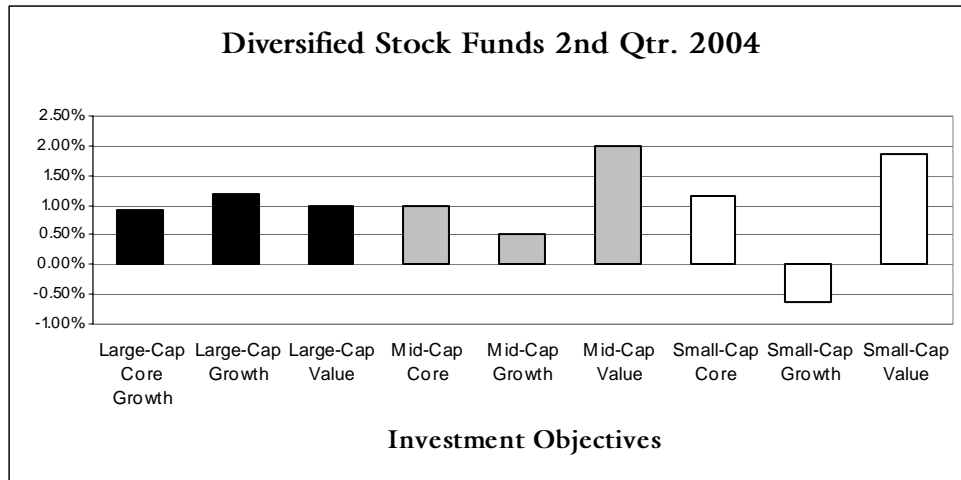
The ever-present push and pull of the upcoming Presidential election, which continues to demonstrate near equal voter support for both candidates, has resulted in neither one demonstrating an upper hand at this point in the race.

Given these factors, it is not surprising that investor optimism was tempered with caution over the future direction of the market during the second quarter. All in all, these developments—while creating some turbulence in the short term—effectively cancelled each other out for the year.

First Quarter Portfolio Performance

With the bulls dozing and the bears hibernating, investment returns, as measured by market capitalization and investment, were closely clustered with few classes outperforming the widely used benchmarks.

The NASDAQ 100 was the best performer in the second quarter, gaining 5.49 percent. The Standard & Poor's 500 Index return was 1.72 percent, while the Dow Jones Industrial Average gained 1.19 percent in the same period. ICM's Large-Cap Core Growth portfolios also posted small gains for the quarter.



Source: *Wall Street Journal*

Portfolio Weightings

Our focus on a strategic long-term investment process and established, quality stock selections continues. We are therefore comfortable with the following sector weightings:

Energy – Over-Weighted

Persistently high oil prices have declined a little in recent weeks, but we are all paying more at the gas station than a year ago. While portfolio energy stocks continue to benefit from those price spikes, it is important to remember we invest in this sector for its long-term prospects, not for short-term gain.

Financial – Under-Weighted

The much-anticipated increase in short-term interest rates has many investors feeling uncertain. However, it is an increase in the 10-year Treasury yield that will be of more interest to the broader reach of stocks and at this point, that long-term rate is holding steady.

Healthcare – Over-Weighted

Despite apprehension over higher prescription drug prices in anticipation of increased benefits to seniors, there has been a steady demand for all healthcare services on the part of an aging population. We anticipate good growth opportunities in this sector.

Utilities – Over-Weighted

Our position remains unchanged relative to this conservative sector, where we believe that high dividend yields and solid growth prospects will provide solid returns over the long-term.

Higher Interest Rates

Apprehension over oil prices, global issues, and the upcoming election were just some of the factors creating an air of uncertainty in the second quarter.

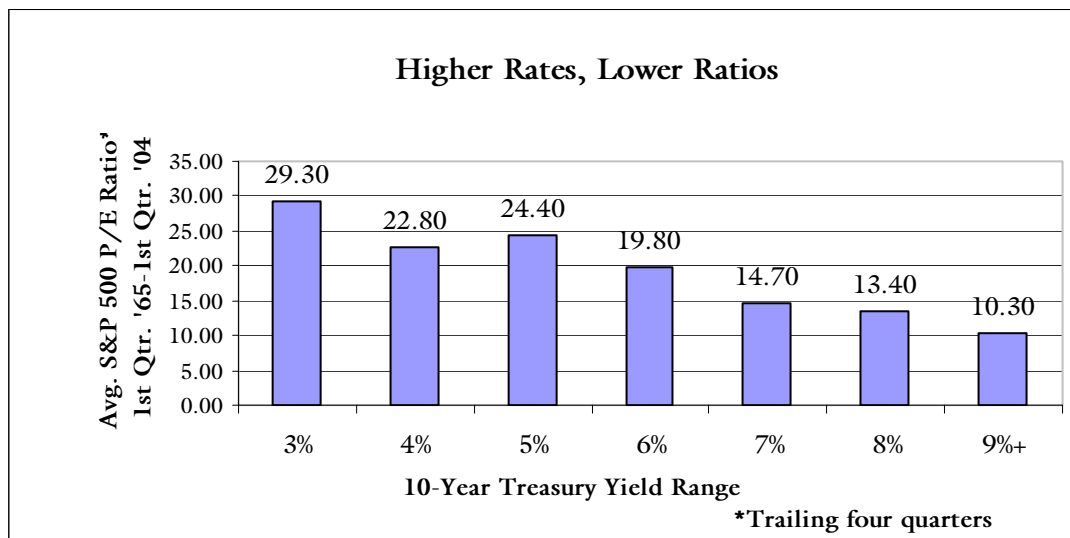
As we mentioned earlier, following a twenty-year decline in interest rates, the Federal Reserve made a much-anticipated move at the end of June and raised the short-term interest rate from 1 percent to 1.25 percent, causing a flurry of concern among investors.

While higher interest rates are usually a sign that the economy is growing stronger, markets reflect the worry that some areas of business will suffer. For example, as interest rates rise banks may refinance fewer mortgages and if consumers decide to “play it safe,” slowing of mortgage re-financing may constrain consumer spending. Additionally, higher interest rates on bonds would improve their attractiveness relative to stocks.

However, the more important effect higher interest rates would have on stocks, all things being equal, is the direct transmission of higher interest rates into lower price /earnings (P/E)* ratios deserved for stocks.

**Price / earnings (P/E) ratios are the standard yardstick by which analysts decide what value for money is received when a share is bought. The P/E ratio divides a company’s current share price—or P—by its earnings per share—or E. Typically, the higher a company’s P/E valuation, the more expensive its shares.*

As shown on the chart, historically, as Treasury yields rise, the price-to-earnings ratio of stocks (the inverse of the earnings yield) generally falls. A comparison of 10-year Treasury yields and the Standard and Poor’s 500-stock index’s earnings yields from March 31, 1965, to March 31, 2004, clearly shows the correlation between the two.



Source: *The New York Times*

In fact, a majority of earnings yields moves (and therefore P/E averages) can be explained by moves in long-term Treasury rates, rather than short-term interest rates, such as we have seen recently. In addition, valuations between large, high-quality shares and small, speculative shares have grown closer, and investors' preferences for the latter, higher-risk stocks have ebbed.

This makes large, high-quality stocks—such as those found in ICM's Large Capitalization Growth portfolio—more desirable. And in an environment where the Federal Reserve may continue to raise rates, attractively valued, large-capitalization stocks are likely to do well.

It is in times such as these that we do well to remember that ours is a long-term strategy, reliant on “staying the course.” Discipline and patience, along with beneficial risk/return ratios result in good performance over the long-term, and are attributable to the style and process we've had in place for some time. We continue to adhere to our core values and the long-term investment processes that are the hallmarks of the ICM Large-Capitalization Core Growth strategy.

We request that clients advise ICM and their financial advisor in the event that there are any changes in their investment objectives, financial situation, or whether they wish to impose or modify restrictions on the management of their account. Please call ICM at (800) 488-4075 or visit our Web site, www.icmasset.com, if you have any questions or need additional information.