

# LARGE-CAP CORE GROWTH COMMENTARY LETTER FOURTH QUARTER 2004

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## *Running Up the Down Escalator*

In science, the term “equilibrium” is defined as the moment when the rate of the forward reaction equals the rate of the reverse reaction. It is rather like running up the down side of a moving escalator. An apt metaphor, we believe, for a glance back at 2004, while steering a steady course forward into the New Year.

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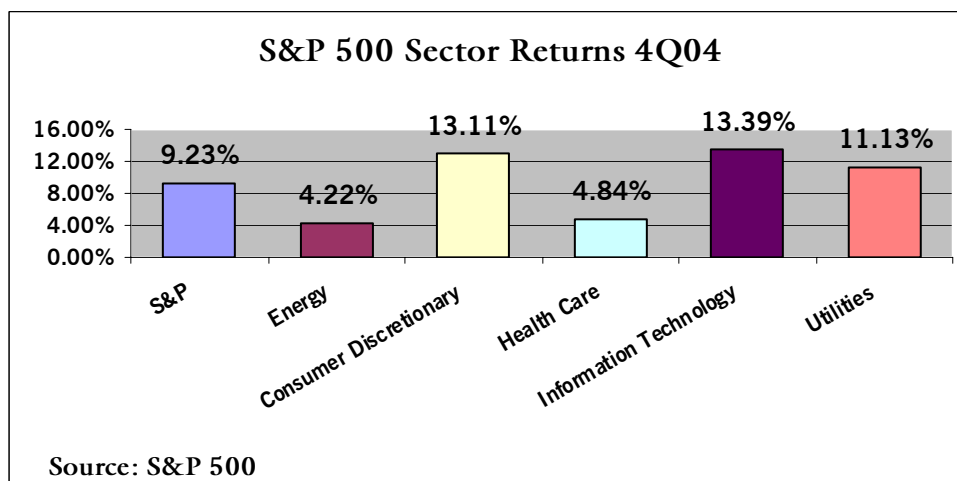
### Market Performance

As 2004 drew to a close, many investors registered profits for both the fourth quarter and the full year. Stocks staged a strong rally at year-end, delivering positive returns for most of the major market indices. With that rally, many investors’ spirits rose. For others, however, after last year’s vigorous recovery from the “bubble bursting” market declines that began in 2000, the gains were disappointing.

Clearly, the stock market’s strong fourth quarter performance saved the day for 2004 as a whole. The S&P 500 Index, one benchmark for ICM's Large-Cap Core Growth portfolio, gained 9.23 percent for the quarter on a purely price change basis and finished up at 10.88 percent for the year. This small difference between the fourth quarter and overall 2004 performance is one example of the trudge up that down escalator.

Other market indices experienced diverse results. It was not until the last week of December that the NASDAQ surpassed its January high, finishing up 8.59 percent for the year. By contrast, the Dow Jones Industrial average achieved an annual price gain of a mere 5.31 percent, far lower than most of the broader-based indices.

The striking and unusually large difference in investment returns between the Dow and the S&P 500 is mirrored in the wide range of returns for differing market sectors as shown in the table below.



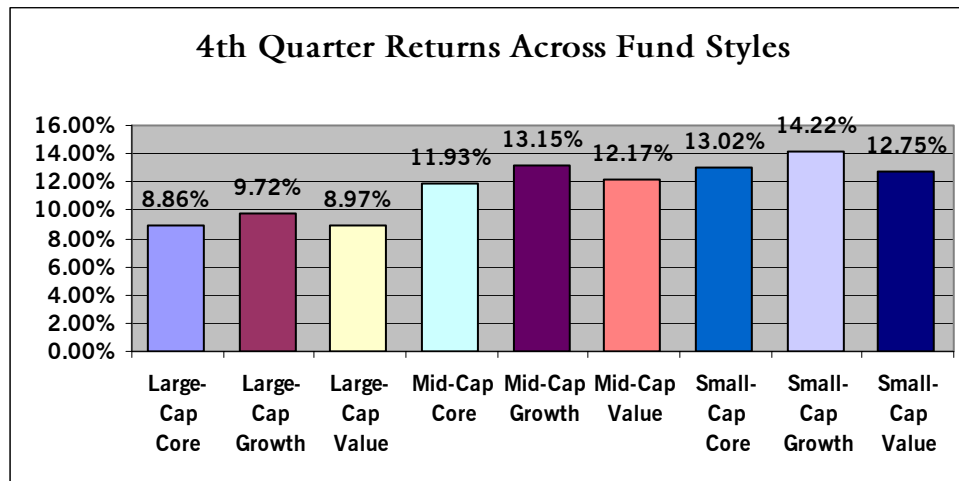
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## Fourth Quarter Performance

Each quarter, ICM's Large-Cap Core Growth commentary letter looks at the performance of U.S. mutual funds. The significance of these returns is in part, reflected in the sheer size of the industry. With more than \$7 trillion in assets, mutual funds comprise 25 percent of today's market, up from just 4 percent in 1984.

As shown by the table below, small-cap growth stocks achieved some of the biggest returns for the fourth quarter and for the year, while large-cap growth equities saw smaller gains. Returns on the stock market for 2004 were not only widely distributed, but they also favored growth stocks over value stocks.

Growth stock investing led to better performance than core or value investing, regardless of market capitalization. International stocks continued to profit from the weak U.S. dollar, particularly in relation to the euro and the pound sterling.



Source: *The Wall Street Journal*

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## 2005 Market Outlook

January is the time when stock market pundits "cast the bones," divining stock market forecasts for the year ahead. Opinion appears evenly divided between the bulls and the bears, the optimists and the pessimists.

Riding the down escalator, pessimists cite the falling dollar, high energy prices, government deficit spending, rising interest rates, and decelerating corporate growth rates as reasons for their less than cheery outlook. However, on the upside, optimists see a healthy economy, low inflation, and positive stock price momentum as catalysts for a rising stock market in 2005.

Between the two camps, we see narrow, yet fertile ground for modest optimism about the stock market's future state. The old saw "it's not a stock market, it's a market of stocks" seems fitting. We believe one key to better future returns is individual stock selection, as contrasted with capitalizing on market trends.

Regardless of the economic environment, we continue to follow a management strategy of identifying high quality companies with strong business fundamentals and holding them for the long-term. Companies with consistent and sustainable earnings growth and quality management teams comprise our Large-Cap Core Growth portfolio. As we move forward into 2005 and beyond, we believe these large, solidly built companies will be more important than ever to our clients' success.

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## Dividend Update

Looking back at our first quarter 2003 market commentary letter, we provided the following outlook:

*Dividends in the 1970s made up 70 percent of the S&P's total return [and] have recently been diminished in importance to a much lower 12 percent of total return. A reduction or elimination of taxes paid by investors on shares of stock could elevate the importance of dividends as a component of total return, which suggests a strategy of searching out companies willing and able to grow dividends faster than other companies in their economic sector or peer group. We feel ICM's Large-Cap Growth portfolios are well positioned to benefit from this strategy on dividend growth.*

Almost two years later, due in large part to the 2003 dividend tax cuts implemented by the Bush Administration, the market did indeed provide those rewards. Dividends on the S&P 500 have risen some \$34 billion. The Cato Institute found that tax cuts helped to reduce a 20-year decline in the number of S&P 500 companies paying dividends and also led to 150 firms initiating dividend payouts. In a separate study, the National Bureau of Economic Research found a "widespread surge in dividend distributions following the tax cut."

There is no doubt that dividends are once again an attractive aspect of investing. Increased corporate earnings have resulted in large excess cash flows for many companies and thus, improved cash dividends. Even if the growth environment slows somewhat, we believe this trend will continue.

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## Summary

ICM's Large-Cap Growth portfolio continued to benefit in 2004 from the stock market's advance in the fourth quarter and the year. As we move forward, we believe the market environment will likely be characterized by a balancing of negative and positive factors, and that the corporate profit growth environment may indeed slow.

We advise investors to temper their expectations with patience. When compared with a very robust 2003, it is easy to see that 2004 delivered more modest gains—what we might

characterize as an “average” year. Investors may do well to expect more “average” years in the future.

We do expect large-cap stocks to generate positive momentum should the market reward companies with large market shares, strong cash flows, stable earnings, and rising dividends. High-quality, low-risk companies such as these continue to be our focus.

ICM’s Large-Cap Core Growth portfolio strategy is reliant on discipline and patience, and benefit from risk-to-return ratios that have resulted in good performance over the long-term. There will always be market-influencing factors that we cannot foresee, which makes our patient, disciplined approach to investing even more important.

Happy New Year, and here’s to a peaceful, prosperous 2005.

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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](http://www.icmasset.com), if you have any questions or need additional information.

