GeoVest Advisors, Inc

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On Course

A quarterly Newsletter from GeoVest Advisors

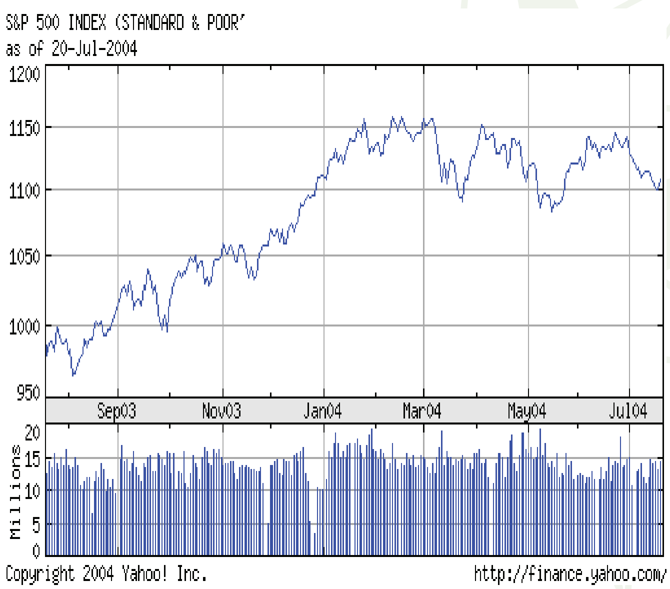
Inside this issue:

Special points of interest:

- The slowing of the economy matches our forecasts for 2004.
- Valuations are too high for the level of economic growth we are experiencing.
- After a sharp rise in interest rates, bonds are attractive.
- A loss of manufacturing jobs is detrimental to the economy.

The Hollywood Recovery III

We're sticking with this theme, because it's working. Six months ago when I wrote the first installment of this theme, the economy appeared to be poised to grow aggressively in 2004 with the equity markets ready to follow. But now, we're starting to see the first signs that the recent economic strength may have been no more than a flare up in a structurally weak environment. The stock market, which anticipates the future, is virtually flat for the year. Notice the chart I've provided, the market is roughly where it began the year.



Some would call our prediction prescient, but I would rather describe it as hard work. We try to anticipate changes in the economy instead of accepting third party forecasts. We believe that by working to understand the drivers of the global economy, we'll be able to identify opportunities and risks before our competitors, which gives us time to develop the right investment strategies to benefit from those changes.

Our successes in forecasting the economy and the market have not led to big gains in your portfolios over the past six months but I urge you to be patient. True stock investing involves identifying mispriced securities in the market, but right now, that mispricing has manifested itself as being overpriced which means that we must be patient until some opportunities are created.

To Be or Not to Be Aggressive

Picture yourself on a winding road that you've never traveled before. Would you even consider trying to make the drive going 100 miles per hour? What's the benefit of arriving at your goal a little sooner compared to the risk of going off the road? Investing is analogous to driving down an unknown road. You want to make the best progress while maintaining control of your vehicle. Aggressive driving, like aggressive investing, often results in some serious setbacks.

At GeoVest, we're trying to balance your portfolio's need for speed with the kind of prudent risk management that keeps you on track to achieve your investing goals. Our economic research is designed to give us a clearer understanding of what lies ahead on the road, so we can make the proper adjustments to the rate of growth in your portfolio that rewards you for the risks you assume.

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Right now, we are taking a conservative posture in all of our portfolios because we believe that the risks to the global economy and equity markets are too high to justify an aggressive stance. As I mentioned in our last newsletter, the main drivers of global economic growth, US consumer spending and Chinese manufacturing investment, are both showing signs of slowing down. If you add high energy prices, global martial conflict, terrorism, high equity prices, and massive levels of debt to this equation, it is easy to justify our current investment policy.

But don't get the wrong idea about us.

But don't get the wrong idea about us. We can and will get aggressive when the investment opportunities warrant it. In fact, we are currently generating some terrific investment ideas for future purchases but not at these levels and not until some of the global risks are priced into the market.

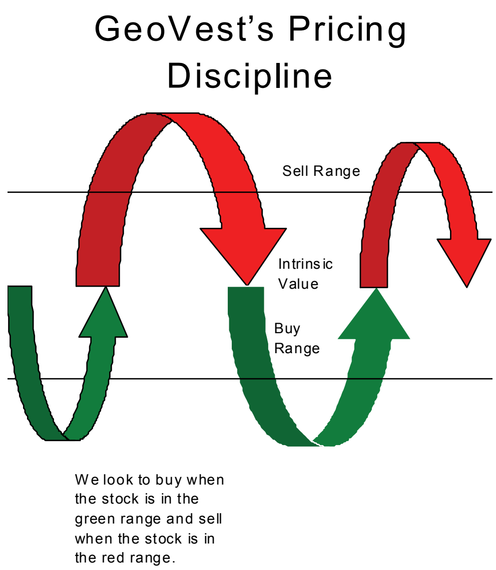
Valuations

High valuations are a risk to the equity markets. Valuations reached this level because most investors assumed that we would experience a normal cyclical recovery in the economy, which is usually accompanied by a strong improvement in corporate earnings. While recent earnings reports have been largely positive, they have not been good enough to justify the very high stock prices currently prevailing in the market.

This is the main reason why we have done comparatively little buying over the past couple of months. If you consider our past discussions regarding being compensated for risk, it should be clear that we are patiently waiting for lower prices in some quality companies before we commit your capital. To do otherwise, in our view, would be irresponsible.

Investors spend a lot of time talking about valuations, but most of this talk centers around justifying overpaying for equities. Maybe I'm being simplistic, but my concept of getting a bargain entails paying a dollar for something that is really worth $1.40. The same goes for stocks. I look for companies that have the ability to generate more in earnings than is currently discounted

by its stock price. Notice the chart I've provided for you.
We look to buy each stock when it is in



the green range, and sell it when it gets into the red range.

Given the high level of both systemic and company specific risk that is inherent in the market today, we are looking for companies that are deeper in the green range than normal. Unfortunately, we also have a high degree of valuation risk inherent in the market today, which means that there are more companies in the red range than is normal. This explains why we have been selling more equities than we are currently purchasing. This situation will eventually change, and when it does, we will be able to buy stocks that compensate you for the risk you are assuming.

The Bond Market

This has been an extraordinarily challenging period for forecasting interest rates. In our last newsletter, I mentioned how we were shortening maturities in our bond portfolios because we expected higher interest rates. Well it happened. Interest rates moved higher and our bond portfolios lost less than they would have otherwise.

It doesn't sound like a great victory but it was. Preserving capital, when the market falls, is as important as earning strong returns, when the market rises. This is because the art of investing is to earn a high return over the long term while incurring the least amount of risk. By preserving capital, we won't have to invest as aggressively in the future to reach your goals, which, ultimately increases the probability that you reach your goals.

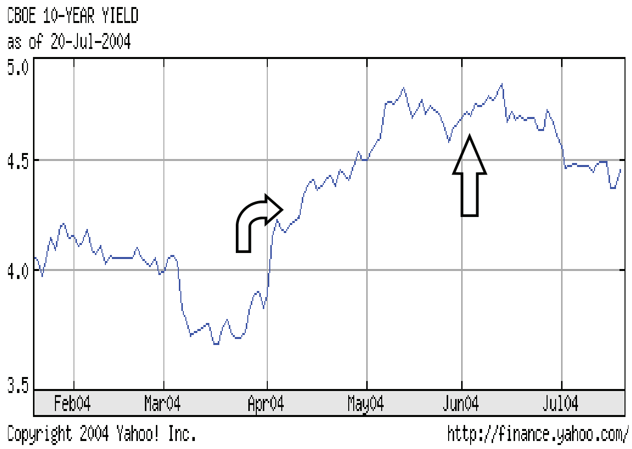
After selling a portion of our portfolio in April, we've gotten back into the market by buying Treasuries and high quality municipals. The reason is that based on our analysis of recent employment trends, we've concluded that the US economy is not adding as many jobs as the official statistics would suggest. If job growth is slow, economic growth will be slow, which should be positive for interest rates.

These recent purchases don't change my opinion that the great bond bull market, which started in 1982, is now over, but the rapid rise in interest rates that we experienced in April and May was too much, too soon, in our opinion.

" Preserving capital, when the market falls, is as important as earning strong returns, when the market rises. "

This means that we believe we can make some nice gains over the next year with the bonds we purchased, but that we doubt that we will hold them until maturity in seven years.

Notice the chart of the 10 year US Treasury bond that I've provided below.



The first arrow is a rough approximation of the level of interest rates when we made our first sales, while the second arrow provides a rough estimate of when we started buying again.

Employment

As I alluded to earlier, weakness in employment is the biggest problem that I see with our economy today. In fact, it is one of the two primary factors leading to my conclusion that we are experiencing a "Hollywood Recovery", with the other factor being our unhealthy reliance on debt to fund our lifestyles.

"As I alluded to earlier, weakness in employment is the biggest problem that I see with our economy today. "

Economists can speculate about the causes and effects of our jobless recovery, but I am certain that it is a function of our trade policies with Asia. By this statement, I don't even want to suggest protectionism in any form. Instead, I view the strong dollar policy which allows nations like China, South Korea, and Japan to "peg" their currencies to the dollar despite the fact that all three have overwhelming trade surpluses with the United States, as the primary factor in our weak employment situation.

To illustrate further, over 38,000 manufacturing plants have been closed in this country since 1998 and over 2.5 million manufacturing jobs have been lost over that time frame. These jobs have largely been shifted to Asia. Sure, we've added some service jobs over the past six months, but service jobs will not close our trade gap.

The GeoVest Approach

At GeoVest Advisors, we've committed ourselves to constant improvement. The changes to this newsletter are just one example of the steps we've taken to provide better service to our clients. If you have any thoughts or suggestions on how we can do a better job, we would like to hear from you.

- Philip M. Byrne, CFA