



LIGHTHOUSE BEACON

A Guide in the 21st Century

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Focus on Your Goals and Take Advantage of Opportunities

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President

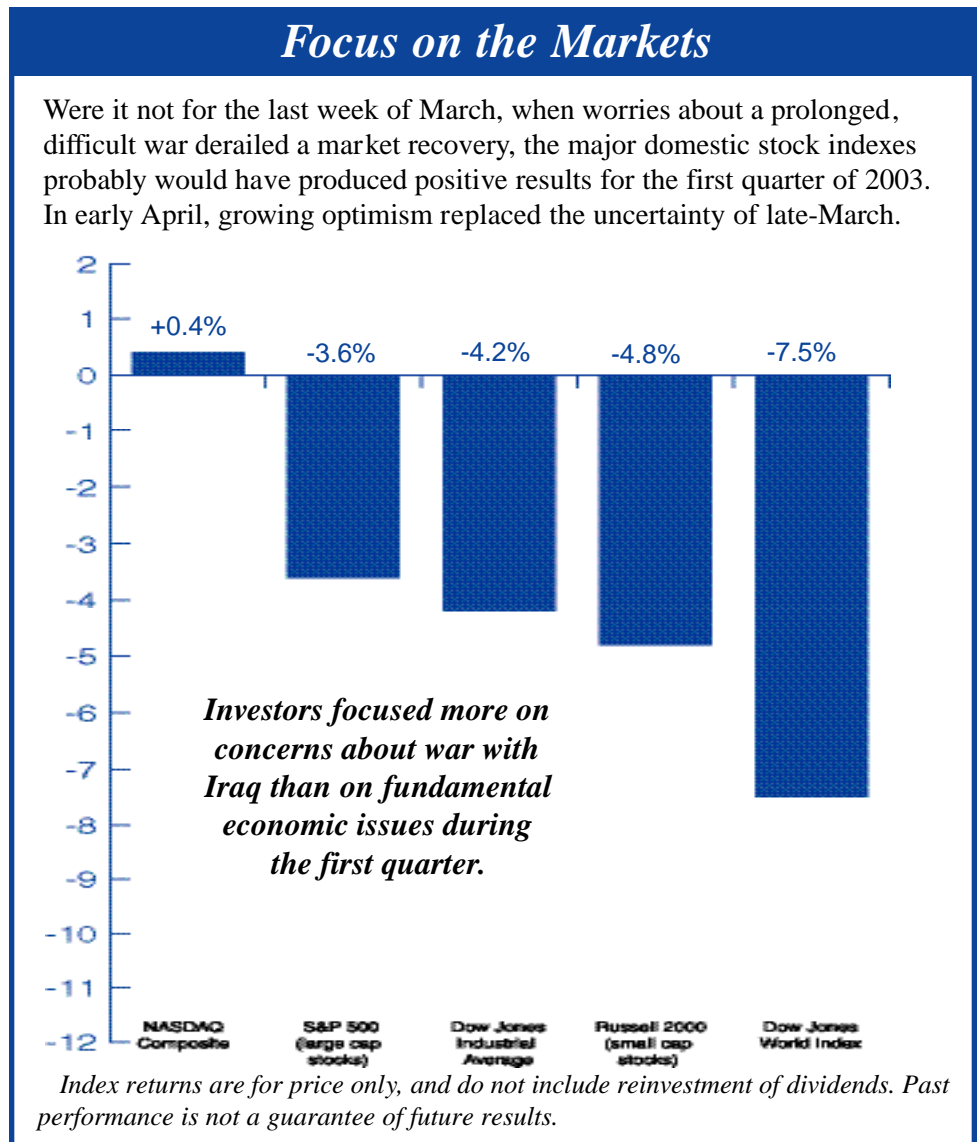
Lighthouse Asset Management, LLC

Sound investing always requires preparing for the situation that is unfolding rather than trying to latch onto a trend that may already have passed.

At the outset of 2003, many of the elements necessary for an economic and market recovery appeared to be in place. Unfortunately, external worries –mostly created by the coming war with Iraq—postponed the recovery. Investors and business leaders were distracted by the uncertainties relating to the potential effects of the war, including the rising price of oil, the possibility of terrorist counterattacks, and concerns about how long the war would last and how much it would eventually cost. As we discovered when the war actually started in mid-March and hopes rose that the fighting would be over relatively quickly, the stock market was prepared to climb at the first sign that the situation was being clarified. However, those hopes fell in the final week of March amid fears that the war might take much longer than anticipated. Anxiety returned and the equity markets corrected sharply.

In the end, the major market averages fell by about 4% during the first three months of 2003 amid all the jitters about war, terrorism, energy prices and declining confidence of consumers and corporate executives.

Now, at this writing at the start of the second quarter, all those factors are reversing. The war appears to be nearing its end quickly and successfully, terrorist reprisals



have not appeared, energy prices are falling, stock prices are recovering and consumer and business confidence appear to be rising. We were starting to see many of these same trends at the start of 2003, before war concerns took over the investor psyche.

One of the early signs of recovery is a rebound in consumer sales, which were dismal during the first quarter. Now, consumer spending is gaining again, possibly as individuals see energy prices start to fall from their peaks of the first

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The Lighthouse Beacon is a newsletter from Lighthouse Asset Management LLC, a registered investment advisor offering portfolio management services to individuals, trusts, retirement plans and small institutions.

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quarter. President Bush's standing in the public's eyes is one of the effects of the war that has positive potential implications for the economy and the stock market in the months ahead. Given his growing popularity, the President is free to turn his attention to domestic economic issues. He now can go to Congress in a much stronger political position to argue for passage of his tax incentives.

As investors stop worrying about Iraq and the effects of the war, they can start refocusing on the economy and corporate profit growth. Despite the difficult environment of the first quarter, some of the earnings reports of industry-leading companies such as IBM, Citigroup, Fannie Mae and Johnson & Johnson are encouraging. This is a very different environment from the one we saw 12 months ago, when corporation after corporation reported dismal earnings.

The economy is not likely to surge in the short run, but a change in direction appears to be taking place. The forces behind this redirection have been present for several months. They include low inflation and low interest rates which have

Lighthouse Highlights

Selected Lighthouse Portfolio Holdings First Quarter 2003 Performance

<u>Company</u>	<u>Sector</u>	<u>Price Change*</u>
Starbucks	Consumer	+26.4%
Amgen	Healthcare	+19.1%
EMC	Technology	+18.3%
Texas Instruments	Technology	+10.1%
GE	Capital Goods	+4.7%
<hr/>		
S&P 500		-3.6%
NASDAQ		+0.4%

** Price change only. Neither company nor index returns include any dividends. Performance of individual stock holdings in portfolios managed by Lighthouse Asset Management are not intended to indicate future results.*

led to heavy mortgage refinancing that has put more dollars in consumers' pockets as their monthly housing costs decline. Further, business investment appears to have bottomed after several negative years. The impact of these forces has been building.

It is time to prepare for a new environment. Investors need to make sure their

portfolios are positioned for the next six months and year, not the last six months or year.

In hindsight, three years ago would have been a terrible time to seize on booming stock prices and increase your equity position. In those three years, bonds produced positive returns while outperforming equities. But now, bonds and fixed income funds appear to be in the same position that stocks and equity funds were three years ago. To be sure, fixed income may be part of a long-term asset allocation strategy. But investors should not overweight bonds now in an attempt to latch onto the trend of the past three years. As the economy starts to improve, and the stock market begins to recover, interest rates are more likely to rise than to decrease, weakening the prices of bonds.

In fact, intermediate- and longer-term Treasury yields have already started to creep up, which has had a negative impact on the values of existing bonds.

Investors should be preparing for a new environment by making sure that their portfolios include healthy representations of the stocks of solid, industry-leading companies with strong fundamentals and positive growth prospects. In the long run, improving corporate earnings always lead to improving stock market performance.

Focus on your goals and prepare for the reality that is unfolding.

Lighthouse Guides

Q: Is the reappearance of large deficits in the federal budget cause for concern about the economy and the stock market?

A: The projected deficit numbers under discussion are far from the levels at which we should be concerned. The key figure to look at is the size of the deficit in relation to the nation's gross domestic product (GDP). At its worst levels, the deficit rose to be about 6% of GDP in the 1980s, when we had recession, hyper inflation and rising oil prices. Our current problems are far less serious, and the highest deficit figure that has been mentioned is \$300 billion, which would be less than 3% of the current GDP of more than \$10 trillion. This is about average for the last 50 years and is a figure with which the nation can deal, particularly with an expanding economy.

Remember that the slumping economy and stock market of the past three years are major reasons that the federal government is collecting less revenue than earlier projected. The weak economy has meant lower personal and corporate income tax collections. And, as the stock market has fallen, individuals have had fewer capital gains on which to pay taxes. Look for both those trends to reverse themselves as the economy and the stock market recover.

We are a long way from the point at which we should be alarmed about federal deficits who rely upon them.

Lighthouse Guides is a regular column answering typical questions posed by clients discussing their portfolios.