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Monthly Update

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Bear-like market

At the beginning of the summer the markets were flat for the year and cyclical. But, since the end of June there has been no recovery; the markets now seem to be in free fall. For example, the Nasdaq is down 14% since the end of June. There are many well-known negative factors weighing on the markets. These include: high oil prices of \$46/barrel, a possible Kerry presidential win, lower future earnings projections, slowing U.S. growth rate to 2.5%, slowing jobs growth and off shoring of jobs, terrorist attack warnings, world wide crude oil disruption fears, weak technology forward guidance, soaring trade deficit of \$55.8 billion, higher Fed funds rates, and lower equity prices. Well known positive factors include: great earnings growth for the last 12 months, increasing dividend payouts, 4th presidential year that is usually good for the markets, strong Dell profits, and the I/B/E/S Fed model indicating that the market is 30% undervalued (using 12 month forward consensus estimates of \$69.69 for the S&P500 earnings and the current 10 year Treasury note yield). Negative market psychology (read the short selling hedge funds) is prevailing. We characterize this market as “bear-like”. Our timing models, summarized on this page and graphed on page 2, are bearish for the S&P500 and the NDX; we are bearish on bond yields also. We are slightly bullish on gold.

Our style box analysis, see page 2, indicates that none of the styles are any good. Only in a relative sense, large cap value is the strongest investment, followed by small cap value, then large cap growth, and finally large cap value. Leading funds include short funds, bond funds, and utilities. The U.S. dollar is weak due to the massive U.S. trade deficit that effectively shorts the dollar by a like amount. Regarding world indexes, none are strong.

Because the markets can turn quickly, be ready. May the market be with you. (August 13, 2004)