

Fast Facts:

Economy -

Just how far the Fed has come: Prime rate is currently 5.50% - one year ago it was 4.00%.

Commodities -

Black Gold: According to statistics compiled by the Department of Energy, the cost for one barrel of oil from an OPEC producing country was \$39.70 in January of 2005. Just 12 months prior, in January 2004, the same barrel of oil cost \$28.22.

Motor gasoline

constitutes about half of total volume of products produced from crude oil and its price generally follows the same pricing pattern as crude oil prices.

Estate-Planning -

Part of sound estate planning involves having a will: Yet 57% of Americans have not created one - should you die intestate - the court will decide the disposition of your personal belongings and property.

Retirement -

Piggy Bank: 45.2 million Americans currently own an Individual Retirement Account valued at \$2.6 trillion dollars. In 2003 41% of all U.S. households report owning at least one IRA.

Demographics -

Baby Boomers Arrive: By 2020 the number of Americans age 55 and older is expected to increase 62% totaling 95 million people.

The President's Letter

Fred Hayek, President/Founder



Greetings!
This year marks the "re-birth" of our popular newsletter the *Value Investment Review*, designed to give clients and

friends insight into our thinking about the economy, the markets, and our investment philosophy used to analyze and manage securities in a dynamic and confusing investment environment. 2005 also marks our 20th year in business as a fee only, independent security analysis - portfolio management firm.

Lots of things have changed over the past twenty years and the rate of change is accelerating. The only constant in this interconnected world we live in is human nature and our response to the basic elements that drive markets and influence outcomes - greed and fear.

Roughly twenty years ago the greatest bull market in history emerged, phoenix-like, from the ashes of stagflation. On the heels of a 14-year secular bear market it soared to maturity and finally crashed and burned in spectacular fashion in 2000. That was then, this is now. Then, interest rates were sky high and stock market valuations were at rock bottom lows. Japan and Russia were on the rise, and America, in F.A. Hayek's words, "was on the road to serfdom." If our economy and markets soar again it will depend on our collective courage to address the structural problems embedded in this complex and rapidly changing economy.

The risks are huge, the challenges great, but it has never been wise to bet against the American spirit or the markets that reflect it.

Market Insight

Eric Kallen, Managing Director



As we wrap-up the earnings release season, there continues to be confusion about how the markets react to a company's earnings release. Frequently you'll see a company's stock price drop after announcing 'record earnings' or 'strong growth,' which to most

seems rather counterintuitive. Understanding how the market views such announcements helps clarify stock price movement in light of these seeming contradictions.

First and most importantly, no one can predict the direction of the market. For as long as the market has been in existence, man has tried to figure out a way to predict its future path, to no avail. The market, described by Stephen Schurr of *The Financial Times*, is amoral and

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Market Insight

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The market is amoral and apolitical, an aggregation of the fear and greed of its millions of participants.

- Stephen Schurr
The Financial Times

apolitical, an aggregation of the fear and greed of its millions of participants. Yet, despite the futility of individuals trying to look into the future, that is exactly what the market does - it moves in anticipation of future events. Even with the Internet and instant worldwide communication, information alone will not assure you of market success.

Investors and analysts alike attempt to answer important questions about some critical aspect of a company before taking a position, all in an attempt to divine the future. Examples of such questions being asked: "What will earnings growth be next year?" "How much demand will there be for their services in the future?" "Will the company be acquired for a much higher price in the future?"

It's important to note that the higher degree of speculation surrounding future events leads to greater stock price risk if those goals are not met. This is exactly what happened during the Internet

bubble. Investors began to speculate and invest based on events 10 and 20 years in the future, and when it looked like these forecasts were overly optimistic the wheels fell off the cart.

Which leads us to the final point – the market does not like surprises. A major focus of many corporations these days is working with analysts and investors to ensure that the current expectations for the company are obtainable. Failure to achieve these goals can have very negative implications for a company's stock price since the market typically overreacts to bad news – anticipating that there is more bad news to come or that things are worse than they really are.

Today it's not good enough to just meet past expectations. The market wants to be reassured that prospects for the future are clearly understood. Without that reassurance there can be dire implications for a company's stock price.

Client Dispatches

Joe Vosicky, V.P. Client Services

A financial custodian keeps custody of stock certificates and other assets.

In a world filled with a plethora of financial custodians, only a select few meet our definition of "trusted partner."

When Hayek Kallen Investment Management evaluates financial custodians to hold client assets, we view them through a lens that looks for the following characteristics:

- Financial strength
- Longevity in serving as a financial custodian
- Concise, easy to understand monthly reporting
- Low cost
- Exceptional levels of client service

In the wake of the Patriot Act, financial custodians are tasked with significant mandates regarding client account documentation and are subject to ongoing oversight by various government agencies.

These responsibilities are in addition to their basic role: to guard, safe-keep and protect the assets placed in their care. Existing as a trusted financial custodian in today's operating environment, while delivering high-levels of client satisfaction and support, is job one.

Custodians of choice at Hayek Kallen Investment Management are Charles Schwab and TD Waterhouse. Both firm's possess the above stated criteria and deliver a powerful combination of value and service.



Value Investment Notes

From the desk of **Fred Hayek**

The Cycle of Market Emotions

When a novice investor discovers he can “make money” in the stock market he buys on hope, holds with love, and usually sells only after a nasty divorce. Once the divorce takes place, one is more cautious about getting into another relationship and hopefully becomes what Ben Graham coined the “intelligent investor.” The market is more about a cycle of emotions than rational thought. We are all guessers to one extent or another and some say that all you find in a balance sheet or research report is what you read into it. The stock selection process, that should be more science than art, often turns out to be an emotional roller coaster of greed and fear.

The market is mostly a matter of psychology and emotion

- L.L.B. ANGAS, 1947

The last great buying opportunity, the point of “Maximum Opportunity” was in the depths of the 1973 - 1982 “secular” bear market, almost a quarter century ago. Those were the worst of times, where few could conceive of the Dow ever reaching (it seems silly now) 1000 again. Interest rates were sky high and market valuations dirt cheap. Despondency and depression were so great that Barron’s, Alan Abelson wrote: “Window ledge space in Wall Street, we understand, is at a premium,” and “Next to the obituary column, the saddest section of any newspaper these days are the

stock tables.” The Dow bottomed in August, 1982 - down a stunning 25% from “another” peak of 1000 just a few years earlier. What many found painful to remember was that the DOW had gone nowhere for 9 years. It hit a “former” high of 1051 in January, 1973. The damage done to the Dow understated the carnage inflicted on the broad market. The NYSE had lost 75% of its value over that nine year slide and the AMEX an unbelievable 88%. At rock bottom again, the Dow had a trailing price to earnings ratio of about 6, (it is 3 times that now) and a dividend yield of 6% (it is 1/3rd of that now). Some stocks did very well in that 9-year bear market; most didn’t.

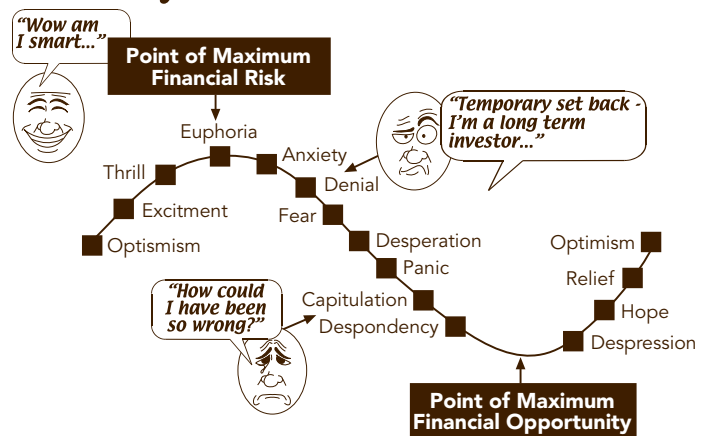
Now that the stock market has had two years of gains can we feel comfortable buying with both hands? Probably not. Stock valuations and energy prices are still high and there is way too much optimism and excitement about owning stocks. Many people are “still trying to catch up” – translated, willing to take excessive risk. Interest rates are on the rise, not falling, and there are several structural problems, like deficits, a weak dollar, zero savings and social security reform that need attention in a “politics as usual” environment. There are reasons for hope though: monetary and fiscal policies are still simulative. Productivity and America’s technology lead are advancing and democracy is budding in many places thought hopeless just a few years ago.

The seeds for the current bear market were sown where they always are – in the speculative “blow-off” stage of the preceding bull market that steamrolled through

excitement, thrill and euphoria. Only after the first leg down in year 2000 did anxiety and denial surface. By 2002 fear, depression and some panic had set in. Many have become desperate, and some have capitulated, which is the natural, emotional, predictable response.

The final and longest chapter is despondency when almost everyone believes things will never get better. For the next bull market to birth from the ashes, professionals have to become despondent too, and maybe they have? The bull market will commence when the pros “swear off” stocks and institu-

The Cycle of Market Emotions



tions rebalance their portfolios with “over weighted” bond positions. The capital that was wrongly allocated in the last half of the 90’s will have been written off and the system “flushed.”

The pieces are falling into place. Major market benchmarks have posted negative annualized returns for five years and we have “poster boys” of the bubble like Ken Lay of Enron, Bernie Ebbers and Worldcom. Vulture-like, the media will feed and regurgitate them flying off screeching a message far and wide, “there are big risks in owning stocks, even the good ones.” Such a message sours people’s appetite for stocks - and that’s a good thing because the birth of the next bull market can only come from the carcass of an old bear.

Just A Reminder

Should you or your tax professional need a copy of your realized gains/losses, expense or income reports, let us know. We'll be pleased to mail or fax them as directed.

When was the last time you reviewed changes to IRS tax law or studied IRA contribution limits?

In reviewing the above subjects we came across one area, IRA Contribution Limits, that deserves a closer look. With the April 15th tax filing deadline fast approaching take a minute to review the following table.

IRA Contribution Limits

Year	Age 49 & Below	Age 50 & Above
2002-2004	\$3,000	\$3,500
2005	\$4,000	\$4,500
2006-2007	\$4,000	\$5,000
2008	\$5,000	\$6,000

Let us know if you have questions. Should you need to make a contribution remember that your deposit will need to be posted into your account no later than April 15th to qualify for the 2004 tax year.

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Both interesting and useful, these financial calculators can help

you get a fast handle on nagging questions such as leasing verses buying, early mortgage payoff and refinancing or answers to the ever popular auto rebate or low interest financing decision. Check them out @ www.HayekKallen.com



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