BERKELEY
CAPITAL MANAGEMENT LLC

Berkeley Capital Management LLC
Dividend Equity
3rd Quarter 2004 Market Commentary

Concerns about the pace of economic growth and oil prices close to $50 combined to put pressure on stocks in the third quarter, which means the market has made little progress through the first nine months of the year. While the Dow Jones average is down for the year-to-date, the NASDAQ is down even more. Our value stocks have done a little better, but there is no clear leadership by our larger, higher quality companies.

While consumer and business spending appear to have slowed only moderately, there are numerous signs that employment growth and earnings growth are also slowing and that business inventories are building, presumably at least in part involuntarily. As a result, perhaps, we have virtually every economic indicator giving weaker readings as we move into the fourth quarter: the purchasing manager survey, non-farm payrolls, industrial production, capacity utilization rates, producer prices, retail sales and durable goods orders are all softer along with consumer confidence and the stock market.

Importantly, inflation and interest rates are also moving lower, in part as a result of the indicators noted above. Consumer inflation in the third quarter was likely less than one-half the rate of the second quarter and as a result, nominal GDP will slow from the prior quarter, even if building of inventories causes real GDP to rise slightly from the second quarter pace.

To the surprise of virtually all observers, interest rates have moved lower this year despite our being in the third year of an economic expansion. Both the stock and the bond markets seem to be telling us that growth is slowing, although both are consistent with continued economic expansion, albeit at a slower rate.

The Federal Reserve has continued its "measured" pace of rate increases with another widely anticipated in November. Recent comments by Fed officials, however, reveal a recognition that neither employment nor final demand are growing as rapidly as anticipated earlier this year. We would expect the yield curve to continue to flatten; that is, longer term rates to move little despite a likely rise in short rates to 2% by year end. We have rolled out the bonds we own in balanced accounts to move closer to the duration of our index.

We expect earnings growth to slow modestly over the balance of the year and into 2005. The stock market currently sells at about 16 times earnings for the next twelve months, about in line with historic norms. Because interest rates and inflation remain low, we expect that stocks could rise 8% to 12% over the next twelve months, even with slower earnings growth. Risks to this forecast probably remain more weighted to exogenous factors, such as terrorism and Iraq, than to our economy.

We remain positioned in larger companies with more stable earnings. Several consumer staples companies preannounced third quarter earnings shortfalls, modest in most cases, but enough to cause the sector to join technology as the weakest in the quarter. The strongest sectors were energy, not surprisingly, and utilities, both electric and telecoms.

After lagging in July and through the August 12 market low, higher beta shares strongly outperformed for the balance of the third quarter. We expect the market to move back toward larger, lower risk companies this quarter and in 2005 due not only to their more favorable valuation but also in anticipation of slower earnings growth in 2005. History has shown that lower beta, dividend paying stocks tend to outperform after earnings growth rates have peaked for a cycle.