

2003 has been a year of highs and lows both for the world community and the U.S. economy. A few of the top headlines include the start of the Iraq war, the increase in gold prices, scandals that afflicted the mutual fund and banking industries, accounting scandals, and mad cow disease. The Iraq war and gold prices had some effect on the economy, but some of the accounting scandals and Mad Cow Disease had a relatively mild effect on the markets. The mutual fund scandal was one of the biggest news items of the year. So much so that we asked representatives from the three major fund families we work with to send a representative to Walla Walla to answer questions related to our exposure. We are satisfied that presently our exposure is minor.

In the world of investing, the market started to move in a mostly positive direction in July of 2003. This has led to large gains in all asset classes including large "Blue Chip" companies, mid sized companies and small cap companies. In fact the Nasdaq, which is comprised mainly of small to mid sized technology stocks, is up over 50% for 2003. Large companies, which are represented by the Standard and Poors 500, can crow about a 28% increase in value for the year.

The market's climb has also been mirrored by overall productivity gains of 9.2% for the third quarter. In simple terms if it used to take 100 hours to make a car, because of productivity gains it now only takes 91.8 hours to make the same car. This is good and bad news for the economy. As you can imagine, if it takes fewer hours to make a car, the car industry becomes more profitable from lowered costs. On the downside, fewer hours translates into fewer jobs which leads to a

stubborn unemployment rate that doesn't seem to fall. So, what's the answer? As long as the U.S. economy expands faster than productivity growth, it will force businesses to hire more workers.

Will this happen? The Federal Reserve would like it to happen. What you have been hearing about is the lowering of the dollar's value as compared to the Euro and the Japanese Yen. Although it sounds terrible, (we never want to hear about something falling in value), it is actually a boon for U.S. industry and should spur on the economy.

Imagine if one Euro bought \$1 U.S. If you bought something like a box of candy that cost 1 Euro in Germany it would cost \$1 in the U.S. Now imagine that the Euro increased in value and 1 Euro now buys \$1.25. Now that same box of candy from Germany which still only costs 1 Euro in Germany now costs \$1.25 in the U.S. This is what we have seen in the increase in the Euro's value as compared to the Dollar this year. European goods, from a Mercedes to a bottle of wine, will now cost more in the U.S. This allows U.S. producers to have a price advantage. In terms my Mom will understand, think of it as a sale at your local department store. There is a 25% sale on U.S. produced goods as com-

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pared to their Japanese and European counterparts. The Europeans seem to take this with stride; the Japanese on the other hand are trying to intervene to prop up the yen.

The downside to a lowering dollar is inflation. This is where the Federal Reserve will toe the line. If inflation starts to increase because goods start to increase in price, the Federal Reserve will step in to increase the value of the Dollar to control inflation. Think of it this way, if there is a sale going on at 25% off and the crowd becomes unruly, the shop owner will lower the sale discounts to control the crowd. That's what the Fed will do once inflation starts to take hold.

Now let's put it all together, as the U.S. economy starts to heat up and U.S. manufacturers hire more employees, unemployment will go down and people will have more money to buy goods. As the Dollar continues to be weak against the Euro, U.S. consumers and businesses will likely buy U.S. produced goods which will be cheaper than the Japanese and European counterparts. As unemployment continues to decline, more people will be able to buy goods and prices typically increase. Increasing prices usually precede inflation which will likely spur the Federal Reserve to increase interest rates.

I don't like to take out my divining rod, but the scenario outlined above is where I predict the U.S. economy will go for 2004 and beyond. Because of

this, we have positioned our approved list of stocks towards heavy industry and companies that cater to the business community. The business community has had three long years of retraction and downsizing. They have put off major acquisitions, and sooner or



FACE TO FACE

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A recent advertisement campaign - to read more about the ad, see page four.

later they will need to revamp factories and offices. Companies like Dell Computer and Eaton will profit from this increased business activity.

One other factor to consider is China. For most of the last century China had shut itself off from the Western world once Mao Tse-Tung took over the

reins of power in the late 1940s. We saw a thawing of relationships when Nixon visited the Great Wall and again when Reagan visited the Chinese Premier. After these initial political overtures, many companies started eyeing China as a vast market for their goods. One of the largest was Schwinn Bikes. Most of those companies had mediocre to disappointing profit margins once they arrived. A lot of companies forgot a tried and true maxim: customers have to have money to purchase a good! Although China has over 1.3 billion people (that's over 4 times the population of the U.S.), the average annual income for a Chinese farmer is \$300 per year.

What businesses found out very quickly is that producing goods in China for their own markets is much more profitable. This production accounts for most of the business investment in China for the last five years. What this takes is an enormous amount of resources. Imagine a factory: it takes raw steel, plastics, and electronic chips on one end to produce a computer on the other end. China is a vast factory that needs the raw materials to produce goods that will be exported to the U.S., Europe and the World. That has put pressure on metal suppliers, plastic manufacturers and energy suppliers to produce larger quantities to fuel this insatiable appetite. Until this need is satisfied, we should see producers of these raw materials increase in value.

Pierre Trudeau, former Prime Minister of Canada, once said, "Being a close neighbor to the United States is like sleeping with an elephant. No matter how nice your relationship with the elephant, you feel every twitch and movement he makes." I venture to say that China may be the next global elephant. Their manufacturing capacity will soon make it a major player in the industrialized world.

The world is changing and so is the Bank. I have assumed the role of Senior Portfolio Manager and have hired a new Portfolio Manager to assist in investing duties. The new Portfolio Manager is Ted

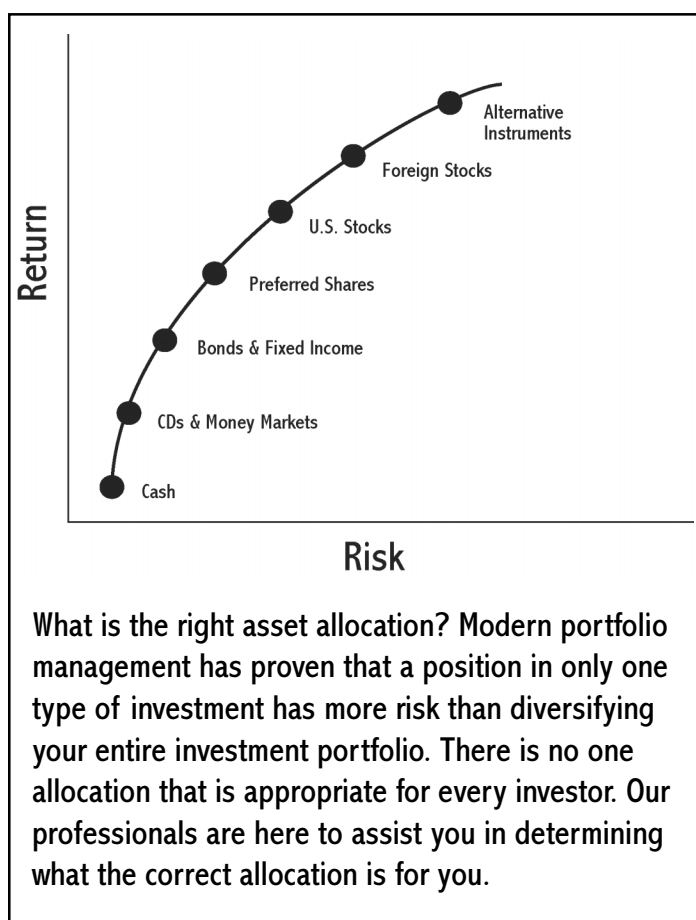
Cohan, and you may have known him from his former position handling investment and trust accounts for our clients. Because of his experience he brings familiarity with our clients, knowledge of their needs, and experience as an investment broker prior to his employment as a Trust Officer. If you would like to discuss your account or the state of the economy, please call me at 526-1412 or email me at the address below.

Thank you for your continued trust in Baker Boyer Bank and the Investment Management and Trust Services Division. We wish you prosperity in this upcoming year.

Mark H. Kajita, CPA

Vice President and Senior Portfolio Manager

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As Mark mentioned I joined the investment group of IMT in October after having been a trust officer for 3 ½ years. I am a Certified Financial Planner, and have been working in the financial field for over 10 years. Before working as a trust officer I was an investment representative with PrimeVest Financial, and have also worked in investments with Merrill Lynch and US Bancorp Piper Jaffray. I am excited to be back working with the markets on a daily basis and with our clients' investments.

As far as the markets and economy are concerned, I have similar views to Mark. I feel the dollar will continue to fall which will increase the price of gold and other precious metals. Interest rates should

remain fairly stable for the first half of the year with potential increases later in the year. China's expansion will continue to drive up prices of raw materials, and unemployment will continue to decline. Lastly, GDP, which was the highest it has been in 19 years at 8.2% in the 3rd Quarter, should slow to a more modest figure in the 4th quarter and 2004.

I look forward to continuing the relationships I have built and beginning new ones. Please feel free to call me to get acquainted, review your account, or discuss the current economic environment. I can be reached at 526-1204 or at the email address below.

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FACE TO FACE

Up close and personal, as a team, drawing from decades of experience... it's how we do business.

Meet the Baker Boyer Investment Management & Trust Services Team. Standing behind each Investment Advisor is an experienced group of financial specialists and support staff.

Our solid investment performance over the decades has been the result of our team working together to analyze opportunities and select those that best meet the needs of each client.

At Baker Boyer, we're not just another 800 number. We're here in your community, making decisions locally with your unique investment goals in mind. Our Investment Advisors take a long-term approach when it comes to investing. We plan with you, over a lifetime, as your wealth builds.

Come see us face to face for a personal and knowledgeable approach to your investment needs.

This was the message that was sent to the community through the Face to Face advertising cam-

paign. The campaign was well received by the community and generated lots of interest. Look for more campaigns to showcase your experienced team of professionals.

Contact Us

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