ORION CAPITAL MANAGEMENT LLC

4th Quarter 2004	Close	Performance
Dow Jones Industrial Average:	10,783.01	7.0%
Standard & Poor's 500 Index:	1,211.92	8.7%
10-Year Treasury Yield:	4.22%	

Investment Outlook
December 31, 2004

Dear Investors,

The fourth quarter of 2004 was the U.S. stock market's best quarter of the year. In fact, the market's entire gain for the year came in the last nine weeks of trading. The S&P 500 Index sprinted ahead 8.7% in the quarter to end up 8.99% for the year. The Dow Jones Industrial Average continued its underperformance of other benchmarks with a gain of 7.0% for the quarter and 3.15% for the year. The 10-Year Treasury note confounded the conventional wisdom by ending the year at a lower yield than that at which it began the year. The consensus expectation (to which I had subscribed, admittedly) was that the 10-Year note would end 2004 at a yield of about 5.0%. In fact, the 10-Year note closed the year at 4.22%, down from 4.25% at the beginning of 2004.

The U.S. presidential election appeared to be the catalyst to get many investors to return to the stock market after a difficult summer. Fundamentally, however, little has changed since before the election to now. The fourth quarter itself featured some decent mergers and acquisitions activity (which is usually good for stock prices) and a Christmas selling season that was a little bit weaker than expected. Now, as investors look into 2005, they are beginning to grapple with a trio of factors.

First, while the rate of corporate earnings growth in 2005 will likely be healthy by historical standards, it will almost certainly be lower than it was in 2004. This is really just a function of the fact that earnings growth in 2004 appeared to be so strong because it was coming off the lower earnings base set in 2003. Nevertheless, slower earnings growth rates will mean that investors will be less likely to reward stocks with high price-to-earnings multiples.

Second, the Federal Reserve is poised to continue its program of gradually increasing short-term interest rates. Long-term rates did not react much to rising short-term rates during 2004, but in my view long rates have nowhere to go but up as the Fed pushes short rates toward 3.0%. Historically, periods of rising long-term interest rates have tended to be difficult for the stock market.

Third, inflation continues to be a worry for both stock and bond investors. A surge in inflation may be the single greatest risk to the performance of both the stock and bond markets in 2005, and there is mounting evidence of inflationary pressure in many parts of the economy. While the Consumer Price

Index, the government's primary measure of inflation, has remained quite low, those of us living in the real world know that there is plenty of inflation. Real estate costs more, as does gasoline, heating oil, steel, copper, medical care, all types of insurance, meat, dairy products and even coffee. It seems that the government statistics may have some catching up to do. The key for the stock and bond markets is for our economy to avoid a spike in inflation that is substantially above the current 3% rate. Without a jolt from inflation, and with corporate profit growth still healthy and companies in generally solid financial shape, a modestly positive performance from stocks would certainly not be out of the question for 2005.

Overseas, stock markets performed very well during the year, particularly when measured in terms of the weakening US dollar. India and China are probably still the two stock markets with the most long-term upside potential—but they are both sure to offer investors a very bumpy ride. Europe appears to be stuck in neutral because of a very strong Euro (which makes its products and services expensive to the rest of the world), and an inflexible and highly-compensated labor market. The Japanese economy has recently shown signs of weakening, and the Nikkei 225 Index ended the year about 5% off of the levels it reached in April. The likely culprit for slowing growth across Asia is probably a weakening of demand from China. The Chinese authorities have been trying for some time to cool off their economy, and it now appears that their efforts may be working. Nevertheless, even if China slows its torrid economic growth to the 5%-7% range in 2005, this level of growth would still probably be enough to assure continued high demand for raw materials.

After a period of excellent performance in global stock, commodity and real estate markets and decent performance in global bond markets, there do not appear to be any asset classes that are compelling values. This remains an excellent time to have a well-balanced portfolio and modest expectations for the performance of both bonds and stocks in 2005.

As usual, I welcome your comments and feedback.

Best Regards,

Peter

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