

Investor Newsletter



THINGS TO WATCH FOR:

OIL

Supply is tight. Russia has essentially nationalized Yukos. Strong demand should keep prices high for some time. We have a \$64 target on crude oil.

COMMODITIES

Developing countries want what the U.S. has. With a cheap workforce and huge inflows of money, these countries are buying "stuff." This appears to be a structural change. We believe a major Bull Market is underway for Commodities in general.

CHINA

Demand and a cheap workforce give rise to a major shift in consumption. China has over 1 billion people who need and want what the rest of the world takes for granted. China will have huge market impacts in the future.

RE-INFLATION

The Fed is clearly on a path of re-inflation. A weak dollar combined with a widening trade deficit and rising oil/commodity prices will move short rates higher in 2005.

Volatility in the market

What to expect and where to invest

World markets had a wonderful showing for 2004. For clients who were invested in equities, it was refreshing to see the S&P 500 return 11%. Investors may be asking themselves if things will continue. Aside from having a crystal ball, chances are slim for returns in general to be in excess of 12-15% going forward for the next 5 years.

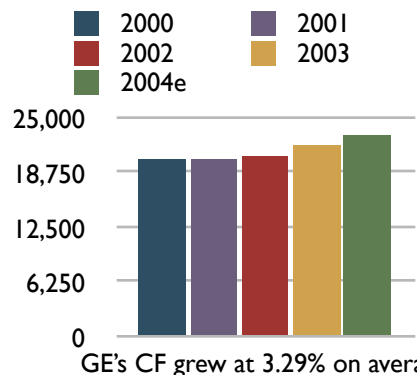
We see earnings growing at a 3-5% rate not including dividends. Currently the S&P is yielding 1.66%, giving a total return of the overall market of 5-8%.

Many tax factors will be in play this year on the market. The American Jobs Creation Act that was passed by Congress in October will give a huge boost to many companies' earnings. This must be watched and not taken at face value. One may ask "How and Why?" Let's explain.

Everyone knows of GE. General Electric, the huge multi-national corporation that brings good things to life. I have been a great fan of GE until December of 2000. GE was and is a very well-run company. My opinion is that GE is the market. Watch General Electric and you will have a sense of what to expect from the overall stock market. On January 21, 2005 GE reported 4Q 2004 and full-year results. The press release touted revenue, earnings and full year cash flow growth up 18%. Nowhere, except the Financial Times Newspaper, did I see anyone really make light of how GE accomplished its growth. **Tax breaks boost GE earnings**, the headline read. The article went on to explain that General Electric pays 11.2% income

taxes, and that its very profitable finance arm will pay just 3% taxes. In a nutshell, we broke down the numbers. If GE paid what they paid last year in taxes, and you add back the accounting charge of \$587 million, GE really only grew at 3%. A far cry from the 6-18% they presented in the news release. Using the reported \$16.593 billion of net income and factoring in some 2003 numbers (because 2004's were not available yet), we derive an intrinsic value on GE of \$39. This is 9% over current value, but our models discount GE's earnings and growth out 10 years. This gives GE under a 3.4% average annual return (including dividends) for the next 10 years. GE is very close to being fully valued.

Hopefully I haven't confused you too much by going off on a tangent on the General. The important thing to realize is that, as an investor, we must research for ourselves the origin of the numbers and what to expect from them.



20 YEAR + CHART OF OIL

CRUDE IS BREAKING OUT

Strong demand should keep prices high for sometime. We have a \$64 target on crude oil.



How does one invest in this market?

Before we answer that, it is best to describe our investment policy and curriculum. Shaw Group believes that investors are rewarded by investing in stocks that are cheap in relation to their intrinsic value. We are a research-driven manager of concentrated stock portfolios. Shaw Group's research seeks to appraise the worth of a company based on the present value of future cash flows. In a simple term, cash is king. By determining a stock's cash flow we derive a value for the security.

We believe that oil and commodities in general will be the places to be in the coming years.

A real look at Oil

For the last twenty years oil has essentially traded sideways. This is shown in the above chart. Basically everything from homes to shoes have experienced inflation except for the one commodity that supplies our needs: Oil.

As shown above, oil is breaking out of a 20-year trend. This is a major development. Supply and demand levels are very tight. Saudi Arabia is the only swing producer with little room to spare. This is evident in the constant market talk that is coming from the Middle East regarding over-supply issues.

Currently China has 10 years of oil reserves. To address this issue, China has been building facilities, slated for completion later this year, that will hold their strategic oil reserves. These facilities need to be filled along with a handful of pipe-

lines coming online for 2005. This will simply add to demand. China, India and Asia in general are raising their standard of living and oil is the product that produces everything.

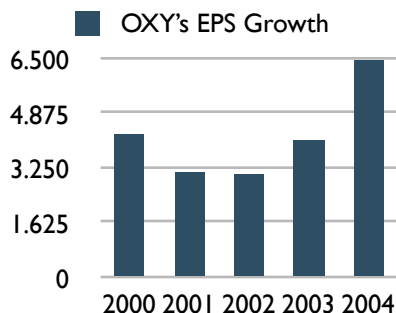
Over the last few years Russia has enjoyed production growth. Many of Russia's fields had been starved for investment and upkeep. New money has flowed into these fields, producing growth in production. This situation seems to be limited.

Long-term decline trends appear to be in place throughout the world. China and India are in a global race to secure reserves for their fast-growing economies. Shaw Group believes this will be a major contributor to higher inflation numbers.



Stocks we like:

Occidental Petroleum (OXY): \$72. Reported its best year ever. Cash flow and revenue growth were very strong. Occidental announced a 13% dividend increase, and is well positioned for growth where others lack it. OXY was just awarded nine of fifteen exploration areas that were auctioned off in Libya. The Libyan Government reports that this area contains about 3 billion barrels of reserves. Plenty to find. Simply put, in our opinion, OXY is one of the best-positioned oil companies out there. Management has consistently delivered results over the last five years.



Amerada Hess (AHC): \$103. Reported strong 2004 results. AHC is producing cash flow in excess of 1.9 billion per year. Shaw Group has added to positions in AHC. We believe that AHC is one of the most attractively valued oil majors out there. Our clients are invested in Amerada Hess's convertible preferred shares. These shares are mandatory convertible until December 2006. Current yield is 3.9% while we wait. Amerada Hess has a majority of its oil production hedged this year, but will be able to

benefit when this strategy unwinds by 2006.

HRPT Properties Trust (HRP): \$13. HRP reported solid growth in cash flow. Although some can be attributed to portfolio gains, HRP has a solid portfolio and lease rates. HRP's book value is close to \$13 per share. HRP appears to be trading at a 50% discount to replacement value. This real estate trust offers a high dividend rate of 6.5%. Combined with possible price expansion, HRP could provide investors a gain well above the S&P Index.

PIMCO FUNDS: We have added to our positions in two PIMCO Funds. Shaw Group is in the camp that believes commodity prices will need to see some inflationary pressure. We feel it appropriate to give a 5% weighting to commodities and a 5% weighting to TIPS (Treasury Inflation Protected Securities). The funds that we like in this area are the PIMCO Commodity Real Return Strategy Fund (PCRAX) for Commodities and the PIMCO Real Return Fund (PRTNX) for TIPS.

Sempra Energy: (SRE): \$42. Reported very strong earnings for 2004. EPS was \$3.83 vs. analyst estimates of \$3.35. Sempra's cash flow is strong, over 1.2 billion, thus management decided to raise the dividend by 16% to an annual rate of \$1.16 per share. We view this as an indication of financial health and strong financial viability, since SRE has not raised its dividend for 5 years.

Many of the stocks in our portfolio have advanced rapidly within the last month. We would like to take advantage of any pullback to add to positions.

MARKET NUMBERS

Dow:	10,936
S&P:	1,225
Nasdaq:	2,90
Fed Funds:	2.50%
3-Month T-Bill:	2.74%
2-Yr. Note:	3.59%
10-Yr. Note:	4.31%
10-Yr. TIPS:	1.62%
U.S. GDP:	3.80%
CRB:	309.37
Oil:	\$53.77

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SELECTION LIST

INVESTING FOR GROWTH

Stock/Symbol	Recommended	Recent Price	Gain/Loss	Target Price	Buy Limit
Archer Daniels/ADM	16.5	25.05	51.82%	47	20
BHP Billiton/BHP	11.99	29.92	149.54%	36	22
Broadcom/BRCM	31.78	32.11	1.04%	45	33
Comcast/CMCSK	30.80	32.78	6.43%	69	33
ExxonMobil/XOM	38	63	65.79%	76	40-45
Ishares for Japan/EWJ	9.80	10.96	11.84%	15	11
Ishares for Netherlands/EWN	18	19.90	10.56%	22-24	18
Marathon Oil/MRO	32.50	48.72	49.91%	100	40
Occidental Petroleum/OXY	28	72.88	160.29%	100	60
Odyssey Re/ORH	22	26	18.18%	36	25
Pogo Prod./PPP	39	50.95	30.64%	52	45
Sempra Energy/SRE	25	42.18	68.72%	70	40
Service Master/SVM	13.04	13.68	4.91	18	13

INVESTING FOR INCOME

Preferred Stock/ Symbol	Recommended	Recent Price	Yield	Credit Quality
Amerada Hess/AHC pfd.	50	90.04	4.21%	BB+
HRPT Properties/HRP	9.99	13.05	6.55%	BBB
PIMCO Muni Income Fd II/PML	14.34	14.83	6.83%	A+
PIMCO Muni Income Fd III/PMX	13.95	14.56	6.85%	A+