

**COMMENTS: INDEX RESULTS, period ending March 29, 2002**

	<u>YEAR</u>	<u>YEAR</u>	<u>YEAR</u>	<u>YTD</u>	<u>CURRENT</u>
<u>STOCKS</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>MONTH</u>
S&P 500	19.6%	(10.1)%	(13.0)%	0.0%	5.1%
S&P 500 Growth	28.8%	(22.2)%	(13.0)%	(0.9)%	2.7%
S&P 500 Value	12.6%	6.1%	(12.0)%	1.3%	7.5%
Dow Jones	25.2%	(6.2)%	(7.1)%	3.8%	2.5%
NASDAQ Comp.	85.6%	(39.3)%	(21.0)%	(5.5)%	6.1%
Ext/MidCap US	25.0%	2.6%	(4.8)%	4.3%	8.3%
Small Cap US	19.6%	(4.2)%	1.0%	3.7%	8.5%
Intl, EAFE	25.3%	(15.2)%	(22.6)%	0.5%	7.2%

**BONDS, Interm.**

Taxable	(0.8)%	11.3%	8.3%	0.0%	(1.5)%
Tax-Exempt	(2.9)%	9.2%	5.0%	0.9%	(1.4)%

	<u>1999</u>				<u>2000</u>				<u>2001</u>			
	<u>1Q</u>	<u>2Q</u>	<u>3Q</u>	<u>4Q</u>	<u>1Q</u>	<u>2Q</u>	<u>3Q</u>	<u>4Q</u>	<u>1Q</u>	<u>2Q</u>	<u>3Q</u>	<u>4Q</u>
<b>S&amp;P 500</b>	4.1	7.6	(7.7)	15.6	2.0	(3.0)	(1.3)	(7.8)	(12.1)	4.8	(13.8)	8.1
<b>NASDAQ COMP</b>	14.6	10.0	0.0	61.0	12.4	(14.8)	(7.2)	(29.6)	(25.5)	12.9	(26.7)	18.3
<b>BONDS: Interm. Taxable</b>	0.0	(0.5)	0.4	(0.7)	2.4	1.5	3.1	4.3	3.2	0.8	4.3	0.0

	<u>2002</u>			
	<u>1Q</u>	<u>2Q</u>	<u>3Q</u>	<u>4Q</u>
<b>S&amp;P 500</b>	0.0			
<b>NASDAQ COMP</b>	(5.5)			
<b>BONDS: Interm. Taxable</b>	0.0			

**MARCH 2002 COMMENTS**

STOCK PRICES increased during the five week period ending March 29, 2002. The main factor in this increase was a series of reports that the general economy was growing again. Even though significant negatives exist, such as the fighting in the Middle East, and a high degree of uncertainty as to whether corporate profits will reach levels sufficient to support higher stock prices, at least for this period the idea the recession was ending and the economy growing generated positive results for the stock market. This same factor of a growing economy created fears of future increases in interest rates, which sent BOND PRICES lower for the period. The month, quarter, and year to date figures are on page 1 of the Comments; longer term figures are on page 7.

A number of clients, distressed at the February results, expressed growing concern about their stock investments. In response it is worth reviewing the month to month results of the three major indices since September 28<sup>th</sup> (market lows were reached September 21<sup>st</sup>, the end of the first week of stock activity after 9/11).

	<b>S&amp;P 500</b>	<b>% Chg From</b>	<b>YTD</b>	<b>DOW</b>	<b>% Chg From</b>	<b>YTD</b>	<b>NASDAQ</b>	<b>% Chg From</b>	<b>YTD</b>
<b>09/21/01 Low</b>	<b>965</b>	<b>9/21 Low</b>		<b>8,235</b>	<b>9/21 Low</b>		<b>1,425</b>	<b>9/21 Low</b>	
<b>SEP 28, 2001</b>	1,040	7.8%	(21.0)%	8,850	7.5%	(18.0)%	1,500	5.3%	(39.3)%
<b>OCT 26, 2001</b>	1,105	14.5%	(16.0)%	9,545	15.9%	(11.5)%	1,770	24.2%	(28.5)%
<b>NOV 30, 2001</b>	1,140	18.2%	(13.7)%	9,850	19.6%	(8.7)%	1,930	35.4%	(22.0)%
<b>DEC 31, 2001</b>	1,150	19.2%	(13.0)%	10,020	21.7%	(7.1)%	1,950	36.8%	(21.0)%
<b>JAN 25, 2002</b>	1,133	17.4%	(1.3)%	9,840	19.5%	(1.8)%	1,937	35.9%	(0.5)%
<b>FEB 22, 2002</b>	1,090	13.0%	(5.1)%	9,970	21.0%	(0.5)%	1,725	21.0%	(11.5)%
<b>MAR 29, 2002</b>	1,147	18.9%	0.0%	10,400	26.3%	3.8%	1,845	29.5%	(5.5)%

These figures indicate the following:

- 1) Overall, all three indexes are up significantly since their 9/21 lows.

- 2) The most significant gains occurred during October and November of 2001. The rally stalled during December 2001 and January 2002, and February 2002 showed significant declines in the NASDAQ and S&P 500. The March 2002 gains restored the S&P 500 to its prior high after the recovery, moved the Dow 4% above its prior high after the recovery, and left the NASDAQ 6% below its prior high after the recovery. So since September 2001, only the February 22, 2002, period showed any declines worth noting.
- 3) Owning stocks has added to overall investment returns since September 2001. Stock prices will inevitably fluctuate, up and down, as they always do, based on the positive and negative circumstances during any particular time. These ups and downs are the price to be paid for realizing the long term favorable returns from stocks. Only if you are convinced this long term history of stock outperformance is likely to be reversed in any time frame relevant to you in achieving your financial objectives, should you consider reducing your allocation to stocks.

Given the sharply different results in different parts of the stock and bond markets over the past few years (see figures on page 1 summarizing results annually since 1999, and also the figures set out on page 7), it is worth reviewing again the various investment choices available in implementing an asset allocation.

## I. Choices in Stocks

- A. By Market Value (determined by shares outstanding multiplied by price per share), referred to as Market “Capitalization” (“Cap”).
  1. Large Cap, Broadly Diversified: Big name companies; Market Values typically above \$5 billion on up into the hundreds of billions. Indexes: Dow Jones Industrials (30 Large Companies); S&P 500 (500 Large Companies). The 30 companies in the Dow Jones are set out in Article I on the Articles page, page 8). Note how during Quarter 1 of 2002, such perennial favorites as IBM, GE, Microsoft, Intel, and Merck, were all down in a quarter that saw the Dow up 4%, while recent “dogs” such as GM, Dupont, and Disney did quite well. These results highlight again the extreme difficulty of picking individual winning stocks in any given time frame.
  2. Midcap, Broadly Diversified: Companies with Market Values between Small Cap (see below) and Large Cap, typically defined as a range of value between \$1-2 billion on the low side, and \$5-7 Billion on the high side (see Article II on the Articles page, page 8). Starting with 1999, this size category has had the best overall performance, after years of trailing the Large Cap Group.
  3. Small Cap, Broadly Diversified: Companies with Market Values up to \$1-2 billion (see Article III on the Articles page, page 8). As with Midcap, Small Cap has outperformed Large Cap during the 2000 – 2001 Bear Market after years of underperformance.

- B. By Sectors - Large, Medium, and Small Cap Companies can all be further subdivided into the sectors of which they are a part. Major Sectors include Technology, Finance, Healthcare, Consumer Goods, Industrials, Energy.
1. The NASDAQ 100 Index is an example of a Large Cap Sector Index, covering the largest 100 companies traded on the NASDAQ, which are primarily technology companies.
  2. International Stocks, that is those companies based outside the U.S., can be considered another sector. Some market experts (i.e., Vanguard's John Bogle), believe (as we do), that a broadly diversified portfolio of U.S. based stocks provides ample exposure to world markets by virtue of the extensive business done internationally by most large U.S. based companies.
- C. By Style – Growth and Value are the two contrasting investing styles. Growth investors look for companies with what they hope are rapidly expanding earnings, and do not pay much attention to the price they pay for such stocks, counting on the rising earnings to lift the prices of their stocks. By contrast, Value investors look for companies with low prices relative to either their current earnings, or earnings prospects, relying on either market recognition, or corporate turnarounds, to lift the prices of their stocks. Growth investing was highly successful until the 2000 – 2001 Bear Market, while Value investing has outperformed Growth during the past few years.
- D. Active or Passive (Index) Investing. Any of the stock investing choices discussed in A., B., and C. can be done with either an Active or Passive investment approach. Active Investors pick and choose stocks, or mutual funds, or sectors, which they believe will outperform broad market indexes. In doing so they run the real risk of underperformance.

By contrast, Passive Investors use indexes to achieve investment results equal to (not better than, not worse than) the segments of the stock market in which they choose to invest. There are indexes available for all the investment choices discussed in A., B., and C. Indexes have cost and tax advantages that give them a built in edge in comparative performance with active management; for active managers to do better than indexes, they must overcome these cost and tax factors, and outperform all the market participants taken as a whole. For an independent expert's view on the difficulty of achieving such a result, see Article IV, on the Articles page, page 8. As you all know, as clients of ours, we have chosen the indexed approach to managing investment portfolios.

Until recently, Vanguard's indexed mutual funds were the primary way to implement a passive investment approach. With the introduction of the so-called Exchange Traded Funds ("ETFs"), which are indexed investments that trade as stocks, the choices available to passive investors have increased dramatically. We of course use both the Vanguard funds and ETFs in our work.

Advocates of the active investment approach maintain the view that outperformance can be achieved by the smartest and hardest working of investors. The problem with this viewpoint is that investment returns in the short term are driven by countless conflicting factors to totally random results, and in the long term are driven by future rates of economic growth and business profitability that are inherently unknowable. Brilliant minds and reasonable people can and do differ on all these matters at all times. There is always some number of investors who outperform the markets for some period of time, but identifying them in advance of their outperformance is impossible, and investing in them after their period of outperformance is simply buying yesterday's news (not to mention the tendency of all investment results, and advisers, to "Regress to the Mean", a subject discussed frequently in these Monthly Comments). Given these difficulties, we continue to maintain that an appropriate Asset Allocation, implemented with broadly diversified indexed investments, is the best solution to the dilemma of how best to invest capital.

II. Choices in Bonds – Bond investing is driven by a few fundamental factors, as follows:

- A. Maturities – All Bonds mature, at which time the investor's money is returned; the length of time from purchase to maturity is a major factor in both risk and reward. The shorter the maturity, the less price change for the bond; as maturities extend in time, bond prices become more volatile. As a corollary, short term bonds provide less interest than longer term bonds (i.e., less risk, less reward). The reason bond prices change is that interest rates change constantly, and as interest rates change, the value/price of bonds with set interest rates also changes. When current rates rise, the value/price of existing bonds declines, and when current rates fall, the value/price of existing bonds increases. The extent of the value/price change is based on the maturity; if your money is to be returned in a year or two, the risk/reward of an interest rate change is much less than if you need to wait five or ten years for your money to be returned.
- B. Credit Quality – The U.S. Government will pay its debts. Most municipalities do likewise. But companies can default and not pay. The more questionable a company's ability to pay, the more interest (or higher yield) it must pay to attract investors. Bonds with yields considerably higher than the top rated credits are referred to as "junk bonds". Here again, more risk, more reward. The risk is the bonds won't be paid, the reward is much higher interest rates if in fact the company succeeds and is able to pay. Enron is a recent, high profile example of a company once believed to be a high quality credit that defaulted on its bonds.

- C. Taxability – U.S. Government and corporate bonds are subject to federal taxation (U.S. Government bonds avoid state taxation, corporate bonds are taxable by the states). Most Municipal bonds are exempt from federal taxes, and also state and local taxes if the investor buys bonds of the state/locality in which he/she lives. But interest paid on bonds subject to taxation is higher than on tax exempt bonds.
- For taxable accounts, whether to own taxable or tax exempt bonds is a function of the investor's marginal tax bracket. For accounts not subject to taxation (i.e. Retirement accounts), taxable bonds should be owned.
- D. Bonds of any kind described above can be purchased either individually or in mutual funds. Using low cost funds provides broad diversification, and maturities, quality, and taxability can be targeted with precision.
- E. Money Markets are a category of bond fund; they hold very short term maturities, and hence are designed not to have any price change.

The point of all this explanation of the choices available to investors in implementing their asset allocations is to try and “Demystify” the investment process. While no choice is without risk, particularly if risk includes the notion of being out of a segment of the market when it is doing well (i.e., “opportunity” risk), a broadly diversified investment portfolio, structured to meet each specific set of investment objectives and risk tolerances, is the most likely way to achieve long term investment success. When markets do poorly, as has been the case with the U.S. Stock Market over the past two plus years, investors often become fearful that this down period will continue, with real losses incurred from which there is no recovery. While there are no guarantees in investing, there is a long term record of positive stock market results premised on long term economic growth. It is of course each individual's choice to decide to what extent he/she can afford to try and participate in this growth based on his/her own particular circumstances and views of the future.

A FINAL WORD ON TAXES: Since you will receive this edition of Comments around the tax deadline, we want to review again our year end 2001 tax strategy. The strategy consisted of selling certain holdings at a loss, thereby realizing those losses for tax purposes, to be used in either 2001 or any time thereafter, and purchasing similar but not identical holdings at the same time, in order to maintain the existing asset allocation while avoiding the 31 day “wash sale” rules. This strategy is discussed in a recent WSJ article (see Article V on the Articles page, page 8).

	<u>S&amp;P 500</u>		<u>Dow</u>		<u>NASDAQ</u>	
<b><u>I. Figures From Period Starting 2001 (% Figures Are Declines From 1/01/01)</u></b>						
Start of 2001	1,320		10,785		2,470	
Sept. 21, 2001 <u>Lows</u>	965	(26.9)%	8,235	(23.7)%	1,425	(42.3)%
End of 2001	1,148	(13.0)%	10,020	(7.1)%	1,950	(21.0)%
March 29, 2002	1,147	(13.0)%	10,400	(3.6)%	1,845	(25.3)%
<b><u>II. Figures From Period Starting 2000 (% Figures Are Declines From 1/01/00)</u></b>						
Start of 2000	1,470		11,500		4,070	
End of 2000	1,320	(10.1)%	10,785	(6.2)%	2,470	(39.3)%
End of 2001	1,148	(13.0)%	10,020	(7.1)%	1,950	(21.0)%
Two Years		(21.8)%		(12.8)%		(52.0)%
March 29, 2002	1,147	(22.0)%	10,400	(9.6)%	1,845	(54.7)%
<b><u>III. Figures From Period Starting 1995 (% Figures Are Gains From 1/01/95)</u></b>						
Start of 1995	459		3,834		752	
End of 1999	1,470		11,500		4,070	
End of 2001	<u>1,148</u>		<u>10,020</u>		<u>1,950</u>	
5 Yr Gain; Anlzed % Gain	1,011;	26.2%	7,666;	24.6%	3,318;	40.2%
7 Yr Gain; Anlzed % Gain	689;	14.0%	6,186;	14.7%	1,198;	14.6%
March 29, 2002	<u>1,147</u>		<u>10,400</u>		<u>1,845</u>	
7yr&3mo Gain; Anl % Gain	688	13.4%	6,566	14.7%	1,093	13.2%