

**COMMENTS: INDEX RESULTS, period ending May 31, 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)%	(7.0)%	(0.8)%
S&P 500 Growth	28.8%	(22.2)%	(13.0)%	(9.8)%	(1.7)%
S&P 500 Value	12.6%	6.1%	(12.0)%	(3.4)%	0.3%
Dow Jones	25.2%	(6.2)%	(7.1)%	(1.0)%	0.1%
NASDAQ Comp.	85.6%	(39.3)%	(21.0)%	(17.0)%	(2.3)%
Ext/MidCap US	25.0%	2.6%	(4.8)%	1.5%	(0.5)%
Small Cap US	19.6%	(4.2)%	1.0%	0.4%	(2.3)%
Intl, EAFE	25.3%	(15.2)%	(22.6)%	1.4%	(0.5)%

**BONDS, Interm.**

Taxable	(0.8)%	11.3%	8.3%	2.6%	0.8%
Tax-Exempt	(2.9)%	9.2%	5.0%	3.5%	0.7%

	<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			

**MAY 2002 COMMENTS**

**In difficult market times such as these, we believe it is important to restate our objectives regarding the work we do on your behalf. Our primary goal is to preserve the assets you have accumulated to the maximum extent possible consistent with achieving investment returns over time that meet your needs with regard to the use of your money. To accomplish this goal, we need to always understand your current and anticipated future financial circumstances, so that we can translate your needs into an appropriate investment program. Note that we do not seek to time markets, or pick specific stocks or mutual funds in an effort to maximize gains by outperforming the markets. Rather, we establish suitable asset allocations for our clients and then implement these allocations with the appropriate mix of indexed stock and bond investments.**

STOCK PRICES moved only modestly lower during the five weeks ending Friday, May 31st, despite the impression of more substantial declines. The absence of any upward movement in stock prices since March, 2002 has made “doom and gloom” the prevailing mood regarding Stocks as an asset class. Indeed, this current Bear Market in stocks is the worst in both amount and duration since the dismal period of 1973-1974 (see chart and discussion on pages 3 and 4).

During these five weeks, Large Cap US stocks were mixed, with the S&P 500 index down less than 1%, the Dow Jones Industrials breaking even, and the NASDAQ Composite down 2.3%. MidCap and SmallCap stocks also had relatively modest declines, at 0.5% and 2.3%, respectively. The Growth style fared worse than Value, at minus 1.7% compared to plus 0.3%. International stocks also had small losses for the month. All these current-month figures are presented on page 1 of these Comments, along with year-to-date 2002, and the years 1999, 2000, and 2001. Stocks are still higher than their September, 2001 lows (see chart below), and from 1995 to date are realizing their positive long-term average returns (see chart III on page 7).

BOND PRICES rose again during May, continuing the more than two-year bull market in bonds. During this market cycle, bond prices and stock prices have moved in opposite directions, a divergence that does not always occur. This recent trend was discussed on page 5 of the April, 2002 Comments.

	S&P 500	% Chg From	YTD	DOW	% Chg From	YTD	NASDAQ	% Chg From	YTD
09/21/01 Low	965	9/21 Low		8,235	9/21 Low		1,425	9/21 Low	
SEP 28, 2001	1,040	7.8%	(21.0)%	8,850	7.5%	(18.0)%	1,500	5.3%	(39.3)%
OCT 26, 2001	1,105	14.5%	(16.0)%	9,545	15.9%	(11.5)%	1,770	24.2%	(28.5)%
NOV 30, 2001	1,140	18.2%	(13.7)%	9,850	19.6%	(8.7)%	1,930	35.4%	(22.0)%
DEC 31, 2001	1,150	19.2%	(13.0)%	10,020	21.7%	(7.1)%	1,950	36.8%	(21.0)%
JAN 25, 2002	1,133	17.4%	(1.3)%	9,840	19.5%	(1.8)%	1,937	35.9%	(0.5)%
FEB 22, 2002	1,090	13.0%	(5.1)%	9,970	21.0%	(0.5)%	1,725	21.0%	(11.5)%
MAR 29, 2002	1,147	18.9%	0.0%	10,400	26.3%	3.8%	1,845	29.5%	(5.5)%
APR 26, 2002	1,076	11.5%	(6.2)%	9,910	20.3%	(1.1)%	1,664	16.8%	(14.7)%
MAY 31, 2002	1,067	10.5%	(7.0)%	9,925	20.5%	(1.0)%	1,615	13.3%	(17.0)%

As we continually stress the importance of establishing and maintaining an Asset Allocation appropriate to your particular goals, there are aspects of this investment approach that require review. One major point is that your Asset Allocation can, and should, change over time. Reasons for change include:

- (1) Your need for the use of your money changes. Either you need money sooner, or later, than originally anticipated when establishing your asset allocation. The longer the time until you need to use your investment portfolio, the greater your allocation to stocks can be.
- (2) Your emotional tolerance to risk changes. In this third year of significant stock market declines, it is reasonable to reassess your feelings toward the material and persistent reduction in the value of your investments. However, this is a difficult point to implement properly, since it is hard to distinguish between an appropriate change in risk tolerance and the more questionable attitude of fear that as stock prices fall, they can only fall further. Indeed, the history of all prior stock market declines is the opposite; that is, stocks recover after declines. The following chart, which has been presented in previous Comments, makes this point abundantly clear. So for stock prices to continue to fall indefinitely, all this prior history would have to be reversed.

Bear Markets Since 1950	Length In Months	Total Return: S&P 500	First Year After Decline:	Months To Break Even From Start Of Bear Market
Aug 57 - Dec 57	5	(15.0)%	43.4%	12
Jan 62 - Jun 62	6	(22.3)%	31.2%	16
Feb 66 - Sept 66	8	(15.6)%	30.6%	14
Dec 68 - Jun 70	19	(29.3)%	41.9%	28
Jan 73 - Sept 74	21	(42.5)%	38.1%	42
Dec 80 - Jul 82	20	(16.9)%	59.4%	23
Sep 87 - Nov 87	3	(29.5)%	23.2%	21
Jun 90 - Oct 90	5	(14.7)%	33.5%	9
Aug 98 - Oct 98	3	(20.0)%	45.0%	6
Mar 00 - ?	?	?	?	?
Average (ex. 00)	10	(22.9)%	38.5%	19
But: 1929-1932	40	(65.0)%	54.0%	88 + 84

Unfortunately, all this history cannot tell us when this Bear Market will end. Note the average S&P 500 decline since 1950 was 23%, with a 10-month duration and 19 months to break even. The current Bear Market has already exceeded these average figures in both percentage amount --37% (see chart on the next page)-- and duration --two-plus years and counting. If the current Bear Market lows turn out to be September, 2001, then its duration would be 18 months from high to low; the first year results after the lows, and the time to return to the previous highs are still unknowns.

	<u>S&amp;P 500</u>	<u>DOW</u>	<u>NASDAQ</u>
1st Qtr 2000 Highs	1,527	11,723	5,048
Sept 2001 Lows	965	8,235	1,425
Decline	(562)	(3,488)	(3,623)
% Decline	(36.8)%	(29.8)%	(71.8)%

As the chart on the previous page makes clear, the 1973-1974 Bear Market lasted 21 months, saw the S&P 500 decline by over 40%, and took 42 months to return to its prior high. This period was by far the worst for stocks since the 1929-1932 stock market crash and depression. The period was marked by huge increases in oil prices, interest rates, and inflation, which resulted in a no-growth, high-inflation economy labeled "stagflation." It is also worth noting that the 1973-1974 declines occurred in the middle of a much longer 16-year period, from 1966 to 1982, when stock prices did not go up at all; almost all the returns from stocks --approximately 5% average annually for the 16 years-- came from dividends.

While general economic conditions today are far better than in 1973-74, there are obviously many current problems affecting stock prices (see page 6, third paragraph). The amount of loss in the current Bear Market from high to low (so far) in the S&P 500 is 37%, which is second only to the 1973-1974 period for all the declines since 1950. For the S&P 500 to reach its prior high within 42 months of its March, 2000 highs (as occurred after the 1973-1974 declines), the index would have to gain 460 points from its May, 2002 level of 1,067, or almost 45%, and to do so by September, 2003. While history suggests this could happen, who among us would consider this possibility, amidst all the current gloom and doom. The stock market is indeed an unpredictable investment arena, in which the price of long-term outperformance can be lengthy periods of poor returns.

- (3) Even if there is no change in either the time in which you need to use your money or your emotional ability to withstand the declines, the movement of market prices can alter your initial allocation significantly enough to warrant restoring your allocation to its initial position. This is referred to as REBALANCING, and is an important part of the overall Asset Allocation methodology.

To best understand Rebalancing, assume that you had a \$1 million portfolio in 1994 with an initial allocation of 50% stocks and 50% fixed income (the latter including both bonds and cash equivalents). From 1995 to 1999, Stock prices soared, such that at the end of 1999 the stock portion of your portfolio would have tripled from \$500,000 to \$1.5 million, while the bond portion would have grown much more modestly from \$500,000 to \$650,000. The stock allocation would then have grown to 70% of your portfolio's value, or \$1.5 million out of a total of \$2,150,000. The principle of Rebalancing would suggest selling enough of your stock portfolio and buying enough bonds to return to the initial 50-50 allocation. While most people resist selling when stock prices are rising, the idea of Rebalancing moves you in the direction of selling when prices are high.

Tracking this illustrative portfolio from the start of 2000, a period during which Stocks are down approximately 25% and Bonds are up approximately 15%, the following results emerge:

### **Rebalanced**

	<u>Stocks</u>	<u>Bonds</u>
Start:	\$ 2,150,000 1,075,000	1,075,000
Current:	2,035,000 (-115,000) 800,000 (-275,000)	1,235,000 (+160,000)
New Allocation Percentage:	40%	60%

### **Not Rebalanced**

	<u>Stocks</u>	<u>Bonds</u>
Start:	\$ 2,150,000 1,500,000	650,000
Current:	1,875,000 (-275,000) 1,125,000 (-375,000)	750,000 (+100,000)
New Allocation Percentage:	60%	40%

### **Observations on Rebalancing:**

- (a) The Rebalanced portfolio is \$160,000 (i.e., the difference between 2,035,000 and 1,875,000), or almost 8%, higher than the Non-Rebalanced one, which is an obvious result, since Rebalancing would have taken money out of stocks near their highpoint, and prior to the current Bear Market.
- (b) For the purpose of clarity, and with the benefit of hindsight, the illustration presents a 20% increase in the stock allocation (from 50% at the end of 1994 to 70% at the end of 1999, as described on the previous page) before Rebalancing. A more typical range would be 10%. Using 10% as the trigger for Rebalancing would have meant selling before the top of the 1995-1999 Bull Market and would have resulted in a less favorable result than presented in the illustration, but would still show a better result than the Non-Rebalanced portfolio.
- (c) Much less obvious, but equally valid, is that the Rebalanced portfolio would now suggest adding 10% to stocks, thereby increasing the Stock allocation to 50% and decreasing the Bond allocation to 50%. In other words, Rebalancing calls for buying the stock market when it is down, even as most people want to abandon it, or rue the day they invested in it and didn't sell.
- (d) While this strategy might look like Market Timing, it absolutely is not. Market Timers try to predict, in advance of market price moves, whether to be in or out of the market. By contrast, the Rebalancer says, in advance, that if there is a market price move of 10%, that is the time to reposition the portfolio back to the initial asset allocation. There is no guesswork as to what the future price moves will be, but rather only a response to prior price moves that forces the investor to sell the asset class doing well and buy the asset class doing poorly. This is a Sell High, Buy Low strategy, and while it may seem counterintuitive, it is a reasonable way to keep your own objectives paramount and avoid some of the nastier consequences of markets that swing to extremes, both overbought and oversold.

- (e) Investors willing to use this Rebalancing discipline should not pick and choose when to follow the strategy; it should be automatic once significant price movements occur. This means ignoring all the “gloom-and-doomers”, whether the bad news is about the economy, corporate profits, accounting issues, terrorists, or regional wars. There are always reasons to ignore a discipline; during the Bull Market, many people came to believe stocks were in a new era and could only go up; now these same people believe the stock market is a perpetual loser. Time, and the history of stock price movements, have proven both those points of view wrong, and instead favor those investors who can allocate properly, and then Rebalance that allocation periodically to take advantage of a Sell High, Buy Low discipline. **As your Advisors, we carefully monitor the broad stock and bond markets to ensure that you have the opportunity, if you so decide, to Rebalance to the allocation appropriate for your situation.**

### **Closing Thoughts on the Current Stock Market:**

A reasonable approach to these current declines is to forget the values you had at the highs, put aside the regret of not selling at the highs, recognize that stocks are not likely to provide the 20%-plus annual returns of 1995-1999, and review your allocation to stocks to make sure it is appropriate for you. Holding certain positions hoping they return to your original purchase level is not a useful strategy; historical cost is relevant only for tax calculations. Rather, your investments need to be evaluated for their prospects from this time forward, not in reference to their historical cost.

During this current period of declines, most news is perceived as negative; in the framework of the “glass half-full” or “half-empty”, it is clear that the markets are seeing events as more empty than full. This pessimism persists in spite of the fact that as recently as March, 2002, most indexes were even or up for the year. Last month's Comments discussed in some detail the major factors affecting the markets: the general economy, corporate profits, fighting in various parts of the world, terrorism threats, accounting scandals related to the reporting of corporate profits, inflation and interest rates, debt levels, and tax rates. In certain areas, the news is positive, such as the improved level of general economic activity following a very brief and modest recession, some reports of improving corporate profits, low inflation, low interest rates, and modestly lower tax rates. But in the current market climate, it is the bad news that is emphasized, starting with threats of terrorism and fighting in various global hot-spots, then moving on to the financial issues of accounting irregularities and high debt. (For those who think nuclear terrorism is inevitable, think back to the time when US-Russian nuclear war was also considered inevitable.) In addition, since stock prices had risen so far above their long-term averages in the five years prior to the current Bear Market, the declines in stock prices have probably been greater than might otherwise have been the case based on the current mix of news.

The key question, as always, is the future direction of prices. It is usually when investors give up hope completely that the bottom is reached. The market reaction to most of today's news gives the impression that many investors are approaching that point. Our suggestion is not to give up, to stay with your long-term program, and to rely on the favorable long-term history of stocks for improvement.

	<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)%
May 31, 2002	1,067	(19.2)%	9,925	(8.0)%	1,615	(34.6)%
<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)%
May 31, 2002	1,067	(27.4)%	9,925	(13.7)%	1,615	(60.3)%
<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%
May 31, 2002	<u>1,067</u>		<u>9,925</u>		<u>1,615</u>	
7yr&5mo Gain; Anl % Gain	608	12.0%	6,091	13.6%	863	10.8%