

**COMMENTS: INDEX RESULTS, period ending September 27, 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)%	(27.9)%	(7.7)%
S&P 500 Growth	28.8%	(22.2)%	(13.0)%	(27.4)%	(7.0)%
S&P 500 Value	12.6%	6.1%	(12.0)%	(27.2)%	(8.5)%
Dow Jones	25.2%	(6.2)%	(7.1)%	(23.1)%	(9.5)%
NASDAQ Comp.	85.6%	(39.3)%	(21.0)%	(38.5)%	(6.0)%
Ext/MidCap US	25.0%	2.6%	(4.8)%	(20.0)%	(5.0)%
Small Cap US	19.6%	(4.2)%	1.0%	(24.7)%	(5.7)%
Intl, EAFE	25.3%	(15.2)%	(22.6)%	(18.7)%	(7.7)%

**BONDS, Interm.**

Taxable	(0.8)%	11.3%	8.3%	6.4%	1.4%
Tax-Exempt	(2.9)%	9.2%	5.0%	7.8%	1.5%

	<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	(13.8)	(14.1)	
<b>NASDAQ COMP</b>	(5.5)	(19.5)	(13.5)	
<b>BONDS: Interm. Taxable</b>	0.0	2.8	3.6	

**SEPTEMBER 2002 COMMENTS**

**Balis Lewittes & Coleman, Inc. has moved.**  
**Please make note of our new address for all correspondence:**  
**909 Third Avenue – 30<sup>th</sup> Floor**  
**NY, NY 10022**  
**All phone numbers remain the same.**

**STOCK PRICES** resumed their declines during the four weeks ending September 27, 2002, bringing the 2002 year to date declines to 27.9% for the S&P 500, 23.1% for the Dow Jones Industrials, and 38.5% for the NASDAQ Composite. All three indexes have basically returned to their July 2002 lows, erasing the gains that occurred during the five-week period ending August 30<sup>th</sup>. All of the damage to stock prices for 2002 has occurred in the second and third quarters, following a flat first quarter and an up quarter closing out 2001 (these figures are presented in detail on the first page of these Comments). A more extensive discussion of quarterly results since 1999 begins on page 3.

As for the extent of the declines for the entire Bear Market, measured from the highs of Q1 2000, the following figures chart these results and put them in the context of results since the end of 1994 (see also the figures on page 7).

	<b><u>S&amp;P 500</u></b>		<b><u>DOW</u></b>		<b><u>NASDAQ</u></b>	
1st Qtr 2000 High	1,527		11,723		5,048	
Year End 2000	1,320	(13)%	10,785	(8)%	2,470	(51)%
April 2001 Low	1,103	(28)%	9,390	(20)%	1,684	(67)%
Sept 2001 Low	965	(37)%	8,235	(30)%	1,425	(72)%
Year End 2001	1,148	(25)%	10,020	(17)%	1,950	(61)%
July 2002 Low	798	(48)%	7,702	(34)%	1,206	(76)%
Sept 27, 2002 Close	827	(46)%	7,701	(34)%	1,200	(76)%

**Context: Prior Five-Year Gains in Bull Market of 1995 - 1999:**

End 1994	459	3,834	752
End 1999	<u>1,470</u>	<u>11,500</u>	<u>4,070</u>
Gain	1,011	7,666	3,318
Avg. Annual % Gain, '95-'99	26.2%	24.6%	40.2%
Avg. Annual % Gain, '95-9/27/02	7.9%	9.4%	6.2%

At present, stock prices move up and down based on the news of the day (or hour, for that matter). An announced reduction in earnings forecasts, a less than upbeat government report on the overall economy, an increase in the unemployment figures, a negative news item on Iraq or the Palestinian-Israeli conflict; all lead prices to declines. Less frequent, but still occurring, are the positive days when news on these topics is more favorable. What is lacking is a time perspective that extends beyond the immediate bad news to a time when the economic cycle swings back to more growth. As growth improves, so too should corporate profits, employment levels, and the other indicators that accompany rising stock prices. Without some time horizon that extends beyond the immediate time period, the current negative news could lead to decisions regarding reductions in stock allocations that prove costly over longer time frames. If your stock allocation has been appropriate to this point, we believe it should be maintained. The favorable combination of historically low interest rates, low inflation, and stock prices that bear a much more reasonable relationship to corporate earnings (i.e., the P/E ratio), should not be overlooked amidst the daily negatives affecting stock prices.

In light of all of this bad news, it is worth stepping back and looking at how this bear market, which includes 2000, 2001, and now the first three quarters of 2002, has developed to its current magnitude. The figures below list the quarterly results of the S&P 500 and NASDAQ Composite index starting with 1999, the last year of the great bull market of 1995-1999, a five year period during which average annual returns were 26% for the S&P 500 and 40% for NASDAQ.

<u>Starting Index Level</u>		<u>S&amp;P 500</u>	<u>NASDAQ</u>
<u>1995:</u>		<u>459</u>	<u>752</u>
<b>Starting Index Level:</b>		<b>1,230</b>	<b>2,193</b>
<u>1999:</u>	Q1	4.1%	14.6%
	Q2	7.6%	10.0%
	Q3	(7.7)%	0.0%
	Q4	15.6%	61.0%
		Up 19.6%	Up 85.6%
<b>Closing Index Level:</b>		<b>1,470</b>	<b>4,070</b>
<u>2000:</u>	Q1	2.0%	12.4%
	Q2	(3.0)%	(14.8)%
	Q3	(1.3)%	(7.2)%
	Q4	(7.8)%	(29.6)%
		Down (10.1)%	Down (39.3)%
<b>Closing Index Level:</b>		<b>1,320</b>	<b>2,470</b>
<u>2001:</u>	Q1	(12.1)%	(25.5)%
	Q2	4.8%	12.9%
<b>9/11</b>	Q3	(13.8)%	(26.7)%
	Q4	8.1%	18.3%
		Down (13.0)%	Down (21.0)%
<b>Closing Index Level:</b>		<b>1,148</b>	<b>1,950</b>
<u>2002:</u>	Q1	0.0%	(5.5)%
	Q2	(13.8)%	(19.5)%
	Q3	(14.1)%	(13.5)%
	Year-to-Date	Down (27.9)%	Down (38.5)%
<b>Closing Index Level:</b>		<b>827</b>	<b>1,200</b>

## OBSERVATIONS:

(1) (a) S&P 500:

Until Q2 and Q3 of 2002, the quarterly periods of significant declines were spread out over time, interrupted by quarterly periods of gains or modest losses that, occurring alone, would have been of no concern. For example, the S&P 500 declined 7.7% in Q3 of 1999, but was up 15.6% in Q4. The short-lived 1999 quarterly decline gave no warning of what was to occur. The first three quarters of 2000, with a negligible cumulative decline of 2.3%, was followed by a more substantial 7.8% decline in Q4. This decline was no greater than the Q3 1999 decline that was immediately erased in the next quarter. Even 2001, with two quarters of double-digit declines, had intervening quarters of gains, including the 8.1% fourth quarter gain following 9/11. In 2002, by far the worst of the three years, Q1 had no loss at all. Then came the most recent two quarters, with declines of approximately 14% each quarter. Yet even the most current quarter had a positive month sandwiched in between the two dismal months.

(b) NASDAQ Composite:

This index, which increased from 752 to 4,070 for the five years 1995-1999, and peaked at 5,048 during Q1 2000, has had much more extreme results. But the pattern of intermittent gains, on the way to declines exceeding 75% from its high, exists even with this index.

(2) Did any of these prior price movements provide clues to subsequent price movements?

Even more importantly, do all these price movements taken together provide clues for the future? Market Timers and Technical Analysts might answer yes, but the erratic nature of these price changes makes this a dubious proposition. Furthermore, the history of all prior stock price declines has eventually been marked by recoveries strong enough to make stocks outperform both bonds and cash equivalents over the long term.

(3) A more reasoned approach to stock prices would state that investors reacting to the new developments of each period gave rise to these results. We therefore now review the major news events influencing this period.

## NEWS EVENTS:

Two Wall Street Journal articles dated Thursday, September 26<sup>th</sup> (page 1 of first section, and page 1 of Section D) discuss a variety of key issues currently affecting the stock market. "Whether...staying with stocks...turns out to be a wise decision will depend less on the daily stream of corporate trials and tribulations than on a few macro issues...whether the U.S. economy is in a prolonged slump, whether companies can rebuild confidence in their accounting and how close the stock market is to bottom" (page D1). "In times like this, it's tough to remember that in mid-August 1982, overshadowed by back-to-back bear markets and recessions, the stock market began an 18-year bull run that saw the Dow rise more than 13-fold" (page D1).

The following is our summary of the major news items and issues affecting stock prices, starting with Q4 2000, at which time the stock price declines began in earnest, and continuing through the worst (or second worst) bear market since 1929-1932.

- (1) The contested presidential election occurred during Q4 2000, which created a high degree of uncertainty that commentators associate with declining stock prices.
- (2) Q1 2001 marked the early signs of a general economic slowdown, most pronounced in the technology sector, where overcapacity and overexpansion led to a major reduction in new business. Government figures now confirm that a mild recession did occur during 2001, but ended some time before year-end.
- (3) Notice that the increases of Q2 2001 reversed some lost ground, but then came Q3, in which business conditions weakened even before the events of 9/11.
- (4) Corporate and Accounting Scandals:
  - (a) Enron, and its accountant Arthur Anderson, first became an issue during Q4 of 2001. This scandal by itself clearly did not hurt stock prices, either in Q4 2001 or Q1 2002.
  - (b) Worldcom's gigantic misrepresentation of its financial situation was first declared at the end of Q2 2002, so this news was not a factor until Q3 2002, and particularly during July.
  - (c) Despite the media's best efforts to bring to our attention additional scandals affecting important U.S. companies, the past few months at least have been lacking in this kind of negative news.
- (5) Global Political Instability:

The two major flashpoints are the U.S. vs. Iraq, and the Israel-Palestinian conflict. These topics may provide convenient rationales for market declines, but history suggests (see 1991 Iraq war) that these events can clear the air for better times.

  - (a) Terrorism in the U.S.

This is one fear that has no real precedent in US history. To reduce or eliminate your stock exposure because of this threat, however, is to believe that the terrorists can bring down the U.S. and its economy.

(6) No-Growth Economic Situation:

The current period is characterized by low profit and employment growth, and an overall economic slowdown. This is clearly a major issue for stock prices, but again history suggests that these periods do end, with economic activity increasing after periods of slow growth. The question of when is obviously important, but most of the experts, including Fed Chairman Alan Greenspan, believe an economic recovery is in our future. Indeed, the Federal Reserve's recent decision not to reduce interest rates further was an indication that the Fed believes the economy does not need this kind of stimulus to return to more desirable levels of growth. The front page Wall Street Journal (WSJ) article from September 26<sup>th</sup> concludes (page 8) with a quote from Mr. Greenspan: "With the growth of productivity well maintained and inflation pressures largely absent, the foundation for economic expansion has been laid."

(7) Stock Prices are Still Too High Relative to Corporate Earnings:

This is another problem that needs to be overcome for stock prices to move higher. Stable prices for goods and services, which are beneficial for the consumer and which indicate that inflation is under control, are not the best news for corporate profits. Cost cutting to sustain profitability can only go on for so long, and if it involves reducing employment, then that adversely affects consumers' ability to maintain the spending that is essential to economic growth. Also, businesses spend less and invest less in their own activities as profits decline, further reducing overall demand.

These problems are real, and stock prices reflect the problems. Current estimates for S&P 500 earnings range from \$40-\$50 (depending on how various accounting issues are addressed). With the S&P 500 at 800, and using the lower \$40 figure, the P/E is 20. A P/E of 20 causes some observers to believe that stock prices are still too high (based on a historical P/E level closer to 15), while others believe 20 or higher is easily justified in today's environment (see Jeremy Siegel, Financial Planning Magazine, September 2002, pages 135-138 and 157; copy of article available upon request).

SUMMARY:

BONDS continue to have positive returns exceeding their interest rates, as lower rates push prices higher. In a properly allocated portfolio, the bond portion often provides a steady return that in times like these helps offset some of the declines from stocks. We continue to advise maintaining your stock allocations, in the belief that "this too shall pass", and there will be a reward for holding on through this period of extreme uncertainty and risk.

	<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>Low</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)%
July 2002 <u>Low</u>	798	(39.5)%	7,702	(28.5)%	1,206	(51.0)%
Sept 27, 2002	827	(37.3)%	7,701	(28.6)%	1,200	(51.4)%
<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)%
Sept 27, 2002	827	(43.7)%	7,701	(33.0)%	1,200	(70.5)%
<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; Annualized %	1,011;	26.2%	7,666;	24.6%	3,318;	40.2%
7 Yr Gain; Annualized %	689;	14.0%	6,186;	14.7%	1,198;	14.6%
Sept 27, 2002	<u>827</u>		<u>7,701</u>		<u>1,200</u>	
7yr&9mo Gain; Annual. %	368	7.9%	3,867	9.4%	448	6.2%

**Victor Levinson**

**Nicholas Levinson**