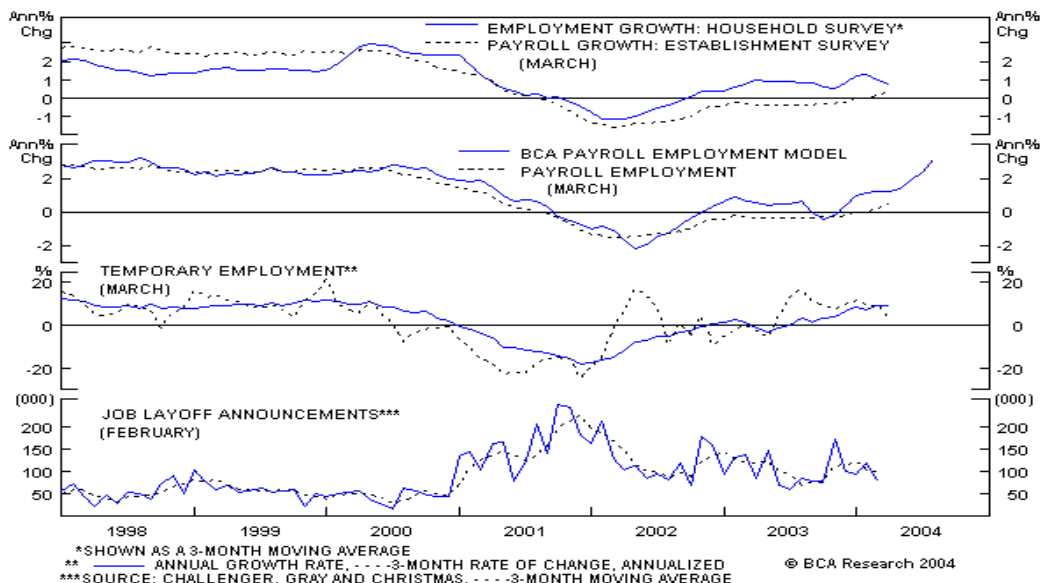


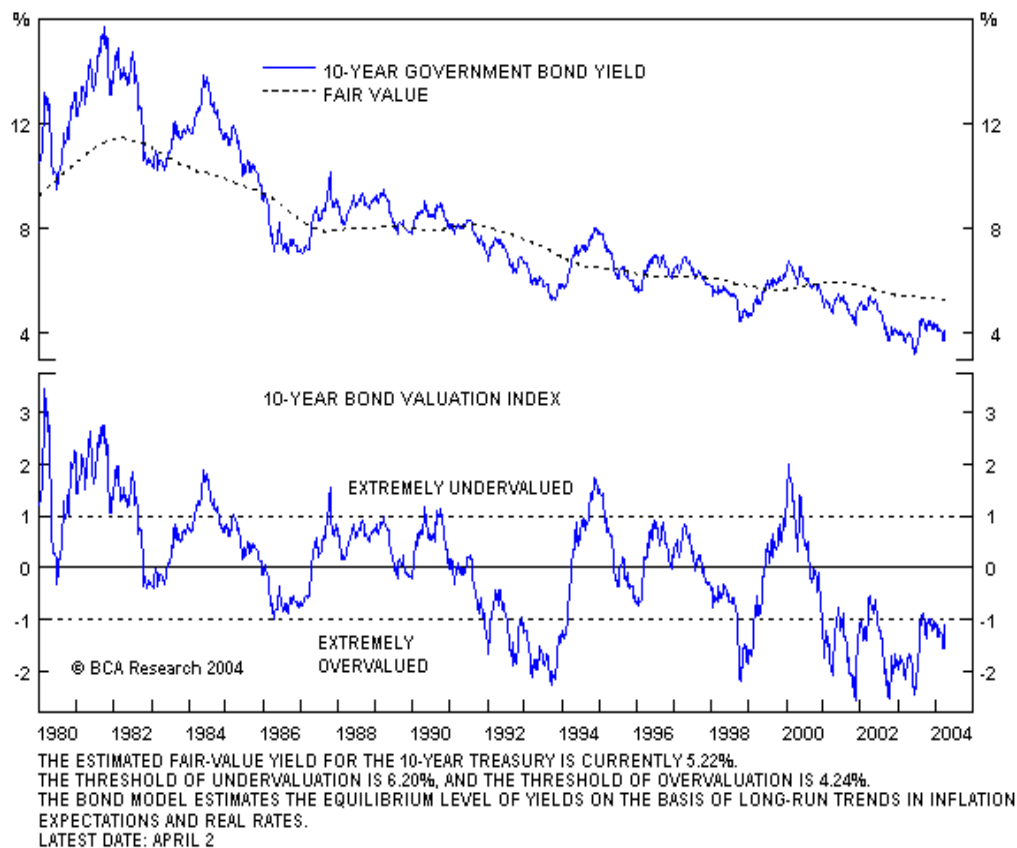


Economic & Market Commentary April 2004

Despite a U.S. economy that has been growing at well above its long-term average of 3% over the last few quarters, much of the recent economic and political commentary has been focused on the anemic growth in jobs. However, the Labor Department's March payroll survey showed that 308,000 new jobs were created, which was well above consensus expectations. The reaction in the stock and bond markets was immediate and predictable; stocks rallied strongly and bonds had one of the largest one-day sell-offs in years. This payroll report should help address the concerns that U.S. economic growth could not be self-sustaining, without a corresponding increase in employment. The reality is that job growth has historically lagged an increase in economic growth and corporate profit growth. Unlike the above average job growth in the 90's, jobs experienced a decline from the 2000 peak and have recovered more slowly than most cycles. Outsourcing of jobs to lower-cost countries is only part of the reason for the slower job recovery. Another reason is the significant improvement in labor productivity that has been achieved, largely because of the huge investment in information technology during the late 1990's. However, the biggest reason has been that most of the job cuts are by larger corporations that are covered by the payroll survey, while most of the job creation is by small businesses. In fact, the household survey has shown improving job growth for a while.



The U.S. economy continues to expand at an above-average rate driven by low interest rates and strong consumer spending. The recovering employment situation should allow the economic expansion to become self-sustaining. As this recovery unfolds, we expect interest rates to move materially higher. Over the next two years, we expect the Fed Funds rate to move up 3 to 4 percentage points and longer-term rates, as represented by the 10-year Treasury, to move up 1.5 to 3 percentage points. The rise in interest rates and fall in bond prices over the past month is the beginning of a bear market for bonds in our view.



Intensifying the problem is the low savings rate in this country and the high trade deficit; these items require foreign capital inflows of approximately \$500 billion a year. Foreign Central Banks own more than \$1.1 trillion worth of U.S. Treasuries and have increased their holdings by approximately \$400 billion over the last two years. If foreign investors at the margin decide not to buy or own U.S. securities, U.S. interest rates would need to rise quickly in order to attract sufficient capital. Equilibrium would occur via cuts in consumption, and thus the trade deficit, accompanied by increases in domestic savings. Demand for foreign capital would decrease, while the supply of domestic savings increased, thus allowing the capital markets to clear.

In order to mitigate the risks that we anticipate in the bond market, we have established short duration fixed income portfolios and increased money market positions as a percentage of fixed income targets.