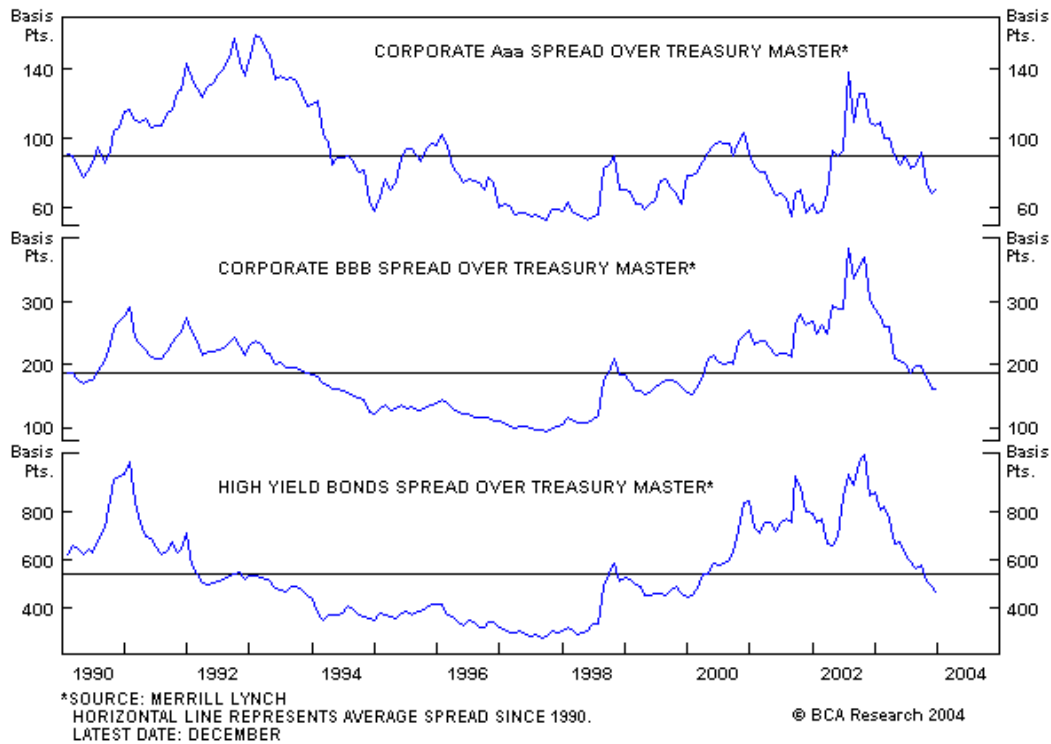




Economic & Market Commentary January 2004



Investors have become decidedly less risk averse since October 2002. As illustrated by the charts above, the spread (additional yield expressed as basis points, i.e. 100 bps equals 1%) offered by corporate bonds versus risk free Treasuries has declined dramatically. In other words, investors have become more comfortable holding risky securities and are not demanding as much compensation to take on risk. The dramatic recovery in the stock market, with the more speculative stocks posting the greatest returns in 2003, is a further indication of the tremendous improvement in investor psychology and increased risk tolerance.

In the summer and fall of 2002, investors were concerned about the health of the financial markets. A crisis of confidence began with the revelation of numerous fraudulent

activities by large corporations. Investors started to question the reliability of all corporate financial statements; hence, the availability of credit to the corporate bond market began to decline and the price (yield) paid for credit surged. The charts above show this phenomenon. The possibility of the credit markets seizing up increased substantially and the risks to a levered and weakening economy were very real. However, the Federal Reserve's easy money policy, extremely low interest rates and aggressive fiscal stimulus prevented a full-blown crisis and jump-started the economy back toward growth. The U.S. economy has grown substantially above its long-term average of 3% over the last two quarters and the chance of a recession in the next year seems remote.

This good economic news is, at least partially, incorporated into current financial asset prices. Just as the expected yields from corporate bonds are much lower today than they were when the risks were higher in October 2002, the expected returns from stocks are now much lower as well. The undervalued stock market of late 2002 laid the groundwork for strong equity returns in 2003, with the Standard and Poor's 500 Index producing a total return of almost 29%.

Our view of the economy, as described in our October 2003 Economic & Market Commentary, has not changed. We expect the U.S. economy to post real GDP growth of 3-4% for 2004. Rising interest rates will presumptively follow this growth. The biggest risk to the financial markets remains the large structural U.S. budget and trade deficits and the resultant pressures on the dollar. Given the rising intensity of the presidential sweepstakes, budgetary restraint will continue to take a back seat to spending proposals. This may place psychological pressure on the financial and credit markets.

Given that investors are being paid less to assume risk today, we caution clients to resist the temptation to increase their risk profile, now that the investment environment has improved. We consistently counsel clients and associates that overly enthusiastic, or markedly pessimistic, appraisals of financial markets can lead to ill-advised departures from one's financial objectives. Some investors have shown short memories of the sharp equity value declines in 2000-2002. After watching the meteoric rise in 2003, they are recommending or moving towards greater equity participation. We counsel caution and a return to reasonable expectations.

Unless client circumstances have changed materially, we advise against raising the investment policy median equity allocation or adopting a more aggressive equity strategy. Investment policies should be established that take into consideration bad markets like the 2000-2002 period without changes. At the same time, we remain prepared to make tactical adjustments with regard to asset allocation and stock selection, when market conditions dictate. Please call us with any questions or comments you may have, or if you wish to discuss your particular situation in greater detail.