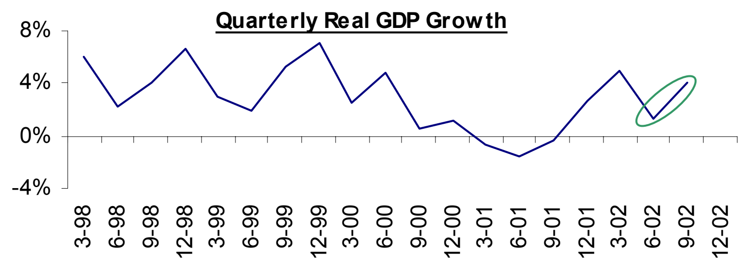
Your Quarterly Update on the Financial Markets
December 31, 2002

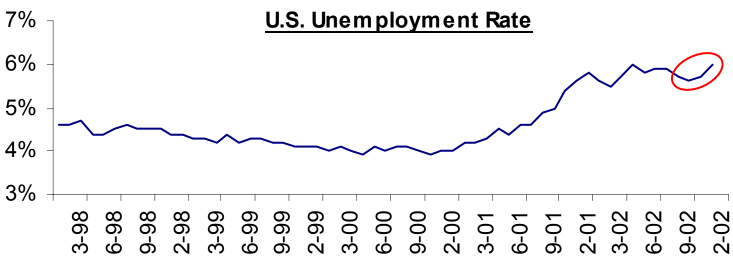
4th Quarter

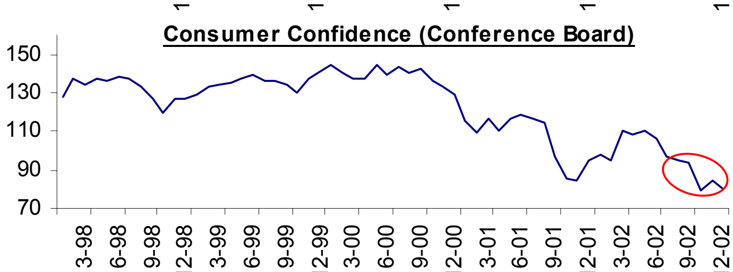
MARKET Recap

The Economy: *Slow recovery, too many "if's"*

The U.S. economy grew at a relatively healthy 4.0% annual rate for the third quarter, driven by consumer durables and, more specifically, automobile production. Other sectors were mixed to negative, and auto sales were projected to fall during the 4th quarter due both to seasonality and diminished returns from rebating and low-cost financing promotions. U.S. manufacturing activity increased in December, while holiday sales were

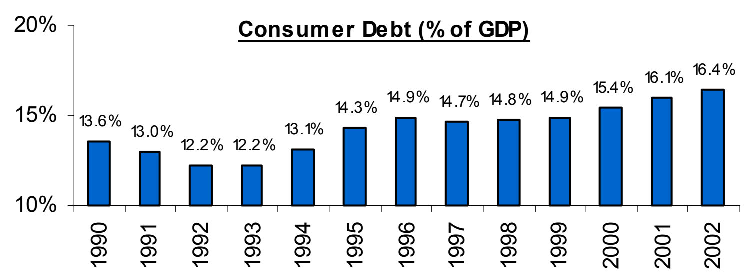






below expectations (anecdotally, as hard data are not yet available). If 4th quarter growth comes in at 1% - 1½%, we should close out 2002 with about 3.5% real growth. Consensus estimates for 2003 range around 3% ±½%, described as "sluggish" by some but in our view realistic for an industrial economy in steady state.

Of course the economy did not feel "healthy" for many. New unemployment claims rose at a higher than expected rate through the Christmas holiday week. Consumer confidence surveys continued to indicate pessimism, illustrated by Conference Board survey scores at or below levels seen just after the 9/11 attacks. The consumer spent anyway, and consumer debt has now risen to a 10-year high (compared to GDP). The Fed helped as expected by cutting rates by 50 basis points in November. With Republicans at the helm in both houses and focus shifting to the 2004 Presidential election, expect tax cuts and other fiscal goodies in 2003 to continue stimulating consumer spending while we wait for business investment to resume.



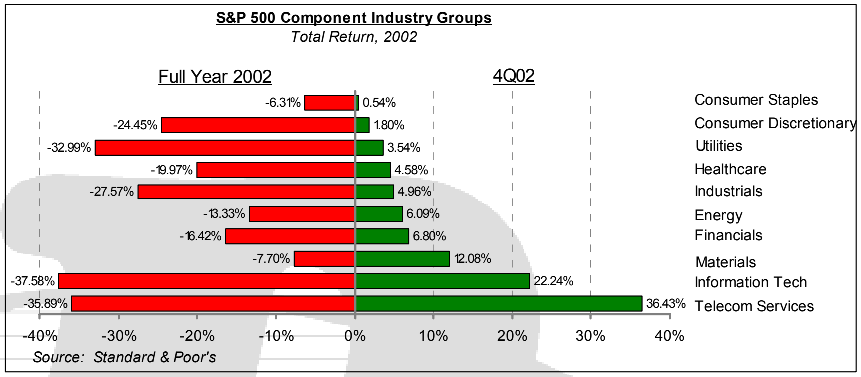
Inflation remained virtually non-existent except for oil prices, which climbed to over $30 per barrel. The situation in Venezuela is noteworthy not just for its short-term impact on the oil supply, but as a general example of the "event risk" overhanging the economy. North Korea is another example where regional economics and political/class struggles can affect the global economy very quickly; only one quarter ago we were focused exclusively on impending conflict with Iraq. Our concerns with consensus forecasts of steady recovery lie not so much with fundamentals, but with layered assumptions of low event risk. For example:

- Consumer spending remains strong;
- Asset markets do not further erode consumer wealth (especially the vulnerable real estate market);
- War with Iraq is averted, or is short and sanitary
- The North Korea situation is resolved without conflict;
- Oil prices stabilize and fall after the situation in Venezuela is resolved;
- No "surprises" elsewhere.

Individually, each assumption seems reasonable; but as the number of hot spots increases, the chance of a single event derailing the recovery grows. Further, we must consider interactions between problem areas; for example, the impact of conflict in the Middle East while there is an oil strike in Venezuela, and while auto sales are the bright spot in the U.S. economy. As long as this level of uncertainty persists, economically-sensitive strategies (including business investment spending) remain very risky.

The U.S. Stock Market

Despite a dismal December, the final quarter of 2002 provided U.S. equity investors with some relief. Better-than-expected earnings news outweighed declining consumer confidence, and the major markets advanced. The S&P 500 was up 8.44%, the Dow gained almost 10% and the Nasdaq Composite rose by over 13%. All 10 of the economic sectors in the S&P 500 rose, but it was the sectors that fared the worst earlier in the year, like telecom and information technology, that led the rally. Top performers for the quarter were Rational Software (+140.5%), Sprint Corp. PCS (+123.5%), Sealed Air Corp. (+120.8) and Qwest Communications (+119.3). Tenet Healthcare (-66.9%), Energy services company TXU Corp (-55.2%), and Allegheny Energy (-42.3%) were the worst performing stocks in the index.



Unlike the quarter's performance, results for the year were generally miserable. 2002 marked the third consecutive year of negative performance for the major U.S. equity markets. Clearly, investors were avoiding equities as an uncertain economic recovery, multiple accounting scandals, fear of terrorism, and the threat of war weighed down investor confidence. The losses in the equity markets were large and widespread. The S&P 500 index gave back 22.1%, its worst loss since 1974, and recorded losses in every economic sector in the index. Telecommunication services and information technology stocks were hardest hit, as expected, but utilities stocks were close behind, as companies with energy-trading exposure continued to feel the fallout from Enron. Of the ten worst performing holdings in the index, seven of them were utilities. Dynegy, Williams Company, Mirant, El Paso, AES, Calpine Corp., and Allegheny Energy all lost over 79%.

Stock Indices - Total Return					
	4Q02	2002		4Q02	2002
Large cap Stocks			**Midcap Stocks**		
S&P 500	8.44%	-22.10%	S&P Midcap 400	5.83%	-14.51%
Russell 1000	8.16%	-21.65%	Russell Midcap	7.92%	-16.18%
Growth	7.15%	-27.89%	Growth	9.16%	-27.41%
Value	9.22%	-15.52%	Value	7.07%	-9.65%
Broad Markets			**Small cap Stocks**		
NASDAQ Comp.	13.95%	-31.53%	S&P Smallcap 600	4.91%	-14.63%
Wilshire 5000	7.82%	-20.86%	Russell 2000	6.16%	-20.48%
			Growth	7.51%	-30.26%
			Value	4.92%	-11.43%

Blue chips stocks were also battered. Losing 16.8% in 2002, the Dow suffered its worse decline since 1977. Only three of the thirty stocks in the index ended the year with gains: Eastman Kodak rose 19.6%, Procter & Gamble gained 9.5% and 3M was up 4.3%. Home Depot was the biggest laggard, down over 53%. The story was even worse for the Nasdaq Composite Index, which holds many large technology stocks, it lost 31.5% in 2002.

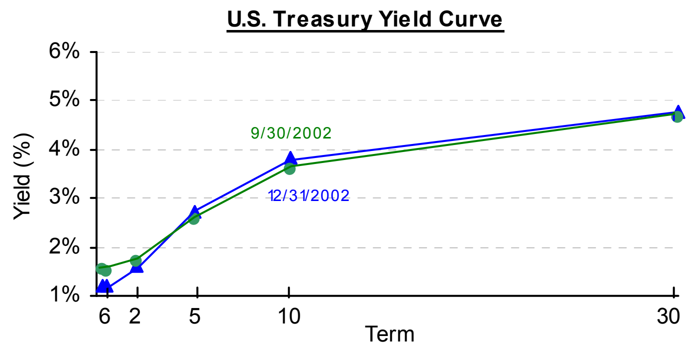
The successful stock picker may have found a few of the bright spots during the year. Although only one-fourth of the stocks in the S&P 500 posted gains, many of those gains were surprisingly large. Credit card lender Providian Financial returned 82.8% in 2002, Boston Scientific was up 76.3%, Newmont Mining gained 51.9% and Apollo Group (parent company to the online University of Phoenix) returned 46.8%.

Many investors are confused about what to expect in 2003. Some are optimistic about the coming year, since the markets have not experienced a four-year losing streak since the Great Depression; others, however, feel investors will continue to avoid equities, fearful of political uncertainly in Iraq and Korea and a sluggish economy at home.

The U.S. Bond Market

The bond sector posted its third consecutive year of equity outperformance as bond yields fell to 40-year lows. During the fourth quarter preferences rotated away from treasuries and into corporate issues with investors attempting to time the bottom of the interest rate cycle, seeking the enhanced yields of the investment grade credit sector.

The Federal Reserve moved to cut the federal fund rate 50 basis points (0.50%) to 1.75% at its November 6 meeting, believing that the short-term stimulative effect would help the economy through a perceived soft spot. Yields on the short end of the curve fell during the quarter, while longer maturities showed a modest increase. The spread between the 2-year note and 30-year bond widened out to 317 basis points with the effect of a steepening of the yield curve.



The default rate for speculative grade credit was running at a record pace of 14.89% for the twelve months ending on November 29, 2002. Even with a record default rate, high yield bonds were the best performing sector during the fourth quarter, returning over 6% versus government and corporate issues at 0.97% and 2.63%, respectively. In 2003 default rates are expected to remain elevated and slowly decelerate as the economy strengthens.

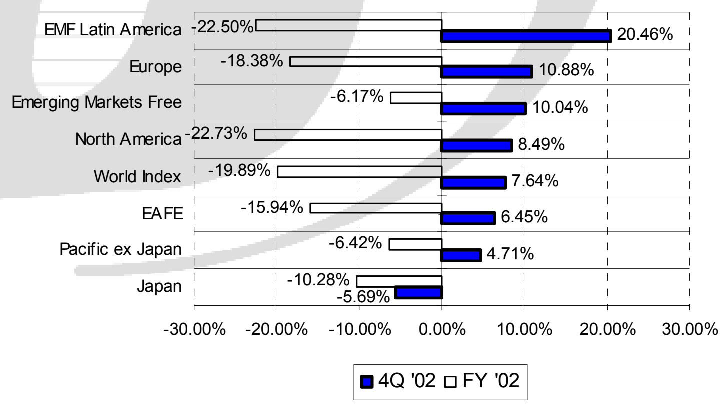
Bond Indices - Total Return	4Q	2002
Lehman Aggregate	1.57%	10.26%
Lehman Interm. Gov't	0.97%	9.64%
Lehman Long Gov't	0.07%	16.99%
Lehman Interm. Credit	2.63%	10.14%
Lehman Long Credit	4.59%	11.92%
Lehman High Yield	6.74%	-1.41%

In 2002 investors in long-term government bonds were the clear winners. The sector returned nearly 17% as investors sought the safety and peace-of-mind that government securities bring during volatile economic times, and benefited from long duration under falling interest rates (*duration* is a statistic measuring the sensitivity of a bond's price to changes in interest rates; longer duration bonds gain more when interest rates fall, but also lose more as interest rates rise). However, pressure on interest rates will coax investors to seek out lower credit quality, higher risk, issues in order to achieve returns. We are beginning to see this happen as evidenced by returns in both the corporate and high yield sectors during the fourth quarter. As many of the accounting scandals of 2002 are put behind the market, investors should find more opportunities in the corporate credit sector.

Can bonds outperform for another year? There are signs that the recovery is continuing with slow, but steady, growth. If stronger growth persists prompting the Fed to raise interest rates after the first quarter, bond performance will suffer. However, the threat of war with Iraq could easily cause another flight-to-quality, driving yields down lower than they are currently, benefiting bond holders.

Overseas Markets

At the close of 2002, hopes of a turn-around in the Global Markets showed some signs of life. In the face of a continued threat of war and looming issues with oil, many of the major MSCI Regions were up significantly for the quarter; however, most sectors were unable to overcome another year of double digit losses.



In Europe most of the major geographic sectors were up for the quarter, fueled by the positive economic news of a subdued threat of inflation and a 50 basis point cut in the borrowing rate from the European Central Bank to 2.75%. The ECB's monetary policy continues to focus on low inflation and price stabilization. But one quarter's worth of positive economic news was not enough to salvage the year. Euroland's manufacturing index was down for the fourth consecutive month with new orders falling to their lowest levels in a year. Germany, with increasing unemployment and low consumer confidence, was down over 32% for the year, followed by France, down over 20% for the year. Modest growth in the region is expected in 2003 with the prospect of continued low inflation and the expansion of the EU.

There was little to cheer about in Japan this year. The jobless rate remained at near record levels throughout the year and falling consumer confidence, coupled with deflation, derailed any hopes of an end to the on-going troubles. Japan was down 5.68% for the quarter and over 10% for the year. One bit of positive economic news for the region is Prime Minister Koizumi's Cabinet finally beginning to orchestrate moves to get the banking system back on solid footing, creating a program that will wipe out some of the $433 billion in bad loans.

Performance in Asia was mixed for both the quarter and year. China, which started the year off strongly, is struggling with its own structural problems of oversupply and deflation and was flat for the quarter, but down over 16% for the year. China is poised for a strong start to 2003 as it reported better than expected GDP of 8% for 2002. Elsewhere, volatility in the region resulting from North Korea's potential re-entry into the nuclear arms race cast a shadow on positive performance in South Korea and Thailand.

Latin America continues to be the most volatile region in the world. All of the major geographic sub-sectors had a strong quarter including Brazil, up over 40%, Argentina, up over 30% and Venezuela, up nearly 19%. However, for the year these same regions were down 33%, 50% and 18%, respectively. In Brazil, the election of Lula da Silva has served to calm the markets as he quickly moved to assure the international community of his commitment to make debt payments and control inflation. In Argentina, stabilization of the peso has caused a slackening in inflation – a positive development for the country. The biggest story in the region is the continuing oil strike in Venezuela, which threatens to spill over into all of Latin America and the greater global financial community.

Focus On: *Equity Sector Definitions*

What's in a mutual fund? Frankly, sometimes it's just hard to tell. There are clues, of course, from the fund's top ten holdings to its investment style. And a full list of holdings is published twice yearly in shareholder reports, albeit on a lag. Beyond that information, what stocks a fund holds at any given time is virtually a mystery.

The fund's investment style provides some indication. Yet two funds with the same investment style often get there different ways – large growth funds heavy in healthcare stocks versus those laden with technology holdings, or large value funds invested in traditional value stocks versus those with opportunistic positions – growth stocks at value prices. As history has proved, the sector exposure of these funds has made all the difference in performance, making good sector data even more critical to making informed investment decisions. Understanding where a fund invests its money is essential to ensuring it has the proper fit in any portfolio, from that of an individual investor to a large retirement plan.

Given the importance of sector diversification, how stocks are classified and reported has received much attention of late. Standard & Poors (S&P), Morgan Stanley Capital International (MSCI) and Morningstar have all introduced new sector classification methods in the last two years. Both classification systems aim to create a better way to evaluate stocks, with one system primarily focused on financial professionals and the other on individual investors.

The Global Industry Classification Standard (GICS) was developed by S&P and MSCI as an attempt to create a standardized structure for the finance industry. The GICS structure, adopted in 2001, consists of 10 sectors, 23 industry groups, 59 industries and 122 sub-industries. The structure applies to companies globally, has four levels of analysis ranging from the most general sector to the most specialized sub-industry, and is reviewed annually to ensure that the structure remains representative of the universe. The previous classification system used 11 sectors and 115 industry groups.

A company is assigned to a sub-industry based on the definition of its principal business activity, i.e., the business activity that produces the majority of the company's revenues and/or earnings. For those companies engaged in more than one substantially different business activity, the company is classified where the majority of revenues and profits are derived or, if no majority, the sub-industry that best reflects the companies principal business. Companies whose business activities are dispersed across three or more sectors are classified in Industrial Conglomerates or Multi-Sector Holdings.

Global Industry Classification Standard (GICS)	
Energy	Companies whose businesses are dominated by either of the following activities: the construction or provision of oil rigs, drilling equipment and other energy-related service and equipment including seismic data collection. Companies engaged in the exploration, production, marketing, refining and/or transportation of oil and gas products.
Materials	Encompasses a wide range of commodity-related manufacturing industries. Included are companies that manufacture chemicals, construction materials, glass, paper, forest products and related packaging products, and metals, minerals and mining companies, including producers of steel.
Industrials	Companies whose businesses are dominated by one of the following activities: the manufacture and distribution of capital goods, including aerospace & defense, construction, engineering & building products, electrical equipment and industrial machinery. The provision of commercial services and supplies, including printing, data processing, employment, environmental and office services. The provision of transportation services, including airlines, couriers, marine, road & rail and transportation infrastructure.
Consumer Discretionary	Encompasses those industries that tend to be the most sensitive to economic cycle. Its manufacturing segment includes automotive, household durable goods, textiles & apparel and leisure equipment. The services segment includes hotels, restaurants and other leisure facilities, media production and services and consumer retailing.
Consumer Staples	Companies whose businesses are less sensitive to economic cycles. It includes manufacturers and distributors of food, beverages and tobacco and producers of non-durable household goods and personal products. It also includes food & drug retailing companies.

Global Industry Classification Standard (GICS) – Continued	
Health Care	Encompasses two main industry groups. The first includes companies who manufacture health care equipment and supplies or provide health care related services, including distributors of health care products, providers of basic health care services, and owners and operators of health care facilities and organizations. The second group includes companies primarily involved in the research, development, production and marketing of pharmaceuticals and biotechnology products.
Financials	Companies involved in activities such as banking, consumer finance, investment banking and brokerage, asset management, insurance and investment, and real estate, including REITs.
Information Technology	Covers the following general areas: Technology Software & Services, including companies that primarily develop software in various fields such as the Internet, applications, systems and/or databases management and companies that provide information technology consulting and services; Technology Hardware & Equipment, including manufacturers and distributors of communications equipment, computers & peripherals, electronic equipment and related instruments, and semiconductor equipment and products.
Telecommunication Services	Companies that provide communications services primarily through a fixed-line, cellular, wireless, high bandwidth and/or fiber optic cable network.
Utilities	Companies considered electric, gas or water utilities, or companies that operate as independent producers and/or distributors of power. This sector includes both nuclear and non-nuclear facilities.

The GICS system was designed to have a market-oriented perspective, able to better handle the difficulty of drawing the line between goods and services, as most goods today are also sold with a service. The "Consumer Goods and Services" sector has become the more market-oriented "Consumer Discretionary" and "Consumer Staples" which both contain goods and services sub-industries. Many mutual fund companies have adopted the GICS methodology, and now report their sector data in this manner.

Implemented in the third quarter of 2002, Morningstar's new sector system was designed to help individual investors more easily compare the sector exposures of both funds and portfolios. The structure provides a consistent way for investors to evaluate common stocks and mutual funds, to better understand the exposure of their entire portfolio to a particular sector. Although Morningstar's new sector structure is primarily used only in its own reporting databases and Morningstar sheets, it is worth understanding given the widespread use of Morningstar among retirement plans and participants.

Morningstar's Sector Structure		
Information Economy	**Service Economy**	**Manufacturing Economy**
Software	Healthcare	Consumer Goods
Hardware	Consumer Services	Industrial Materials
Media	Business Services	Energy
Telecommunications	Financial Services	Utilities

The Morningstar sector structure divides the economy into three "super sectors:" the Information Economy, the Service Economy, and the Manufacturing Economy. Each of the super sectors contains four sectors, for a total of 12. Within each sector, there are 40 industry groups composed of 128 individual industries ranging from semiconductors to medical equipment. Most notable is how technology stocks are classified. The old "Technology" sector is now divided among three sectors: Software, Hardware, and Telecommunications, all falling under the super sector of Information Economy.

Regardless of the system you prefer, the challenge for mutual fund investors remains finding timely, accurate holdings data. Current SEC rules require fund managers to disclose their holdings semi-annually, with a significant time delay. Some fund managers voluntarily disclose holdings more frequently and provide sector classification to help investors make more educated investment decisions. Many large institutional investors are able to use their scale to require other managers to provide better data. For other investors help is now on the way; the SEC has proposed new disclosure requirements for investment companies. In December 2002, the Commission proposed that a fund be required to file its complete portfolio holdings schedule with the SEC on a quarterly basis, rather than semi-annually as currently required. The information would be available online in Electronic Data Gathering, Analysis, and Retrieval System (EDGAR), where interested investors could access it.

Until further disclosure requirements are implemented, sector data will continue to be essential for investors to make informed investment decisions. To learn more about the GICS and this year's updates effective April 2003, visit www.msci.com/equity/gics.html or www.standardandpoors.com. Morningstar sector information is available to subscribers of Principia Pro, or online at www.morningstar.com.

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