Bellwether CONSULTING

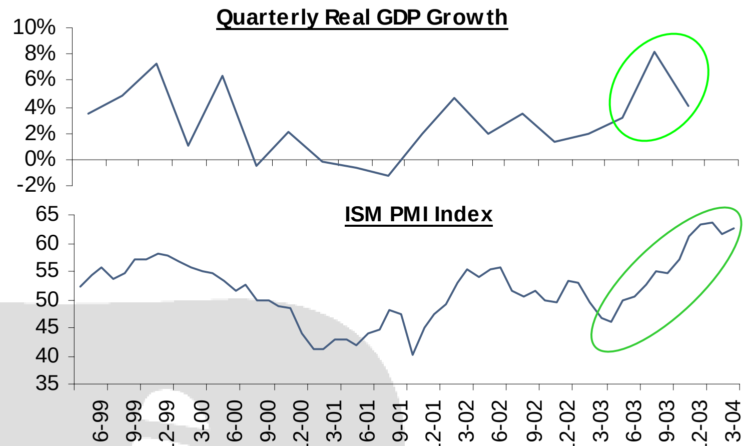
Your Quarterly Update on the Financial Markets
March 31, 2004

1st Quarter

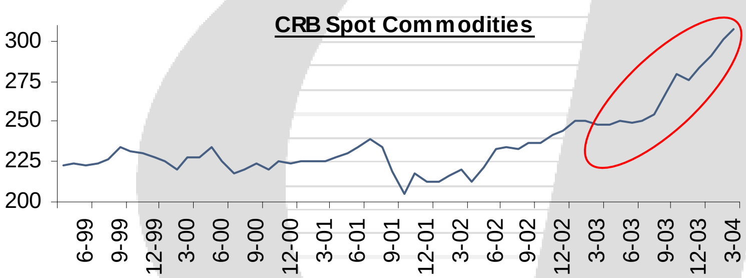
Market **Recap**

The Economy: *Factor Prices Threaten Maturing Recovery.*

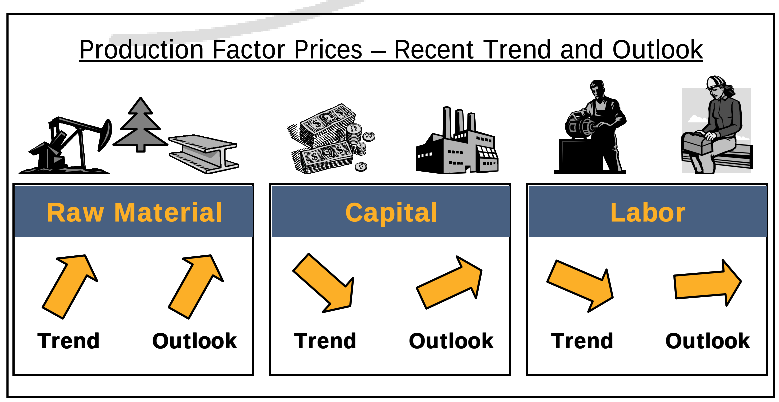
Fourth quarter GDP growth came in at 4.1%, revised upward from 4.0% on improved data, a strong finish for a recovery year. Business capital spending proved stronger than expected, and exports were buoyed by a weaker dollar. The Institute for Supply Management's PMI Index rose to 62.5 in March, re-testing a 10-year high achieved in January. As we've discussed in previous reports, this widely followed composite index measures activity in the manufacturing sector including new orders, production, employment, supplier deliveries, and inventories. March payrolls rose by 308,000 following gains of 46,000 for February and 159,000 for January. Unemployment edged up to 5.7%, reflective of people resuming job searches rather than new job losses.



Corporate profits for the 4th quarter grew 7.6% as companies were able to contain costs in spite of increased business activity, another factor supporting expectations for continued business investment spending. However, we continue to view inflation as a significant threat, as our outlook for all three production factors is now inflationary. Commodity prices continued to surge last quarter, and OPEC production cuts may likely increase upward pressure on raw material prices. The cost of capital (plant, equipment, and the money to finance it) has helped keep overall inflation in check, but the stage remains set for rising interest rates as Japan and other nations cannot continue purchasing U.S. treasuries at the current pace. Finally, the cost of labor has been held in check due largely to substitution effects. The practice of substituting foreign for domestic labor has attracted much attention during this election year, but the much larger and longer-term trend of substituting technology for labor has had a much greater impact on labor productivity. It is in part the low price of capital that has permitted businesses to make that substitution, a trend that may be arrested quickly in a rising-rate environment. There are also practical limits to sourcing foreign labor, as reflected in current rising demand for domestic labor.



Very recently all eyes were focused on prices, but the big concern was disinflation! Traditional measures of broad inflation like the Consumer Price Index have yet to signal meaningful price increases – yet inflation and deflation are already prevalent in large sectors of the economy, depending largely on how sensitive the sector is to the three production factors (consider the rising price of gasoline compared to the falling price of clothing). The "average" CPI can be quite misleading. That aside, we believe corporate profits will be quite sensitive to rising factor prices in an environment where increased costs are difficult to pass along to leveraged, price-sensitive consumers. That leads us to expect an early peak in the profit cycle, and ultimately pressure on businesses to resume efforts to constrain spending, playing out over the next 12 months or so.



The U.S. Stock Market

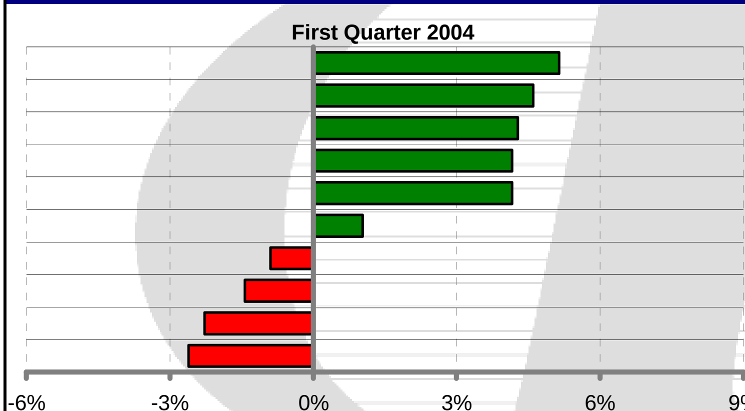
Stock Indices - Total Return			
Largecap Stocks		**Midcap Stocks**	
S&P 500	1.29%	S&P Midcap 400	5.07%
Russell 1000	1.90%	Russell Midcap	5.14%
Growth	0.79%	Growth	4.83%
Value	3.03%	Value	5.35%
Broad Markets		**Smallcap Stocks**	
NASDAQ Comp.	-0.46%	S&P Smallcap 600	6.22%
Wilshire 5000	2.22%	Russell 2000	6.26%
		Growth	5.58%
		Value	6.92%

Market volatility returned with a vengeance during the first quarter. Broad-market indices managed to finish the quarter in the black, but went on a daily roller coaster ride as economic news, oil jitters, terror threats and the preview of the upcoming presidential campaign roiled the markets. The S&P 500 had its fourth straight quarterly gain, finishing the quarter up 1.3%. Smallcap and midcap stocks continued to outpace large caps and value strategies outperformed their growth counterparts.

Consumer staples led all S&P sectors as surging consumer confidence continued to drive spending and a sustained economic recovery. Retailers Toys R Us and J.C. Penney were among the top ten in percentage gainers for the quarter on strong sales and earnings growth. The energy sector also performed well as rising oil prices, combined with high demand and low supply, spurred performance. Sector performance rotated over the quarter; basic materials which had surged at the end of 2003, and technologies which had also run up through last year, lagged all other S&P sectors. The tech bellwether NASDAQ Composite was down nearly one-half percent, the first quarterly decline since the third quarter of 2002.

As the quarter drew to a close business and consumer spending, corporate profits and consumer sentiment appeared to be slightly ahead of expectations. According to First Call earnings expectations have been revised upward from 13.4% growth to 16.7%. This follows a favorable earnings season with negative to positive pre-announcements closing at 1.7 to 1, well ahead of the 2.8 to 1 ratio seen last year at this time.

S&P 500 Economic Group Components - Total Return



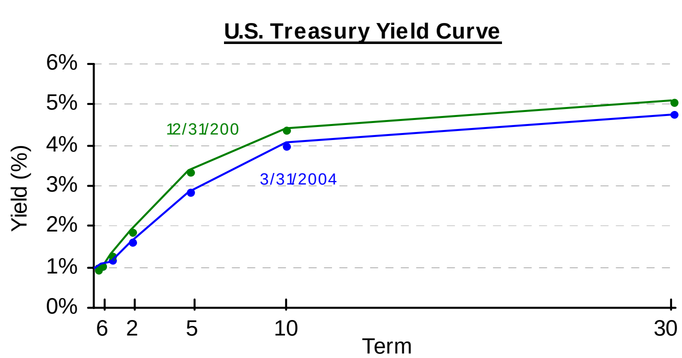
Sector	1Q04
Consumer Staples	5.14%
Energy	4.60%
Financial	4.28%
Telecom Services	4.16%
Utilities	4.16%
Consumer Discretionary	1.03%
Healthcare	-0.89%
Industrial	-1.43%
Materials	-2.28%
Information Tech	-2.61%

Source: Standard & Poor's

As reported earnings have increased, the price-to-earnings ratio of the S&P 500 has continued to fall. The P/E ratio currently stands at about 23 times trailing earnings; still high by historical standards, but much less so than during the stock market bubble. Investors need to remain vigilant of Fed moves as inflation begins to creep into the economy. Rising interest rates will erode both earnings growth by increasing capital costs and consumer confidence with the potential to curtail equity market momentum.

The U.S. Bond Market

Rates fell fairly steadily through the first 10 weeks of the quarter on general pessimism and speculation that economic recovery was slowing. Yields on the 10-year Treasury note, for example, fell below 3.7% on March 15th, more than 70 basis points below the starting point for the quarter. However yields backed up during the last week of the quarter on anticipation of stronger economic performance including an upward revision in 4th quarter GDP, interpretation of language following the March 16th Fed meeting, and speculation that Japan would end its aggressive campaign to support the U.S. dollar. At the end of the quarter rates were still well below their starting point, but with strong upward momentum.



Source: Bloomberg LP

Bond prices and pension liabilities increased with falling rates, providing bond returns on par with smallcap stocks and well ahead of the broader U.S. stock market. Corporate spreads were much less volatile than we've seen in past quarters, widening modestly at the long end of the curve but finishing virtually unchanged in the intermediate zone. We expect market conditions to be difficult for bonds in the near-term, as our economic outlook calls for inflationary pressure and rising rates.

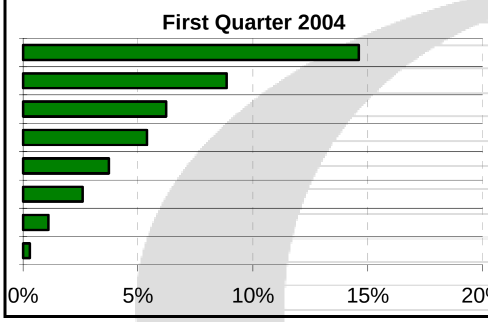
Bond Indices - Total Return	
Lehman Aggregate	2.66%
Lehman Interm. Gov't	2.21%
Lehman Long Gov't	5.36%
Lehman Interm. Credit	2.82%
Lehman Long Credit	4.73%
Lehman High Yield	2.34%

Overseas Markets

Global market performance continues to show stamina in some sectors, keeping pace with US domestic markets. However, specific geographic sector performance has been mixed with strong outperformance in Asia and Latin America and weak performance in major European sectors.

Performance in Europe was weak due in large part to a strong euro. The strong local currency makes it difficult for countries to export goods, since the goods are more expensive in foreign markets. To date the European Central Bank has left interest rates unchanged, but there has been growing pressure to lower rates to continue to spur economic growth. France and Germany, the EU's two largest economies, continue to disappoint. In France expectations for GDP growth remain negative even given a recent up-tick in consumer confidence. France still boasts the EU's second highest unemployment rate at 9.6% with a budget deficit that continues to exceed EU limitations. The MSCI France Index was down 0.36% for the quarter. In Germany business confidence fell for a second month in March, dragged down by a drop in retailing. Unemployment continues to stand at a historically high 10.3%. The German economy showed zero GDP growth year-over-year. The MSCI Germany Index was down nearly 4.5% for the quarter.

Gross Total Return of Selected MSCI Regional Indices



Region	1Q04
Japan	14.62%
Emerging Markets Free	8.87%
Latin America	6.24%
Pacific ex Japan	5.40%
EAFE	3.75%
World Index	2.60%
North America	1.10%
Europe	0.29%

Japan continues to show signs of strengthening with the MSCI Japan Index up 14.6% for the quarter. The most recent Tankan Survey, a widely-followed survey of sentiment among manufacturers in Japan, rose to its highest level since 1997. The index for large manufacturers rose to 12 from 7. Confidence in the service industry also turned optimistic for the first time in seven years. Strengthening has been largely export driven with a noticeable pickup in consumer spending. Japan's Finance Minister has said that the central bank stands ready to intervene when yen exchange rates deviate strongly and threaten to cool down expansion.

China has become the dominant story in Asia. Growth in China has been robust, creating a strong appetite globally for raw materials to fuel expansion with a concurrent inflating of commodities prices worldwide. Factory construction and speculative investing are driving growth in bank loans, leading to fears of an economic "bubble" forming. At the close of the quarter, Chinese policymakers tightened credit by 63 basis points to try to cool off the projected double digit growth which threatens to cause ripples in the global economic framework. If monetary policy fails, policymakers may be forced to revalue the current pegged exchange rate to slow growth. The MSCI China Index was down 3.5% for the quarter.

Latin American markets continue to perform well. In Brazil, the central bank made a slight cut to interest rates near the end of the quarter citing recent indications of lessening inflation risk. Brazilian President Lula da Silva recently met with his Argentinean counterpart Kirchner to discuss loan terms from the IMF. Both countries are seeking latitude under their agreements with the IMF to make major infrastructure investments in their respective country. The MSCI Brazil Index was down -0.41% for the quarter. Argentina recently threatened to default on a loan payment to strong-arm the IMF into making a $3 billion loan disbursement. The Argentine economy is experiencing a strong rebound, revising its 2003 growth rate from 8.4% to 8.7%. The MSCI Argentina Index was up 10.8% for the quarter.

Focus On: *Managed Account Innovations for DC Plans.*

Prior to the SunAmerica Opinion of 2001, plan sponsors and retirement plan providers tried, with limited success, to help qualified plan participants save enough money for their retirement needs. Study after study concluded that most would fall far short. Small legislative steps coupled with a burgeoning internet fostered the first attempts to help address the need for more guidance and advice. Many plan recordkeepers created proprietary guidance modules which helped participants allocate money among their plan investment options. Companies such as Financial Engines and Morningstar took the next step by developing online advice sites, which go beyond mere guidance by choosing funds for the participant.

Unfortunately, usage rates among participants have generally fallen short of expectations. Apathy, inertia, insufficient investment education, and a lack of comfort with web-based advice were all factors. As a result, most participants continued on a track that would leave them far short of their financial needs at retirement. Plan sponsors also faced the same issues that have plagued them for years, namely low participation rates, equally poor deferral percentages (savings rates), and improper allocation of assets by their employees who did participate.

In 2001, the Department of Labor granted SunAmerica Retirement Markets, Inc. ("SunAmerica") an advisory opinion that it could provide discretionary asset management and investment advice to participants in ERISA plans. SunAmerica sought an exemption due to the fiduciary status it would incur, along with the potential for increased advisory fees that it, or an affiliate, might receive. The DOL based its Opinion on the following:

- The plan fiduciaries responsible for selecting the SunAmerica investment program would be fully informed about, and would have to approve the program and types of services provided, including the role of the financial expert;
- The investment recommendations provided to, or implemented for, participants would be the result of methodologies developed and maintained by a financial expert who is independent of SunAmerica and any of its affiliates; and
- The arrangement between SunAmerica and the financial expert would preserve the financial expert's ability to independently formulate the basis of the asset allocation.

This Opinion and the rationale behind it paved the way for other retirement plan providers to offer similar programs to their plan sponsors and participants. The generic name used for these programs is "Managed Accounts".

Managed Accounts are an alternative for qualified plan participants whereby they delegate all investment related responsibilities to an independent financial expert for an asset-based fee. The expert chooses the funds and allocates assets based upon information provided by the participant, and is solely responsible for ongoing monitoring and investment changes within the account. Managed Accounts are often coupled with an accelerated savings feature allowing for incremental increases in the participant's deferral rate.

SunAmerica Exemption Requirements

- Each account must be managed on the basis of the participant's financial situation and investment objectives.
- The sponsor of the program must obtain sufficient information from each participant to be able to provide individualized investment advice to them.
- The sponsor and portfolio manager must be reasonably available to consult with each participant.
- Each participant must have the ability to impose reasonable restrictions on the management of their account
- Each participant must be provided with a quarterly account statement containing a description of all activity in their account.
- Each participant must retain certain indicia of ownership of all securities and funds in their account.

Qualifying Requirements for Managed Accounts

Several key requirements must be met in order for a product to qualify under the DOL SunAmerica Opinion, including individualized management, client contact, reasonable participant-imposed restrictions, quarterly account statements, and retention of indicia of ownership over the account.

A product provider will typically designate a portfolio manager (e.g., Financial Engines, Ibbotson, Morningstar) who gathers information from the participant, recordkeeper, plan sponsor, and third parties, including a participant's financial circumstances and retirement income objectives, prior to assigning a specific allocation. Participants can provide additional information by going online or calling the provider's service center to receive more personalized service.

Most providers will contact each participant at least annually to determine if their financial situation or objectives have changed, or whether they want to impose reasonable restrictions on management of the account or modify current restrictions. Participants are reminded, in writing, at least quarterly that they should contact the provider if there have been any changes in their situation, or if they want to impose or change restrictions. Whether a particular restriction is "reasonable" will depend on an analysis of the relevant facts and circumstances by the portfolio manager. Programs need not provide participants control over specific securities or types of securities, and restrictions could be deemed unreasonable in the aggregate even if each restriction is reasonable separately. In addition, restrictions could be unreasonable if they are changed with excessive frequency.

An accounting of all transactions made on behalf of the account, all contributions and withdrawals, and all fees and expenses charged to the account is required. The statement must include the value of the account at the beginning and end of the quarter. Participants must receive trade confirmations from the party executing the transaction. The confirmations must include all information specified by the applicable law governing such content.

This quarter's focus article was written by Todd Valles, a colleague of ours with considerable experience in designing retirement products. He may be reached via Bellwether Consulting for questions or comments.

Automatic Enrollment and Accelerated Savings

Managed Accounts are usually offered with some form of automated or "negative election" enrollment. In June 1998, at the National Summit on Retirement Savings, President Clinton spoke favorably of automatic 401(k) enrollments stating that companies with automatic enrollment reported 90% participation compared with 67% overall participation rates for all other plans. Furthermore, demographic groups most at risk for insufficient retirement savings seem to benefit the most from automatic enrollment. If these groups do not participate or save sufficient amounts, it reduces the amounts that highly compensated employees can contribute to the plan due to discrimination rules. In addition, inertia comes into play.

Behavioral experts believe that confusion leading to procrastination is a key reason why participants do not enroll on their own. Individuals simply put off making changes to more suitable choices because the decision seems too complicated. When people don't know what to do in a difficult situation, they often do nothing. By automatically enrolling participants into the plan and managed accounts, the decision is made for them. However, experience shows that many of these participants tend to defer the default or minimum amount indefinitely.

An "accelerated savings" feature addresses the issue of low deferral rates. Participants automatically have their deferral rate boosted by 1 – 3 percent at specified future dates unless they opt out. Plan sponsors could make these dates coincide with anticipated pay raises. This would increase deferral rates and also help employers overcome IRC discrimination rules which plague highly compensated employees. These automatic increases continue annually until participants either reach the plan deferral maximum or opt out of the program. In studies of mid- and large-sized companies conducted by quantitative behavioral scientists Thaler and Benartzi, deferral rate increases were noted, and more importantly, few participants elected to discontinue the managed savings element once they were enrolled.

Advantages

Managed Accounts along with accelerated savings helps to resist the prevailing trend that participants generally remain with both the default contribution rate and the default investment allocation (e.g. money market), even though such inaction may fail to take full advantage of the matching and results in inadequate income at retirement. Because of low savings rates, automatic enrollment by itself may not be enough to achieve the result sponsors are hoping for concerning discrimination and HCE issues. Experience shows that inertia generally rules 401(k) savings behavior. The vast majority of participants seldom make changes as they progress toward retirement despite inadequate contribution rates, inappropriate allocations, changing market conditions, etc. The managed savings component helps to overcome this hurdle.

Aside from the advantages noted above, sponsors may have much to gain by implementing a Managed Accounts program within the framework of their plan. By implementing the program, they more effectively discharge their fiduciary duties for choosing and monitoring investments and address Sec. 402 issues. In addition, by offering a plan with Managed Accounts, a sponsor may limit or eliminate potential suits by participants attempting to hold sponsors responsible because they did not save enough for their retirement. Finally, sponsors pay no additional fees to offer this service. Fees are borne by the participant in the form of an additional wrap ranging from 50 to 120 basis points. As more providers offer this service competition will drive down the fees. However, plan sponsors should consider these costs carefully; Managed Accounts are best implemented using low-cost underlying investment funds.

Participants receive complete personalized investment services from an independent financial expert including asset allocation, fund selection, fund monitoring, and a savings feature, all designed to provide them with adequate retirement income. The participant can provide personal and spousal data to assist the independent financial expert to augment the service. Aside from electing the service, the participant has no other responsibilities. The wrap fees for the service are deducted along with the underlying fund expenses on a daily basis so there are no out of pocket expenses.

Product providers benefit in two ways. Managed Accounts should attract additional assets. Also, the provider collects the asset-based fee for the Managed Account services. Fees payable to the independent expert range from 5 – 15 basis points of assets under their management; the balance is retained by the product provider to offset administrative expenses and contribute to profit.

It is too early to determine whether plan sponsors and participants will embrace Managed Accounts in large numbers. Its success will depend upon the type of enrollment options approved by the sponsor, cost, and the number of participant steps necessary to sign up for the program.