Your Quarterly Update on the Financial Markets April 2001

Market **Recap**

1st Quarter

Stock Indices - 1Q 2001 Total Return			
Largecap Stocks		**Midcap Stocks**	
S&P 500	-11.9%	Russell Midcap	-10.5%
		Growth	-25.1%
Russell 1000	-12.6%	Value	-3.5%
Growth	-20.9%	**Smallcap Stocks**	
Value	-5.9%	Russell 2000	-6.5%
		Growth	-15.2%
		Value	1.0%

Bears reign on Wall Street

The U.S. Stock Market sold off sharply during the first quarter, extending and accelerating the fourth quarter trend. Market indices all moved lower, with the Dow Jones Industrial Average suffering its worst percentage loss in 26 years. The damage was much worse for the NASDAQ due to heavy weighting in technology stocks, which led the market decline. Value stocks continued to outperform growth stocks by a wide margin.

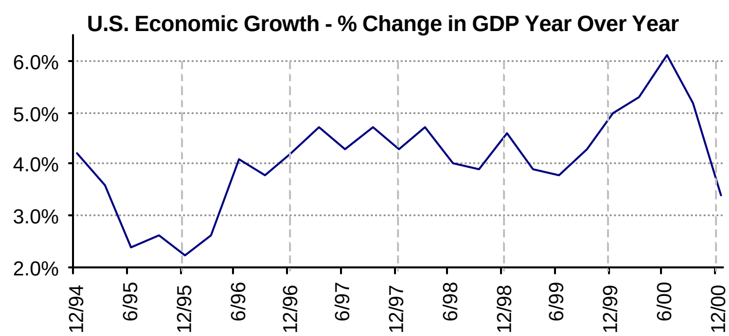
Major overseas markets fell in sympathy with the U.S. market. In Japan, the Nikkei index dropped to a 16-year low. Japan still suffers from low consumer and business confidence.

Bond prices surged in response to the Fed's decision to lower interest rates. Yields assumed a more normal configuration, and short-term rates fell below long-term (the relationship had been reversed for several previous quarters, an unusual condition known as an "inverted yield curve.") High-yield bonds performed particularly well in January. Although they gave back some of the gains in March, high-yield posted a better quarter than all other major market sectors. Overall, the bond sector finished ahead of equities for only the 7th time in the last 26 years.

Bond Indices - 1Q 2001 Total Return	
US Investment Grade	
Lehman Aggregate	3.0%
Lehman Gov/Credit Intermediate	3.4%
Lehman Gov/Credit Long	2.7%
US High Yield	
Lehman High Yield	6.4%
World Bond	
Lehman Global	1.7%

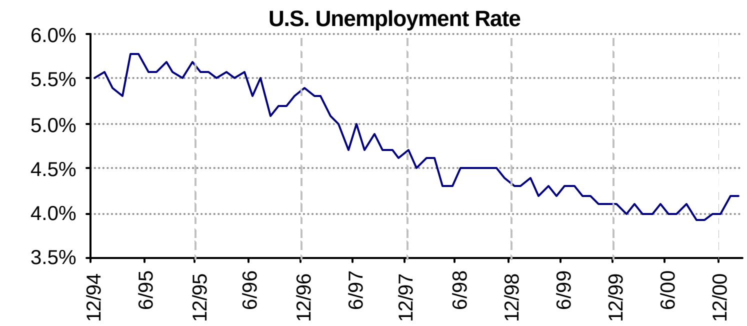
The Economy

Leading indicators of economic activity continued to trend lower, causing widespread concern of recession. Companies braced for a slowdown by reducing expenses; from December 1 to date, more than 400,000 employees were laid off. According to outplacement firm Challenger, Gray & Christmas, March's job cuts were nearly triple the level of a year ago and over 100,000 for the 4th month in a row. Staff reductions were not limited to technology firms.



Staff reductions were not the only signs of a slowing economy in the first quarter. Statistics show the NAPM index moving lower. In advance of a slowdown, companies are selling existing inventory rather than making purchases. While this may argue for recession, a positive outcome is that once inventories are depleted, manufacturing will be necessary to replace exhausted inventories.

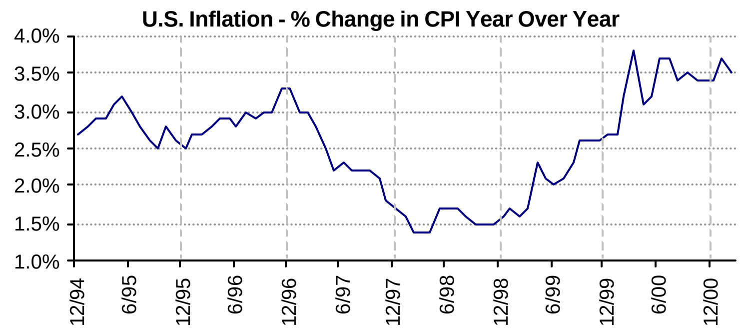
In response to the slowdown, the Federal Reserve cut interest rates three times, including an unusual half-point decrease between regularly scheduled meetings. The total reduction of 1% brings rates back to 1998 levels, the early days of the last economic surge. While the cuts should spur economic activity, we believe it takes 6-12 months for the effects of a rate change to work through the economy. As the charts show, approximately 6 months lapsed between the Fed's last rate increase of 2000 and the drop in economic activity.



The latest economic statistics show some promise. In particular, consumer confidence rebounded in March after plummeting to a cyclical low in February. We believe positive leading indicators, along with more normal bond yield relationships and stock prices, bode well for a recovery later this year.

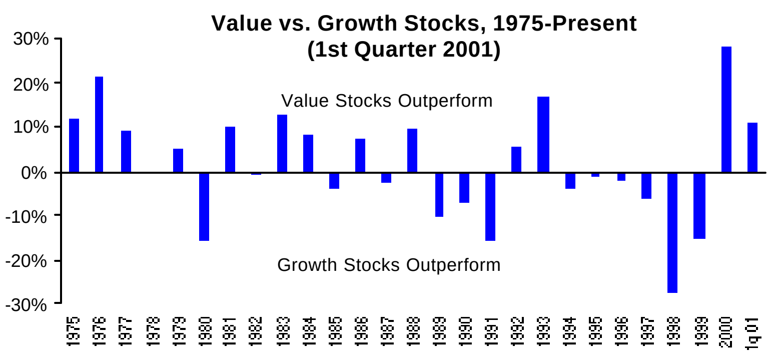
There are, of course, significant risks: two in particular stand out. The first is the much discussed "wealth effect," cited by the Fed and others as a driver of the booming stock markets of the late '90s. Much of that wealth, which supported high consumer confidence and robust spending behavior, was erased over the past six months. We simply do not know the long-term effects of a bear market on today's investors.

The second is oil, an ever-present driver of economic conditions. Black gold is a special focus for us this quarter. As we learned from the '70s, higher oil prices combined with recession can lead to severe economic conditions. OPEC reduced output twice last quarter in response to lower U.S. demand, and expressed sentiment that current prices were at the low end of their target range of $26 to $32 per barrel.



The U.S. Stock Market

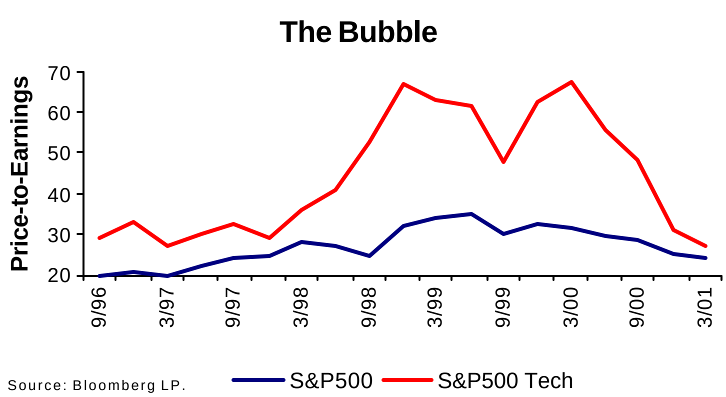
Bear market conditions prevailed in the broad U.S. market, driven by two major factors. First, concerns that an economic slow-down leading to recession would depress future earnings growth. Stock prices, especially in the tech sector, could only be justified by very aggressive growth assumptions. The price-to-earnings ratio, a measure of investors' willingness to pay a premium for future earnings growth, peaked at 35 for the S&P 500 and 68 for the S&P 500 Technology Sector, well above the historical range of 15–20. Several earnings warnings served as catalysts for the first quarter slide, most notably Cisco and Nortel Networks.



Source: BARRA. Difference in returns of S&P/Barra Value and Growth Indices since inception.

Second, we witnessed broad erosion in confidence: Consumer confidence, business confidence, and investor confidence. The latter half of the quarter was noteworthy in the absence of sideline buyers stepping into the market after each dip. According to data from the Investment Company Institute, stock mutual funds had a net outflow of $3 billion in February, compared with net inflow of $25 billion in January.

For the technology sector, general conditions were aggravated. Many dot-com companies were forced to shutter or restructure without the ability to generate earnings or obtain investor capital. These companies were big spenders, and so major software and hardware suppliers higher in the food chain suffered.



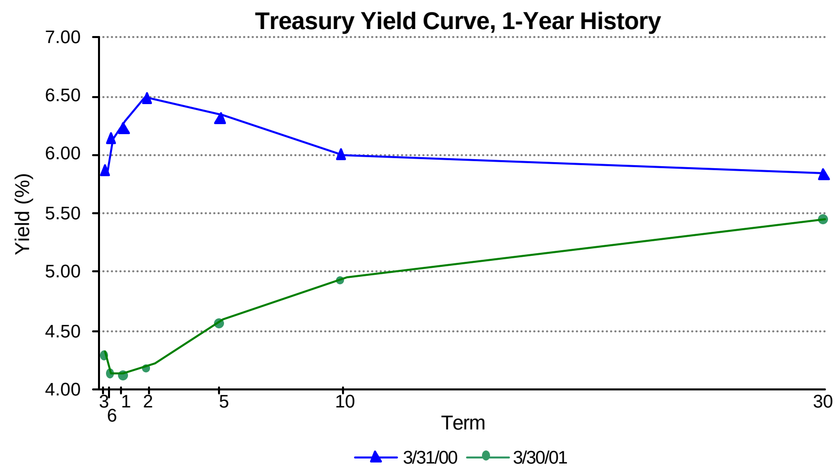
Source: Bloomberg LP.

The good news is that stock prices are approaching historic norms once again, and the disparity between prices of "old economy" and "new economy" stocks has been virtually erased. There is talk on the Street about finding value in technology stocks, and analysts from value shops have been sighted at high-tech company presentations.

S&P 500 Components	
Transportation	-0.40%
Utilities	-7.71%
Healthcare	-15.15%
Consumer Staples	-8.16%
Financial	-10.00%
Energy	-6.58%
Communication Services	-0.54%
Consumer Cyclicals	0.64%
Basic Materials	-6.51%
Capital Goods	-13.83%
Technology	-24.84%

The U.S. Bond Market

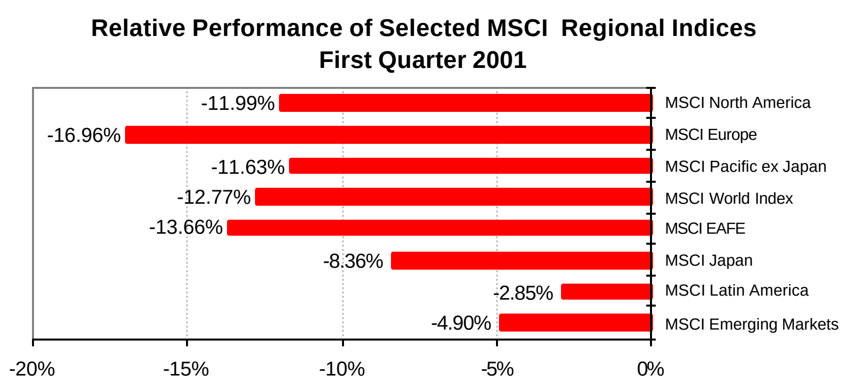
Bonds were the place to be last quarter, with high positive returns in virtually every sector of the market. Short-term rates fell most quickly, reshaping the yield curve into a more normal, upward sloping configuration. High yield bonds surged in January. Credit spreads, which were unusually wide in the latter half of 2000, contracted sharply in January. Spreads widened somewhat in March, but much of January's gains were left intact. The volume of investment grade bond issuance increased 79% to $201bb in first quarter, up from $102bb in the fourth quarter. Poor performance in the equity markets with an increase in inflows to bond funds and an appetite for acquisition financing drove the increase. The Telecom sector led corporate issuance, followed by financial companies and automakers.



The high yield bond market is very sector- and issue-specific. There is a considerable block of low-quality debt from the late '90s, issued in the early days of the technology "bubble," that is of concern as the economy slows. High yield bonds, like cyclical stocks, are susceptible to a slowing economy's impact on profits and may prove too risky for investors in the long term even given their attractive yields in the current falling interest rate environment. Skillful investment managers that can navigate through the complexity of this market segment should be able to add considerable value.

Overseas

World stock markets fell in sympathy with the U.S. markets. Economic conditions in Europe present somewhat of a puzzle, growth remained stronger in Europe than in the U.S. or Japan prompting the central bank to pass up several opportunities to reduce interest rates. The Bank has been more focused on preventing inflation and defending the Euro than guarding against recession. On the other hand, European manufacturing dropped for the 11th straight month. As in the U.S., the Purchasing Managers Index for Europe was down. Germany, France and Italy all showed slowing export orders. The U.S. was the largest investor in the Euro Zone in 2000, absorbing 13% of exports, but with the slowdown in U.S. markets, the outlook for future growth is weak. In the U.K., weaker than expected production has prompted a call for the Bank of England to lower interest rates. The cut is seen as an insurance policy for the U.K., since there is currently low inflation. All evidence is that the UK economy won't be able to avoid the expected effects of the U.S. slowdown.



Confidence among

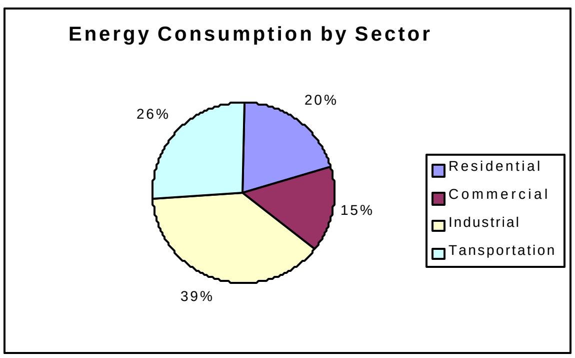
executives and consumers hit a 20-month low in the European Community amid growing concern over the U.S. economy.

Turmoil increased in Japan as the Nikkei index reached a 16-year low and the economy threatened to slide back into recession. Stock market losses came in spite of the news that economic growth was up 0.8% for the 4th quarter. The growth was due to demand in the technology and telecom sectors and analysts are concerned the lagging GDP statistic does not yet reflect the global slowdown in those sectors. The Bank of Japan lowered interest rates to near zero in response to the slowdown and widespread criticism. Fundamental problems in the capital markets remain, including bad debts, and the practice of holding stock in customers and business allies. A number of major banks and corporations began reducing exposure to cross-held securities, a step in the right direction but one which creates added short-term selling pressure. In Asia, Korea turned in a strong performance, whereas the markets in Hong Kong and Singapore sold off sharply.

Strong economic growth rallied the Mexican stock market in the first quarter. Growth prospects in the financial and telecom sectors led the market. The Bolsa finished the quarter up 3.1%. Argentina's index, the Merval, also posted a gain of more than 6%. Economic growth in Mexico and Brazil is expected to have a positive impact on the entire Latin American region. S&P is expected to upgrade Mexico's credit rating to investment grade based on passage of current fiscal proposals. The entire region is beginning to be seen as a good value with stronger growth expectations than the U.S.

Focus On: ***Oil - 'Black Gold'***

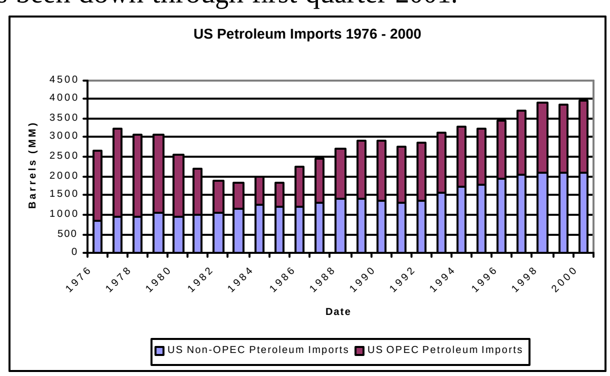
In recent years, U.S. consumers have spent over half a trillion dollars a year on energy that is consumed in three sectors: the residential and commercial sector, the industrial sector, and the transportation sector. Industry has historically been the largest energy-consuming sector of the economy, ahead of both the residential and commercial sector and the transportation sector. One of the main economic drivers of output is oil. Oil is needed to produce goods, to move products to market, to bring buyers and sellers together and, ultimately, to consume produced goods. Most developed economies are intimately tied to the production and consumption of oil.



Source: Energy Information Administration

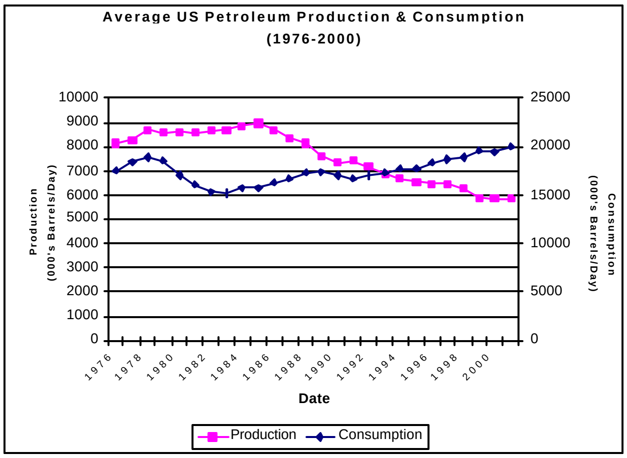
OPEC, the Organization of Petroleum Exporting Countries, provides more than 40% of the world's oil supply. At its recent meetings in January and March 2001, OPEC decided to cut their output by 1.5mm and 1mm barrels per day, respectively. OPEC cited counter-seasonal price drop during late 2000 and early 2001, slackening demand as less heating oil is needed, and low demand prior to the summer driving season. The slowdown in the U.S. economy was also cited as one of the main reasons for the production cuts. The U.S., the world's biggest consumer of oil, has enjoyed unprecedented economic expansion over the past decade, and as the economy shows signs of slowing, the consequences for oil demand by the U.S. are assumed by OPEC to be negative, necessitating a supply reduction to support current prices. It is unclear exactly what effect the U.S. economic slowdown will have on oil demand, although worldwide oil demand has been down through first quarter 2001.

Decreased production by OPEC will most likely lead to higher oil prices. OPEC's objective is to maintain oil prices between $26-$32 per barrel. As of this writing, the price of oil is approximately $27.50 per barrel, down from a high of $34 as late as November 2000. Higher oil energy prices have precipitated three of the past four recessions (1973-75, 1980, 1990-91). At the time of the other recession (1981-82), oil prices were falling but had been high and, thus, contributory. The connection between higher energy prices and recession is obvious: paying more for energy leaves less money to spend on other consumable goods. In addition, businesses are hard-hit by higher energy prices. Higher energy prices impact the bottom line and as corporate profits are



Source: Energy Information Administration threatened so are the stock markets. A hit to the markets can translate into a hit to wealth and can serve to further reduce consumer spending. Since oil is used in many phases of production and petroleum derivatives are found in many finished products, higher energy prices will impact many economic sectors. Higher costs of production lead to increases in manufacturing prices. The impact of these increases is partially offset through higher prices charged to consumers, but ultimately corporate profits are hit as well. As corporate profits decrease, businesses scale down by reducing workforces with the potential for a negative spiral effect.

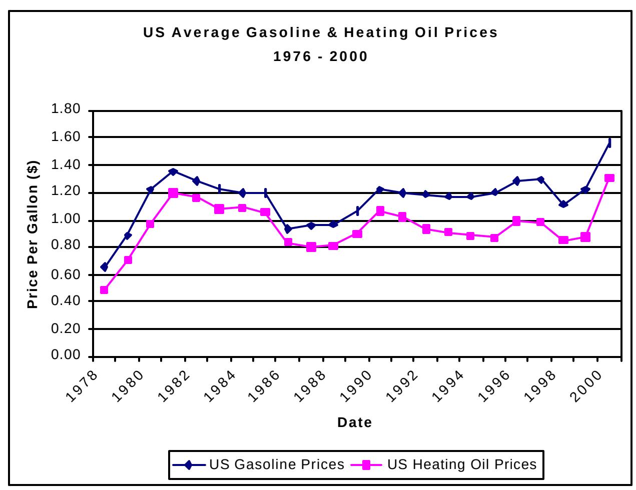
A cold winter in the Northeast and Midwest have added to oil woes, leading the U.S. to add to domestically available petroleum stocks from the SPR, the Strategic Petroleum Reserve. While this move added to supplies, it did not have as great an impact on price as expected. The variable price of energy is still one of the greatest threats to the U.S. economy. Unless the U.S. can develop a large measure of energy independence, the domestic economy will always be at the risk of suffering a shock if our supply of crude oil is interrupted.



Source: Energy Information Administration

However, the effect of oil prices on the economy may not be as drastic as it once was. In 1980, oil accounted for 6% of all of the personal expenditures for Americans. Even with present energy prices, oil accounts for 2.7% of the present personal expenditures in the U.S. Better auto fuel efficiency, the continued movement of the population to warmer climes, and the movement away from energy consuming production jobs to service jobs have lessened the impact of energy price increases on the economy. The transition to a Republican administration in Washington has seen a new set of energy policies put forth by the Bush camp, with Spencer Abraham serving as Energy Secretary. Chief among the new policies is to try to open 1.5 million acres or 8 percent of Arctic National Wildlife Refuge (ANWR) to "environmentally responsible" drilling. Currently, the U.S. imports around 55% of its petroleum demand, with the expectation that this reliance will increase to over 60% within the next ten years. The ANWR is believed to hold between 3 and 16 billion barrels of crude oil that the administration believes should be used to cut domestic dependence on imported petroleum.

Bush would also like to modify the newly established 2-million-barrel Northeast home heating oil reserve to be privately managed by distributors instead of by the federal government. The Bush plan would also use the Strategic Petroleum Reserve only in the event of major supply disruptions. In addition, the Administration hopes to provide tax credits to small operators of low-volume oil wells when energy prices fall, which would help to keep the wells operating. Owners of so-called "stripper wells" would get a tax credit of $3 per barrel when oil prices fell below $15 a barrel. Large corporations such as Exxon Mobil would also receive a break in paying federal royalties when prices fall. The legislation also seeks to reduce cash royalties that major energy firms pay on offshore production when oil prices fall below $18 a barrel for 90 consecutive days. Vice President Dick Cheney, a former oil industry executive, is heading a special panel that will review what changes in energy policy the administration should make. At this time it is unclear how the new energy policy will impact the economy, although there has been strong opposition to drilling in the ANWR by conservation groups and members of the Senate.



Source: Energy Information Administration

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