Bellwether CONSULTING

Your Quarterly Update on the Financial Markets

June 30, 2001

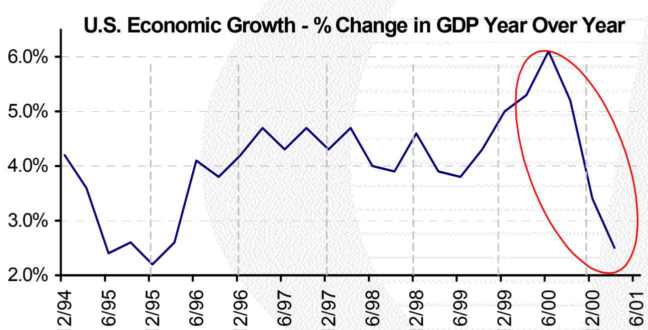
2nd Quarter

MARKET Recap

The Economy: *Wait, Watch, and Worry*

Date	Action	Rate	Bias
2001			
8/21	<next scheduled meeting>		
6/27	Decrease	3.75	Weakness
5/15	Decrease	4.00	Weakness
4/18	Decrease	4.50	Weakness
3/20	Decrease	5.00	Weakness
1/31	Decrease	5.50	Weakness
1/4	Decrease	6.00	Weakness

Investors watched closely for signs of life throughout the second quarter as the Federal Reserve cut interest rates three times, culminating in a ¼ point cut at their June 27 meeting. The benchmark Fed Funds rate ended the quarter 275 basis points (2.75%) below the 2000 peak level, now approaching levels not seen since the end of the 1991 recession and start of last decade's bull market. Despite the weak job market, consumer sentiment and spending behavior remained fairly strong with statistics on home sales and durable goods orders better than expected. Reduced pressure on commodity and labor markets have kept inflation out of the picture so far; however concern over inflation appears to be growing within the FOMC, as suggested by the more moderate June move. Expectations are for any further easing to be at a more modest pace.



Shrinking corporate profits remain one of the foremost concerns for regulators as well as investors. Although profit expectations have been greatly reduced, closing the gap somewhat between expectations and reality, substantial pessimism continues to pervade the business community. The aftermath of the technology stock meltdown continues to ripple through other industries, and we may have underestimated the psychological impact of the stock market's fall on key decision-makers. Companies have braced for recession through spending cuts and layoffs.

Irrational inexuberance? Perhaps, but we believe it poses a real threat to recovery. Further earnings disappointments and stock market malaise may result in more spending cuts, ultimately affecting the consumer. It remains to be seen what catalyst, if not Fed easing, will cause corporate America to resume spending.

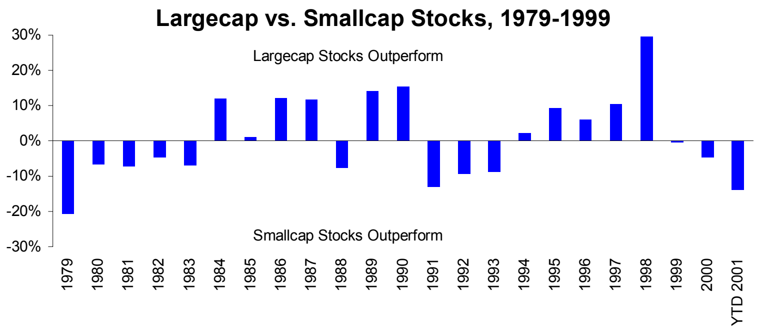
Other related threats include economic weakness overseas and continued strength in the dollar, which has added to profit pressure for large U.S. multinationals. All that said, aggressive Fed easing is strong medicine, and the consensus forecast remains for recovery toward the end of the year.

The U.S. Stock Market

It may have been the greatest recovery never told. All major market indexes gained in the quarter, propelled by solid returns in most sectors of the market. But did anyone take notice?

Stock Indices - 2Q 2001 Total Return			
Largecap Stocks		**Midcap Stocks**	
S&P 500	5.85%	Russell Midcap	9.53%
		Growth	16.18%
Russell 1000	6.31%	Value	7.04%
Growth	8.42%	**Smallcap Stocks**	
Value	4.88%	Russell 2000	14.38%
		Growth	18.12%
		Value	11.70%

The 2nd quarter marked a turnaround for U.S. stocks, particularly technology, with the tech-laden NASDAQ closing the quarter with a 17.4% advance after four straight quarters of declines. Peoplesoft, eBay, Siebel Systems and Verisign were top performers, though in some cases still well off their highs. Growth stocks also returned to favor, outpacing their value counterparts across the board, though they still lag for the year. Small cap stocks continued to prevail. Looking at year to date, only small cap stocks, measured by the Russell 2000 Index, show any results in positive territory, gaining 6.94%



Source: Frank Russell . Difference in returns of Russell 1000 and Russell 2000 Indices since inception.

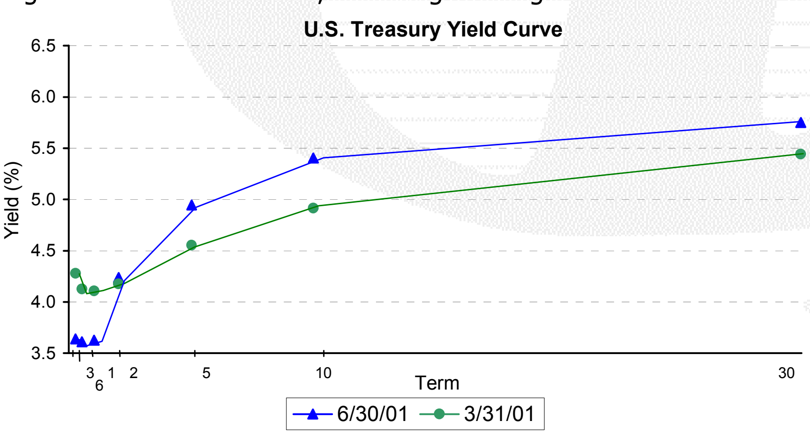
During a period of weak corporate profits, failed merger deals and lower earnings forecasts, the market rebound seems to have passed on by without much impact on investors, who are simply looking forward to greener pastures. The questioning has gradually shifted from 'how low can it go?' to 'when will it recover?' with hopeful investors looking to late in the year for answers to the economy's woes. Cautiously optimistic for a late year recovery, buyers gradually returned for bargains among the battered tech stocks. According to data from the Investment Company Institute, new sales of stock mutual funds in May was the highest since January, but it is still a third behind for the year compared to the same period in 2000. Prevailing sentiment is that while there may be light at the end of the tunnel, we haven't reached it just yet.

The Bond Market

Fixed income securities came off of their first quarter highs, and even the best performing sectors posted only modest returns. The short end of the curve responded to aggressive Fed easing, while inflation concerns pushed yields for longer term bonds higher (and therefore reduced returns). U.S. Credit (investment grade corporate bonds) outperformed other sectors, benefiting from tightening spreads. Continuing the first quarter trend, supply of new issues is still high. $383 billion of corporates were issued in the first half of 2001, surpassing full year 2000 levels.

Bond Indices - 2Q 2001 Total Return	
Lehman Aggregate	0.56%
Lehman Interm. Gov't	0.42%
Lehman Long Gov't	-1.75%
Lehman Interm. Credit	1.01%
Lehman Long Credit	1.22%
Lehman High Yield	-2.29%
Lehman Global ex US	-1.82%

High Yield bonds retreated, as ratings downgrades and increased defaults led to a loss of 2.29%. The biggest drag on performance was in the Communication Services sector, especially among lower rated issues, which lost over 12%. Financial issues benefited from the Fed actions and were the biggest winners to date, gaining 24.31% for the year. Also of note: the Technology sector is back in positive territory, contributing 7.96% for the quarter and 15.90% year-to-date.

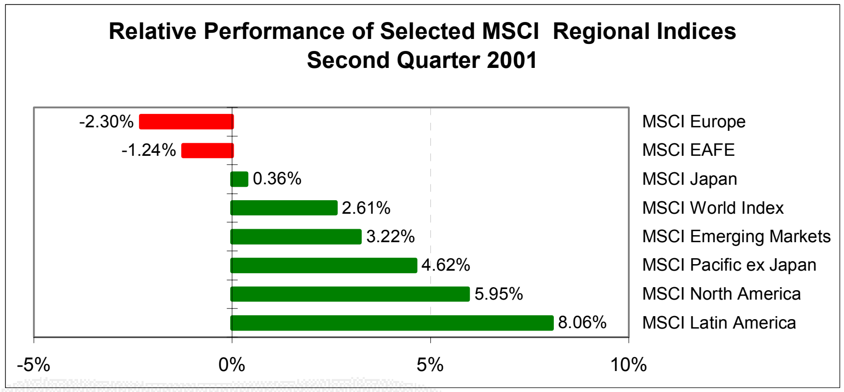


Even though results were well outpaced by equities, bond funds continued to attract substantial investment during the second quarter. Flows into Investment Grade bonds were $6.65 billion and flows into High Yields were $1.08 billion.

Overseas

The overseas stock markets were mixed during the second quarter with Europe and the EAFE losing ground while Japan, the Emerging Markets and Latin America all showed positive performance. The major themes during the quarter were continued concerns over U.S. corporate earnings growth creeping into the European market, hope over a new Japanese Prime Minister, and the strong performance of the Emerging and Latin American Markets.

In Europe almost every industry sector posted losses, most notably Telecommunications, down over 15% for the quarter and over 31% year-to-date. The fragile European economic environment continued to suffer the effects of a weak Euro. A decrease in manufacturing output, high energy costs and a lack of confidence seemed to take their toll on the Euro-zone market, especially in Germany and France with both countries lowering their growth estimates for the year. The European Central Bank took steps to lower interest rates with a quarter-point reduction on May 10 in the wake of aggressive U.S. rate cutting by the Federal Reserve. Global investors continue to call for more rate cuts in the face of pending inflation and a slowing European economy.



Japan's new Prime Minister Koizumi took office in April and began calling for caps on government debt and tax reforms as the country's economy continues to suffer. The impact of lowered interest rates last quarter has yet to materialize as another quarter of negative growth caused by increased savings rates is expected. Structural economic reforms may be needed to help the Japanese economy in the long-term. Elsewhere in Asia, the markets of Hong-Kong, Thailand and Korea posted gains as the materials, consumer discretionary and technology hardware sectors showed positive performance. Taiwan fell on concerns of decreased production and a lag in semiconductor prices.

Latin American emerging markets showed the strongest performance during the quarter. Mexico led all countries, with strong performance in the financial and energy sectors, posting a 24% gain for the quarter. Oil producers throughout Latin America enjoyed the benefits of higher energy prices. Brazil, which had shown good performance during the first quarter, stumbled during the second with currency devaluation, relative to the U.S. dollar, combined with a decline in the cyclical and utility sectors and an increase in interest rates.

Focus On: *Benchmark Basics*

When evaluating whether your funds stack up, the answer inevitably centers on the almighty benchmark, the yardstick all good investments are measured against. But what do you really know about this critic of fund performance? No two benchmarks are exactly alike, and some change all the time. Understanding the subtleties may not always be practical, but obtaining a good general knowledge of what makes some of the major benchmarks tick will help you make educated decisions about your investment program.

Just like funds, benchmarks come in all shapes and sizes. Some are designed to represent the broad market, while others tend to focus on a specific niche, like particular styles or sectors. Then there are those that represent the average of similar funds. Which flavor should you choose? How do you know if what you're using is appropriate?

To answer these questions, let's examine the types of benchmarks used in the industry. Indexes are the most common. An index is a pre-selected group of securities that represent the overall performance of the market or segment of the market. You're probably familiar with the Dow Jones Industrial Average and the S&P 500 - they often make the headlines and are useful gauges for the activity of the general market. Not long ago it was common for the performance of most equity funds, regardless of their focus, to be graded relative to this kind of *broad market index*. The risk of using a broad index is that the contribution of the manager or the investment style will not be recognized. Consider a top quartile small cap value manager in 1998. The S&P 500 index gained 28.58% for the year, while a top performing small cap value manager returned only 1.83%.

Market Segment	Core Index	Style / Sector Specific Index
Total Market	Russell 3000 Wilshire 5000	Russell 3000 Growth and Value
Large Cap	Russell 1000 S&P500	Russell 1000 Growth and Value S&P500/Barra Growth and Value
Mid Cap	Russell Midcap S&P Midcap 400	Russell Midcap Growth and Value S&P Midcap 400/Barra Growth and Value
Small Cap	Russell 2000 S&P Smallcap 600	Russell 2000 Growth and Value S&P Smallcap 600/Barra Growth and Value

So what benchmark might have been more meaningful? *Sector-specific indexes* have been a good solution for many plan sponsors. Sector performance is widely published in newspapers and posted on the internet, and using this performance allows for a more precise comparison and helps reduce the mismatch risk that can occur from using market indexes. In our example, specifying the Russell 2000 Value Index rather than the S&P 500 Index for our small cap value fund could have prevented the likely dismissal of the manager, saved the plan sponsor the cost and effort of finding a replacement fund, and shielded the plan sponsor from the risk of adding an even poorer-performing fund. If you're scratching your head because you're not exactly sure what you're using to benchmark investments offered in your plan or even in your personal account, it might be a good time to check. We've outlined some commonly used and frequently published indexes for U.S. Stocks. Index providers for other major asset classes include Lehman Brothers and Salomon for fixed income, and Morgan Stanley Capital International (MSCI) indexes for international equities.

Most index providers strive to ensure their indexes are a fair and accurate representation of the markets. But as you can see from the example below, significant differences can exist with regards to the construction and maintenance of indexes from different families.

	Standard & Poors	Russell
Index Construction Which stocks to include	• Discretionary based upon committee decision • Companies included are leading companies from leading industries	• Formula driven
Weighting How much of the stock to include	• Based on market capitalization	• Based on free-float • Number of shares outstanding is adjusted for cross ownership and privately held shares to reflect shares available for trading
Rebalancing	• S&P rebalances its indexes continuously and will always hold the targeted number of companies (i.e. 500 for S&P 500)	• Russell rebalances its indexes once per year, on June 30th based upon May 31st market capitalization
Maintenance How to treat corporate actions	• Mergers, acquisitions and the like are adjusted as they occur • Committee may periodically remove a stock for lack of representation	• No adjustments are made throughout the year for mergers, acquisitions or bankruptcies
Style Index Methodology Growth / Value	• Teams up with Barra to construct value and growth versions of the S&P indexes. • The market capitalization of the "parent" (S&P 500, S&P Midcap 400 and S&P Smallcap 600) index is divided equally between growth and value • The split is based on a company's book to price ratio (B / P) • Rebalanced twice per year, on June 30th and December 31st	• Uses proprietary formula • 70% of the individual stocks will be classified as either value or growth. The remaining 30% will have a portion of their market value in both the growth and value style indexes. • The growth versus value split is based on book to price ratio (B / P) and Institutional Brokers Estimate System (I/B/E/S) forecast long-term growth mean • Rebalanced once per year on June 30th.

Peer groups are often used as benchmarks. Peer groups are more subjective than an index, and are less consistent. Categories will change every month as the funds experience style drift, are merged into other funds or are closed, so the basket of funds used as a benchmark will be constantly changing. On the other hand, these are the most appropriate when a relevant index is not available, or when the manager's style is very unique (e.g. concentrated portfolio or multi-sector bond fund). Avoid using peer group comparisons as the sole barometer of performance whenever possible; rather, use them in conjunction with an index.

Benchmarks are useful tools and an important part of the investment monitoring process. They can be misleading, however, if not chosen appropriately. As we close the first half of the year you're likely evaluating the performance of your plan's investments. Perhaps it's a good time to evaluate your benchmarks as well. Most index providers maintain a web site with more information about their index products. Many include monthly or daily returns, key characteristics, and major constituents free of charge. For more information, have a look at these sites: www.spglobal.com, www.russell.com, www.lehman.com, www.salomonsmithbarney.com, and www.msci.com.

Bellwether Consulting LLC
2 Yorkshire Drive, Cedar Grove, NJ 07009
mailto:consultants@bellwetherconsulting.net