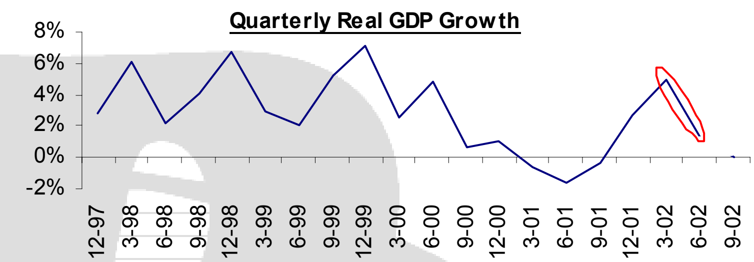
Bellwether CONSULTING

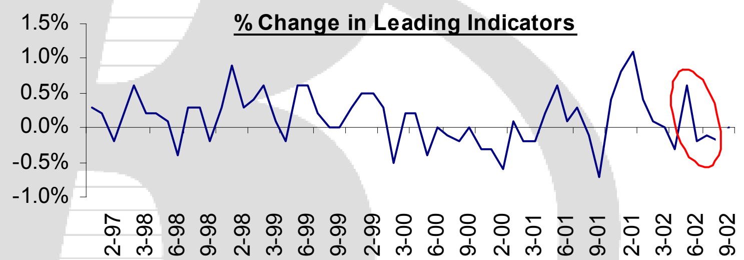
*Your Quarterly Update on the Financial Markets*
*September 30, 2002*

3rd Quarter

# MARKET Recap

## The Economy: *Consumer-Investors Fight the "Double Dip"*

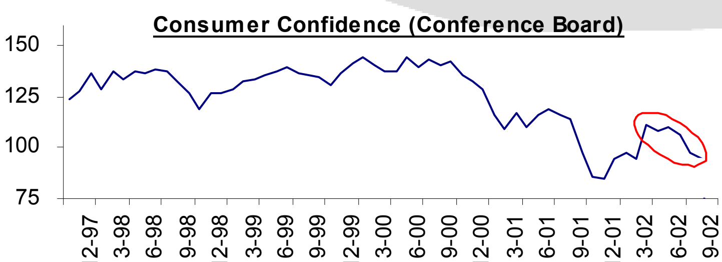



Concerns over the health of Corporate America and a potential shooting war in Iraq created a difficult environment through the summer, threatening to stall a budding economic recovery. The pace of real economic growth slowed faster than expected in the second quarter, and the more predictive (and volatile) Index of Leading Economic Indicators fell in July and August.

Consumer sentiment turned decidedly negative, driven primarily (in our opinion) by ongoing frustration with corporate scandals and dismal stock market performance. Interestingly, people expressed their frustration with words but not with deeds. Retail sales rose in August for a third consecutive month. Refinancing activity, investment in home improvements, and auto sales were quite strong. In part we believe this is driven by loose credit, with interest rates at a 40-year low. While business inventories rose in response to surprisingly strong consumer demand, business investment spending remained highly guarded in an atmosphere of tremendous uncertainty. Consumer spending has been the primary driver of growth in this cycle, and will likely continue to be for some time.

The Federal Reserve FOMC met on September 24 and left rates unchanged, but reiterated a bias toward future economic weakness. Meanwhile, corporations continued to exorcise their demons. The required CEO/CFO certification process was completed without incident. It was a good first step, however, negative earnings surprises dominated the news after the certifications were completed. Companies have already tightened their belts considerably on the expense side and, lacking the usual bag of financial engineering tricks, they had little choice but to report bad news. According to First Call, 123 earnings warnings were issued by S&P 500 companies during the quarter, compared to only 47 upside surprises. The stock market was hammered repeatedly, taking wealth from the very consumers who were propping up the economy with their spending.




The "reverse wealth" effect discussed briefly in last quarter's newsletter looms much larger, as so many consumers are now investors. It will likely take more than one quarter of fundamentally good news on earnings to convince "consumer-investors" that Corporate America can earn an honest buck. We look for a rate cut at the November 6 Fed meeting or sooner to stimulate holiday spending, attempting to prolong consumer spending until investor confidence is restored.

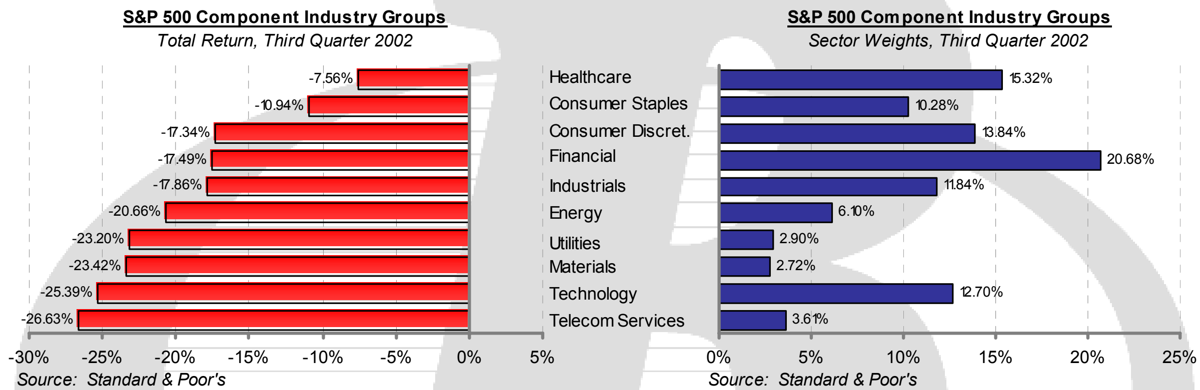
Overshadowing the economic fundamentals is the threat of war. While war can benefit a narrow range of industries and provide short-term stimulus, the economic impact is generally bad even for the winner. Recall that a 1991 post-war recession cost the very popular George H.W. Bush a second term in office. We close the quarter with developments that may provide a peaceful path forward, but even an optimistic observer must take weapons inspections with a grain of salt, or at least admit that much uncertainty remains. Still, the situation at press time is improving, which may provide some relief to battered consumer-investors.

# The U.S. Stock Market

Investors found little relief in the third quarter from the market turmoil experienced most of the year. Continued fears of terrorism, the threat of war with Iraq, and ultimately concerns over corporate profits pressured markets lower. Although the recertification of corporate financial statements occurred in August with no major surprises, investors were still uneasy from corporate governance abuses and confidence remained low. All of the major market indices ended the quarter with double digit losses, dragging already poor performance even lower. Year-to-date the S&P 500 lost over 28%, the DJIA lost 23% and the NASDAQ Composite Index was down almost 40%.

| Stock Indices - 3Q 2002 Total Return | | | |
|---|---|---|---|
| **Large cap Stocks** | | **Midcap Stocks** | |
| S&P 500 | -17.28% | S&P Midcap 400 | -16.55% |
| Russell 1000 | -16.91% | Russell Midcap | -17.64% |
| Growth | -15.05% | Growth | -17.18% |
| Value | -18.77% | Value | -17.95% |
| **Broad Markets** | | **Small cap Stocks** | |
| NASDAQ Comp. | -19.81% | S&P Smallcap 600 | -18.61% |
| Wilshire 5000 | -16.81% | Russell 2000 | -21.40% |
| | | Growth | -21.52% |
| | | Value | -21.29% |

Losses were widespread. Only 42 of the 500 stocks in the S&P 500 gained ground during the quarter, and none of the 10 sectors of the S&P 500 posted gains. Dynegy (-84%), AMR, the parent of American Airlines (-75%) and telecommunications equipment maker Avaya (-71%) led the decline; while Nextel Communications (+135.2%), International Game Tech (+22%) and advertiser Omnicom Group (+22%) were top performers. Results in the Dow were equally dismal, with only 3 of the 30 stocks posting gains for the quarter and only 2 posting gains year-to-date.

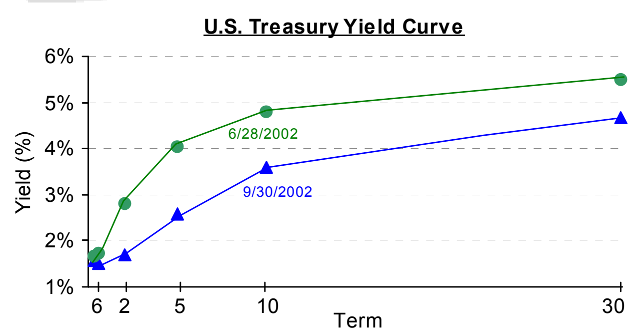



Small cap stocks underperformed large caps as the Russell 2000 fell short of the Russell 1000 by 4.5%. Reversing the prior two quarters of outperformance, large value stocks lost more than their growth-oriented peers, although year-to-date value stocks are still ahead.

Considering the huge losses posted so far this year, the equity market is well on its way to a third consecutive year of losses and many investors are taking action. According to the Investment Company Institute (ICI), Domestic equity funds had an outflow of $629.0 million in August, compared with an outflow of $49.0 billion in July. Stock funds that invest overseas had an outflow of $2.3 billion in August, compared with an outflow of $3.6 billion in July. Conversely, bond funds had an inflow of $17.4 billion in August, compared with a record inflow of $28.1 billion in July.

# The U.S. Bond Market

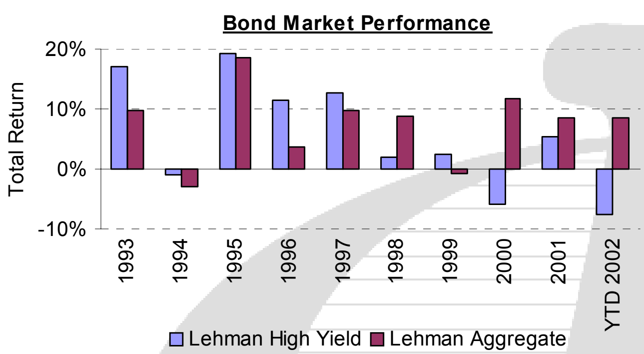
Bonds continued to benefit from investors' flight from risk. Persistent stock market losses, fear of terrorism, concerns over Iraq, and a lackluster economic recovery sent bond yields lower (pushing prices higher). All maturities along the yield curve experienced declining rates. The spread between the 2 year note and 30 year bond steepened slightly, ending the quarter at 298 basis points. Conversely, spreads between shorter maturities flattened by 100 basis points, ending the quarter at 13 basis points. The Fed left the overnight bank rate unchanged at both the August 13th and September 24th meetings, holding at 1.75% (a 40+ year low). While the August vote was unanimous, there were two dissenters at the September meeting, fueling speculation that the Fed will soon lower rates.

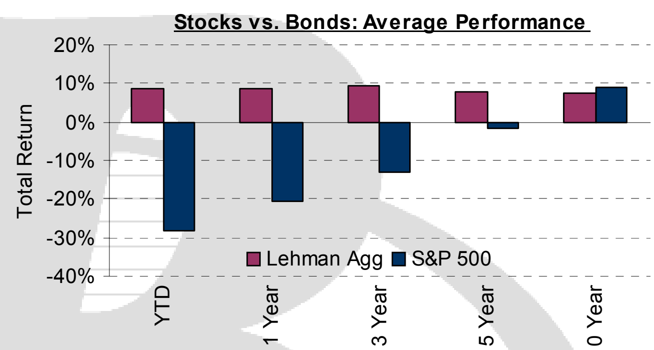


Government securities, especially those with long duration, were the clear winners for the quarter, outpacing other sectors in the bond market and trouncing equities. In the corporate sector, spreads relative to treasuries widened, and bond sales continued to slow. According to Lehman, $73 billion of high grade issues were sold in the quarter, down 34% from a year ago. Downgrades continued to weigh on the market, with investment grade corporates experiencing 5 downgrades for every 1 upgrade. Despite positive performance in August, high yield bonds once again ended the quarter in negative territory, giving back 2.93%.

| Bond Indices - 3Q 2002 Total Return | |
|---|---|
| Lehman Aggregate | 4.58% |
| Lehman Interm. Gov't | 4.82% |
| Lehman Long Gov't | 12.09% |
| Lehman Interm. Credit | 4.19% |
| Lehman Long Credit | 5.51% |
| Lehman High Yield | -2.93% |

Falling interest rates have been friendly to borrowers, who are able to finance large purchases like cars, boats and homes or refinance existing loans at record low rates. Freddie Mac reported the average rate for 30 year home loans recently dropped below 6%. However, falling rates can be problematic to some investors. For example, holders of mortgage securities are receiving their principal back earlier than expected and are forced to reinvest at lower current rates. The low rate environment is also impacting many pension plans. Falling interest rates have caused pension liabilities to increase significantly, and plans that have the bulk of their assets invested in equities are facing considerable funding pressure.

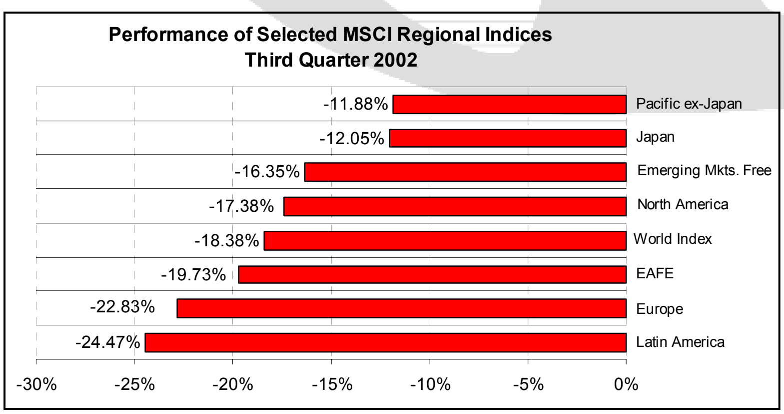



Continued outperformance of bonds relative to equities has clearly begun adding up over the long-term, as the graphic above indicates. Note the Lehman Aggregate Bond index outpaced the S&P500 index over the 5-year period and is steadily gaining ground on the 10 year average.

# Overseas Markets

Global markets saw no relief in the third quarter as all of the major geographic sectors lost ground. Markets in Europe, Asia and Latin America suffered double digit losses as negative global economic news continued to affect an already anemic recovery.




In Europe, it was another quarter of unfulfilled expectations. The European Central Bank, which lowered rates four times last year, has shown no signs of adding additional monetary stimulus as money supply and CPI, its two policy objectives, are at target levels. Concerns that budget deficits in Germany and France may increase to EU warning levels of 3% of GDP hurt the region. Business confidence in Germany fell to an eight-month low in September and the index of French manufacturers showed low expectations of a turnaround. The European Monetary Affairs Commission revised the region's growth forecast downward from 1.4% to 1.0% for this year.

Japan was unable to hold onto gains made during the second quarter. The economy continues to be plagued by failed banking reforms. Members of the G7 have continued to call for resolution of Japan's bad debt problem. The government may finally take a definitive step towards resolution, possibly using emergency funds to bail out banks. Deflation also had a negative impact as September's CPI was down 0.9% year-over-year. Unemployment has also run unabated; the total number of jobless increased to 3.6 million, maintaining a historically high 5.4% unemployment rate. The quarter ended with Prime Minister Koizumi poised to overhaul his cabinet due to the ineffectiveness of his staff to quell the financial crises facing the country.

Elsewhere in Asia performance was mixed. South Korea continues to impress with industrial output nearly doubling expectations, driven by strong auto and semi-conductor sales. Increasing exports also helped Korea's current account turn a US dollar surplus. Performance in China slipped this quarter even as the government announced the possibility of allowing foreign investors to participate in government controlled business. The Chinese market was down over 16% for the quarter.

Latin American markets continue to teeter on the precipice of financial devastation. In Argentina the CPI has risen for seven consecutive months to 34% and inflation estimates have been revised from an expected 50% by year-end to 64%. The Duhalde government has been ineffective at implementing structural changes while being rebuffed by the IMF for bailout funds. Brazil, however, has been the beneficiary of IMF aid. A $30 billion loan is expected to keep Brazil solvent through the end of the year. Once again this quarter, Mexico has been hit by a slowing economy. Monetary easing earlier this year has failed to turn the economy around. The blow has been softened by an increase in oil prices resulting in gains to Mexico's current account.

# Focus On: *Capitol Hill Legislation - Looking Out for the Little Guy*

It's been almost a year since the fall of energy giant Enron, a year filled with a flurry of legislative activity aimed at helping the little guy, the small investor, the retirement plan participant. Both the Senate and House have responded to the significant loss of employees' retirement income, corporate scandals and lack of confidence in corporate America with reform legislation addressing corporate governance, financial reporting, and retirement plans. Much of this new legislation focuses on regulations at the corporate, or retirement plan sponsor level, with the individual to ultimately benefit.

Following is a discussion of highlights of recent and proposed legislation. The measures are quite detailed, too much so to address fully here. Instead we have chosen to explore some of the measures that impact retirement plan sponsors specifically. We encourage you to review the legislation directly to understand the implications on retirement plans and participants.

### *Sarbanes-Oxley Act of 2002*

In an effort to restore investor confidence after a year plagued by corporate scandal, the first of many legislative proposals was quickly passed by Congress and signed into law in the third quarter. Dubbed the "Corporate Fraud Accountability Act of 2002," the Sarbanes-Oxley Act is primarily designed to address fraud in financial reporting and lack of corporate oversight with tightened regulations, criminal penalties and prison terms for corporate fraud. The Act is widely known for its provision requiring public company CEOs and CFOs to personally certify periodic reports filed with the SEC, but it also has several implications on retirement plans.

| ***Implications of the Sarbanes-Oxley Act on Retirement Plans*** |
|---|
| ▪ Plan administrators must provide 30 day advance notice of blackout periods; specific notice requirements |
| ▪ Executive trading of the issuer's stock banned during blackout |
| ▪ The maximum allowable ERISA section 501 criminal penalties now ten years imprisonment and/or $100,000 ($500,000 for a corporate entity) |
| ▪ Stock transactions by directors, officers, and 10% or more beneficial owners must be reported to the SEC within two business days |
| ▪ Loans by the company to or from any director or executive officer of that company are prohibited |

Most notably for participants, the Act calls for changes pertaining to blackout periods, to be effective January 26, 2003. It requires plan administrators to provide 30 day advance notice of blackout periods to affected participants and beneficiaries in an individual account plan. The notice must include the reasons for the blackout, an identification of the investments and other rights affected, the expected beginning date and length of the blackout period, and a statement that the participant or beneficiary should evaluate the appropriateness of their current investment decisions in light of their inability to direct or diversify assets credited to their accounts. There are exceptions to the 30-day rule, dealing primarily with unforeseeable events and circumstances beyond the administrator's control.

A "blackout" is defined as a period of more than three consecutive business days in which any ability of individual account plan participants or beneficiaries, which is otherwise available under the terms of such plan, to direct or diversify assets credited to their accounts, obtain loans from the plan, or to obtain distributions from the plan is temporarily suspended, limited, or restricted. The Act also prohibits directors or executive officers of an issuer from trading the issuer's stock during blackout periods.

The maximum allowable ERISA section 501 criminal penalties applicable to any person who willfully violates any provision of part 1 of ERISA increased considerably: from one-year imprisonment and/or $5,000 ($100,000 for a corporate entity) to ten years imprisonment and/or $100,000 ($500,000 for a corporate entity).

Stock transactions by directors, officers, and 10% or more beneficial owners (as defined in section 16 of the SEC Act) must be reported to the SEC within two business days; or within 10 days of an individual becoming a beneficial owner, director, or officer. The Act also includes a provision prohibiting loans by the company ("issuer") to or from any director or executive officer of that company. It is unclear whether this provision applies to plan loans.

### *Proposed Pension Legislation*

Two pieces of pension reform legislation garnering much attention are the Protecting America's Pension Act (S. 1992), sponsored by Senator Kennedy, and the Pension Security Act of 2002 (H.R. 3762), sponsored by Representatives Boehner and Johnson. Both bills would reform pension law to avoid future losses of retirement savings as happened at Enron. They both contain a number of fairly similar provisions pertaining to blackout periods (which were incorporated into the Sarbanes-Oxley Act), quarterly statements, investment education notices, and the right to diversify company stock after three years of service.

However, the bills differ on a several key areas: the amount of company stock permissible in retirement plans, how to provide sound investment advice to participants, expanded employer liability for pension-related fiduciary obligations, joint employer-employee trusteeship of defined-contribution plans, and the creation of a pension watchdog at the DOL.

On the company stock issue, the Senate bill (S. 1992), backed by Democrats, gives employers an either/or option. Employers can either match 401(k) contributions with company stock or offer it to workers as an investment option. This provision essentially limits the amount of company stock in which a participant may invest in the plan. The Republican-supported house bill does not impose limitations on how much company stock an employee could hold in a retirement plan. It does stipulate that the plan must offer three investment alternatives in addition to company stock, and that companies would have to educate employees about diversifying investments.

On investment advice, the House Bill includes the Boehner Advice Bill (H.R. 2269), which would allow employers to offer investment advice through the plan's service provider, as long as the provider discloses all fees and any potential conflicts of interest. The Senate Bill incorporates the Bingaman Advice Bill (S. 1677), which does not change the prohibited transaction rules that generally prevent parties in interest from providing investment advice. Instead, it does provide plan sponsors relief from their duties and liabilities as fiduciaries relating to advice if they follow the various requirements outlined in the Bill.

***Proposed Pension Reform Legislation Highlights***

| Senate Bill | House Bill |
|---|---|
| ■ Company stock investment by participants limited<br>■ Sponsor relieved of liability for advice, providers must still be independent<br>■ Expanded fiduciary liability<br>■ Employee board representation required<br>■ Office of Pension Participant Advocacy created | ■ No limit on company stock; 3 additional options required<br>■ Sponsor relieved of liability for advice, parties-in-interest may provide advice with disclosures |

The Senate Bill calls for ERISA Section 409 (liability for breach of fiduciary duty) to be expanded for 401(k) plans to apply to individual participants. According to the bill, fiduciaries are liable to "make good to such individual account plan and to each participant or beneficiary resulting from such breach" and to "restore to such participant and beneficiary any profits of such fiduciary which have been made through the use of such assets of the individual account plans by the fiduciary." The rights of a 401(k) plan participant or beneficiary to sue under Section 409 shall be in addition to all existing rights under Section 409, 502 or any other provisions of ERISA.

Also of note in the Senate Bill is the requirement of equal representation of participants on board of trustees for individual account single employer plans with more than 100 participants, and creation of the Office of Pension Participant Advocacy within the Department of Labor. The advocate would evaluate efforts to assist and protect participants, identify problems, develop proposals for change, promote the expansion of pension coverage, advocate participant rights, give priority to low and moderate income participants, and develop information about plans. The Advocate would have the power to sue on behalf of participants and to assist in obtaining settlements.

As of this writing, the pension reform bills have not made it to the Senate Floor, despite indications from Senate Majority Leader Tom Daschle that he will address defined-contribution reform legislation before the November elections. Given the short time remaining in this session and pressing national security matters, it is unlikely, but possible, that the House and Senate will reconcile their competing bills this year.

We applaud the legislative efforts focused on the rights of participants, but believe that many of these provisions require additional discussion and evaluation and discourage a rush to enact reform legislation this year. Efforts to better educate and advise participants are admirable, and participants should be allowed to diversify their holdings out of company stock as they see fit; yet imposing specific limits on company stock or any other investment seems to us at odds with the very essence of investor choice in participant-directed plans. Overregulation threatens to increase the Plan Sponsor's administrative burden, presenting challenges particularly for small companies. Finally, exposing plan sponsors to expanded liability may discourage employers from offering such plans as part of their benefit programs. It is worth the additional time and effort to strike the right balance.

Once again, we encourage you to fully acquaint yourself with the recent and proposed legislation. To view the complete text of the Sarbanes-Oxley Act of 2002 or the proposed pension legislation, visit the Library of Congress on the web at thomas.loc.gov.

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