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FINANCIAL MARKETS COMMENTARY
1st Quarter 2003

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Summary

Stocks backtracked somewhat during the first quarter of 2003. Geo-political tensions, most notably the war with Iraq, are largely to blame. Businesses continued to be cautious with spending plans, which kept a lid on economic activity. Payrolls declined. Even when it became clear late in the quarter that the worst fears with regard to Iraq would not be realized, the stock market could manage just a modest rally. It appears that lower prices and an end to hostilities in and of themselves are not going to be enough of a catalyst to get the market going.

There were no broad trends at work in the market last quarter. Some funds had modest success bottom fishing in technology, which finished down 0.3% last quarter, about 3% better than the market average. Others rode more defensive sectors like real estate and health care, whose operations fluctuate less from quarter to quarter, to 1% gains. More economically sensitive sectors like financial services and telecommunications tended to under-perform the averages, each sinking more than 5%. Precious metals went from first to worse (-12%), highlighting the dangers of buying last year's winner. Large company stocks again tended to do better than small company stocks, and growth funds generally lost less than value funds.

Credit-sensitive bonds continued to out-perform interest-sensitive bonds. The financial scandals of recent years have led to an emphasis on repairing corporate balance sheets, which is a positive for corporate bonds. High yield bonds gained 5.6% during the quarter, reflecting the narrowing of their risk premium over government bonds. The latter gained just 1%. International bonds gained more than 4%. They continue to benefit from the falling dollar. International stock returns are also aided by a weak greenback, but this served only to reduce their loss from 11% (in local currencies) to 8% (for dollar-based investors). European economies were especially weak and the rancor over Iraq had a major impact on investor confidence. Japanese stocks are currently making 20-year lows.

Strategy

We have not altered our defensive stance. Genuine rallies usually spring from low stock prices and poor investor sentiment. Prices are much lower than they

were three years ago, but it most cases are not particularly cheap. Sentiment is way down, but again not near extreme levels. A 5%-10% rally is possible at any time, but we aren't going to change our overall positioning until the upside potential is much greater.

Our moves will be limited to replacing weak performing funds with better ones of the same type. At the end of January, we made majors changes to the international component of the portfolios in response to surprising weakness in that area.

Performance

Our Balanced Model Portfolio declined -.84% last quarter. This compares with the -1.91% return for the Balanced Benchmark and compares with a negative -3.15% for the S & P 500 and a positive 1.65% for the Lehman Gov't /Corporate Bond index.. We would expect that our strategy would result in a smaller loss than the overall market in a down quarter, and that is exactly what happened. Our Aggressive Model Portfolio fell -5.79% during the quarter. It was not a particularly good quarter to be aggressive, so while we are not pleased, this result was not altogether unexpected.

Outlook

A resolution to the Iraq conflict that was close to the best end of possible results has failed to trigger the kind of rally many hoped for. Nevertheless, it is highly unusual for the stock market to decline four years in a row or fail to produce two consecutive positive quarters for more than three years. The bear market is long in the tooth. Even if it isn't over, it seems likely to at least go into "remission" soon. We would not be surprised at all to see a modest rally this quarter. Other than the decline in energy prices, however, we don't see the kind of catalyst to drive the market meaningfully higher.

Commentary – Don't Just Do Something, Stand There

Some of the best decisions financial professionals make involve doing nothing. There is always the temptation, among both experienced and novice investors, to act. Changing prices must create opportunity, right? Too often, however, decisions made in response to volatility are correct in the short term and wrong in the longer term. We sell the falling stock, giving us that psychological comfort, forgetting all the positive attributes that caused us to buy it in the first place. Or, more often, we want to buy that rising stock and immediately feel the joy those that bought earlier are feeling now. In most endeavors, we seek immediate positive feedback from what we do, we seek to act in concert with others, and we want our joys and sorrows shared. We prize loyalty and will sacrifice for stability.

In the area of investing, this is not the formula for success. Responding to powerful gut-level emotions like fear and greed are very often hazardous to

one's wealth. Seeking the approval of others generally results in one's getting the performance of others, that is, mediocrity. Instant gratification often leads to long term regret. Investments are tools; they don't love you when you buy them, nor will they hate you when you sell them. Modern Portfolio Theory teaches us that more stable an investment is, the lower it's expected return.

Happily, there are certain qualities that translate well from everyday activities to investing. One is patience. If you are truly correct about an issue, time will eventually vindicate you. There are fewer sweeter things in life and in investing as when the consensus eventually comes to see things your way. Another is discipline. Knowing what you are going to do at all times helps you to make good decisions in a crisis. Humility is a big one. Even the best investors make mistakes (read Berkshire Hathaway's annual reports if you don't agree). Accept that you will make them so that when you do, you can deal with them and move on. The last important quality for individuals and investors I believe is serenity. Sometimes all the lane changing in the world won't get you there any faster. This bear market will end, and when it does, we will respond. Nothing we do will end it any sooner.

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