

PERAC Financial Bulletin

NO. 18, JULY 2003

great expectations



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As the long-anticipated conflict with Iraq was concluded quickly and successfully, the Federal Reserve Board lowered interest rates to their lowest levels in 45 years, and another round of tax cuts

was passed by Congress, the stock market finally had reason to rally and the results were powerful.

As the market enjoyed its best quarter since late 1998, the S&P 500, having recovered

more than 25% from its low of October 2002, rallied 15.4% and is up 11.8% for the year. The long-suffering technology-laden NASDAQ Composite was up 46% from its low and 21% and 21.5%, respectively, for the quarter and year-to-date. Small caps and mid-caps outperformed large caps, while value outperformed growth among large caps but growth prevailed in the small cap universe. International stocks had a very strong quarter, aided by the continuing weakness of the US dollar in currency markets, although they still lag the S&P 500 for the year. Both for the quarter and year-to-date, emerging market equities have enjoyed impressive performance.

Bond performance remained positive even in the face of the stock market recovery. In its effort to reduce the risks of deflation, the Fed's 13th rate reduction of this cycle brought the federal funds rate to a miniscule 1% as 2, 10, and 30-year Treasury yields remained historically low at 1.30%, 3.51%, and 4.56%, respectively. Junk bonds did well as the high yield market, in anticipation of a more robust economy, rallied back to more reasonable yield spreads relative to high grade bonds.

Reflecting a market that has been weakened by the

Chart 1 | Equity Valuations Are Still High

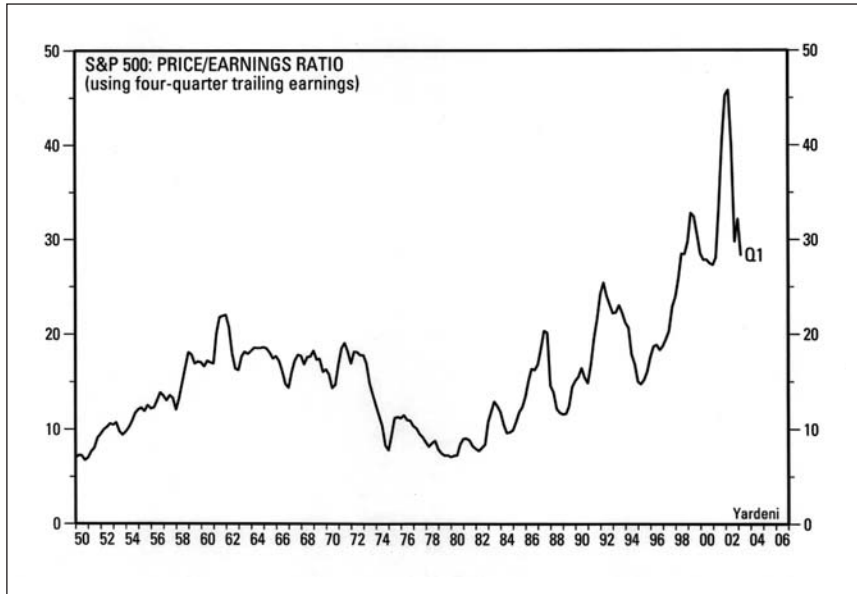


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Chart 2 | Interest Rates Fall to Historic Lows



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economy but still basically healthy, real estate continued to offer positive returns, with publicly-traded REITs enjoying a particularly strong quarter. Activity in venture capital and private equity remained very light, but participants hoped that a continuing stock market recovery might bring some stabilization to this troubled sector. For hedge funds, which generally preserved capital during the bear market, composite returns will likely show results that are positive but lagging the major equity benchmarks this year.

Investors rejoiced in the stock market's rally but professionals remained cautious since the market was reflecting expectations of an improving economy rather than reality to date. With the unemployment rate rising to a nine-year high and business spending still stagnant, the best that can be said about the economy at this point is that it has leveled off. Only time will tell whether the fiscal and monetary stimulus, and apparent decline in geopolitical tensions, will succeed in reinvigorating the economy. In the absence of meaningful growth and job creation, the future direction of the stock market—which appears attractive relative to today's extremely low interest rates but still fully priced relative to

Chart 3 | S&P 500 in 2003: The Trend is Up

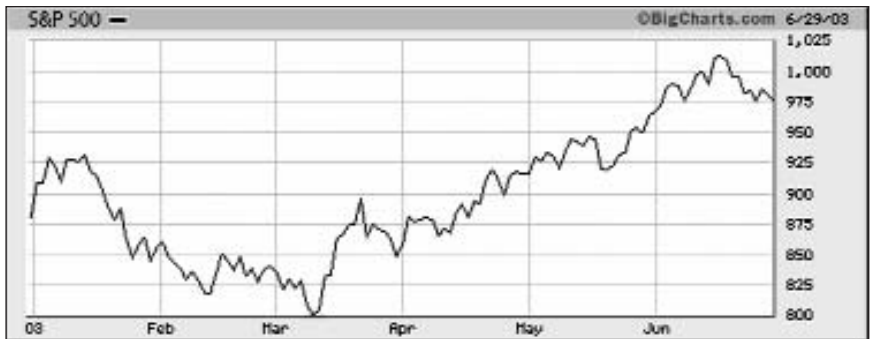


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Chart 4 | S&P 500: A Ten-Year Perspective

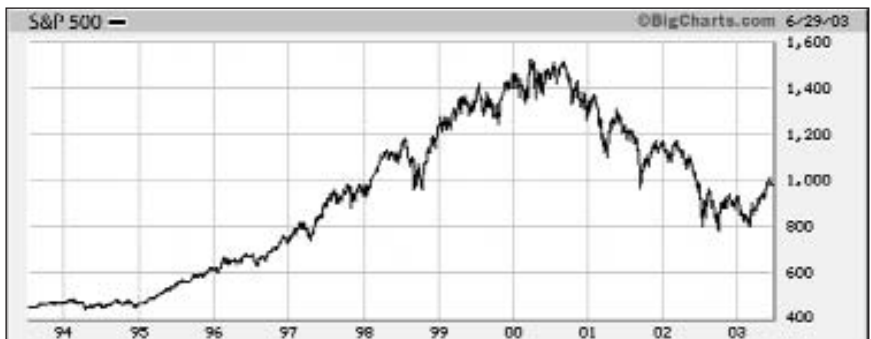


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Chart 5 | S&P 500 vs NASDAQ: After the Bubble

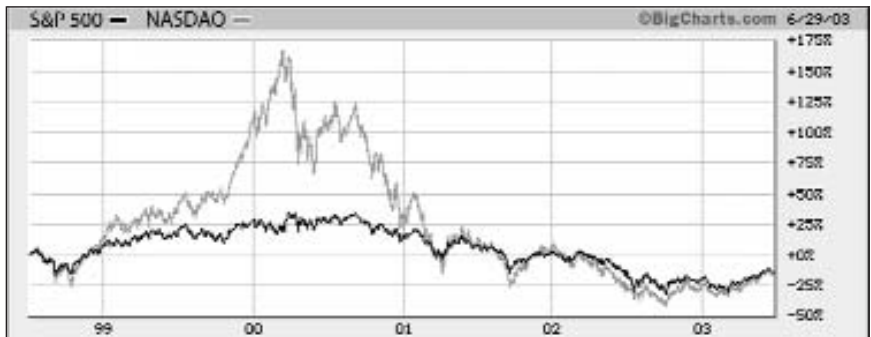


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current corporate earnings—remains an open question.

As always, we welcome your comments on this report and encourage your suggestions for future investment research reports. For those systems that would like to discuss their

portfolios and strategies in the context of the current market or to talk about any other relevant investment topics, we would welcome an invitation to attend one of your board meetings.

TOTAL RETURNS | *Second Quarter, 2003*

INDEX	SECOND QUARTER, 2003	PAST 12 MONTHS
US EQUITY MARKET		
Dow Jones Industrial Avg.	+ 13.13%	+ 9.01%
Standard & Poor's 500 (Large Cap)	+ 15.39%	+ 11.76%
NASDAQ Composite	+ 21.00%	+ 21.51%
Wilshire 5000 (Broad Market)	+ 16.50%	+ 12.91%
Standard & Poor's Mid-Cap 400	+ 17.63%	+ 12.41%
Russell 2000 (Small Cap.)	+ 23.42%	+ 17.88%
GROWTH VS. VALUE		
S&P 500 Growth	+ 12.17%	+ 11.25%
S&P 500 Value	+ 18.84%	+ 12.29%
S&P Midcap 400 Growth	+ 16.01%	+ 12.52%
S&P Midcap 400 Value	+ 19.18%	+ 12.26%
Russell 2000 Growth	+ 24.15%	+ 19.33%
Russell 2000 Value	+ 22.72%	+ 16.49%
INTERNATIONAL EQUITY		
M.S.C.I. - E.A.F.E.	+ 19.27%	+ 9.47%
M.S.C.I. - Emerging Markets	+ 23.29%	+ 15.89%
FIXED INCOME		
Lehman Brothers Aggregate Index	+ 2.50%	+ 3.93%
First Boston High Yield Index	+ 9.73%	+ 17.31%
REAL ESTATE		
NAREIT - Equity Real Estate Investment Trusts	+ 13.11%	+ 13.87%
NCREIF Property Index	+ 1.88% (Q1)	+ 7.13% (Trailing)