

PERAC

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DISILLUSIONMENT

OVER CORPORATE ACCOUNTING SCANDALS

dealt a major blow to fragile investor psychology already damaged by threats of terrorism, weak corporate profits, and a falling dollar.

The retracement of the epic bull market of the late 1990s was turning out to be one of the longest and most painful bear markets ever.

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FINANCIAL MARKET REVIEW | SECOND QUARTER, 2002

MICROSOFT

INTEL

CISCO

SUN MICROSYSTEMS

ORACLE

These were some of the high-flying companies that were in the headlines in the late 1990s as they were hailed as the leaders of the technological revolution that sparked an historic bull market.

Enron

Tyco

WorldCom

Global Crossing

ImClone

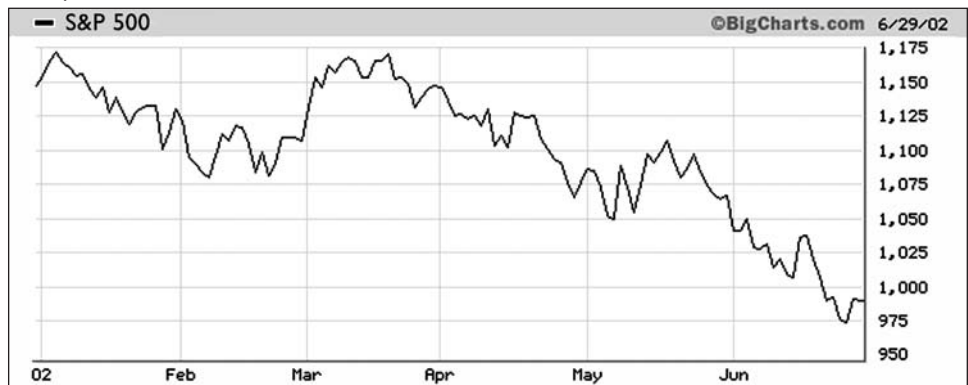
These are some of the disgraced companies garnering the scorn of investors today as they express growing disillusionment and cynicism toward a market that is now in the third year of painful and sharp decline.

Although the economy appears to be slowly working its way out of recession, the equity market has been unable to overcome concerns over persistent threats of terrorism, continuing instability in world trouble spots, weak corporate profits, a declining dollar, and a spate of corporate scandals. As the second quarter ended, two of the broad US market indices neared the panic lows reached last September following the terrorist attacks. All major indices are now back to levels

reached in 1997 or 1998.

The continuing decline has confounded experts as the market has failed to respond to traditional stimuli. The Federal Reserve has aggressively reduced short-term interest rates to the lowest levels in forty years but the S&P 500 is more than 20% lower than when the central bank began easing in January 2001. The market has also registered double digit losses this year despite the fact that an economic rebound, however fragile, is thought to have begun in January.

#1 | 2002: AFTER A TERRIBLE SECOND QUARTER, S&P 500 DOWN 13.2%



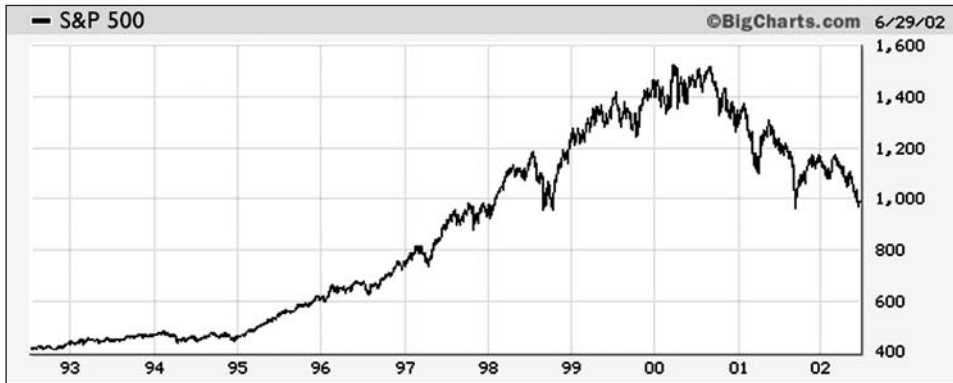
#2 | FIVE YEARS: THE S&P 500 IS BACK TO 1998 LEVELS



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Value continues to dramatically outpace growth in all capitalization categories.

#3 | S&P 500: BOOM AND BUST, A TEN-YEAR PERSPECTIVE

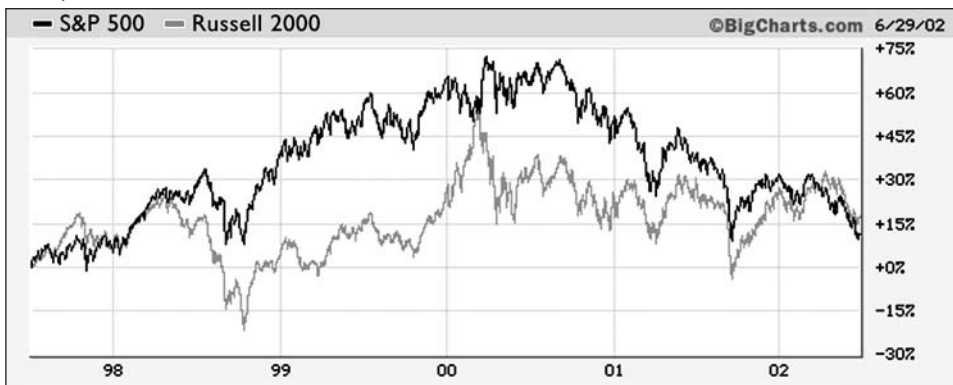


worst ever. Not only is the profit picture for small stocks more favorable than for large caps, but small companies are also seen as less likely to be engaging in financial shenanigans.

With no rebound in sight for the beleaguered technology sector, the NASDAQ Composite's drop of almost 21% for the quarter was its worst second quarter performance ever and the seventh worst performance for any quarter. Its year-to-date performance of nearly -25% is the index's worst start ever. It is now more than 70% off its March 2000 high.

Home building and home furnishing stocks, defense companies, and hospitals held up reasonably well,

#4 | OVER FIVE YEARS, LARGE CAPS AND SMALL CAPS ARE ABOUT EVEN



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The Dow Jones Industrial Average, with its concentration of manufacturing stocks, has held up relatively well, although its 11.2% gross decline in the second quarter was one of its worst quarterly declines ever. The Dow is off 22% from its January 2000 peak of 11,722 but it is the one major index that remains well above its September 2001 low.

After a 13.4% loss for the second quarter, the S&P 500 Index of large cap stocks is 36% off its March 2000 high. The Russell 2000 Small Cap Index continues to outperform its large cap counterpart, although its 8.35% decline for the quarter was also one of its

along with natural resource companies and financial corporations, while the former "new economy" stocks continued to get clobbered. Telecom stocks remained mired by debt concerns and overcapacity while there was no sign yet of any pick-up in demand for technology products.

As noted, small caps continued to exact sweet revenge against large caps. Similarly extending the trend of the past three years, value continues to dramatically outpace growth in all capitalization categories. While the second quarter was a downer for all categories, small and mid cap value indices

Money flowed into high quality fixed income instruments from investors seeking havens of safety from the weak equity markets.

remain positive for the year-to-date in sharp contrast to the carnage in the growth sectors. Many strategists feel that value has fully retraced the gap left after growth's epic outperformance during 1995-1999. Indeed, many previously high-flying technology growth stocks have fallen so drastically that they are now seen as being value stocks.

International stocks failed to provide a buffer of positive returns in the face of the declining US market. Most developed markets suffered from the same elements of malaise affecting the US market. However, an 8% decline in the composite value of the US dollar during the quarter did allow international market indices to register lower percentage losses in dollar terms than the major US indices. The MSCI-EAFE index was down -1.94% for the quarter and -1.38% for the year-to-date. As usual, performance varied widely around the world, with Indonesia (seen as a dynamic Asian economy) rising 18% in dollar terms while Brazil (beset by political and financial uncertainties) fell by 24%.

Just as stocks have failed to respond positively to the onset of economic recovery, bond prices have resisted any decline, contrary to their typical behavior during periods of economic improvement. Money flowed into high quality fixed income instruments from investors seeking havens of safety from the weak equity markets. The actual levels of high-grade interest rates remained relatively

#5 | FIVE YEARS, S&P 500 VS NASDAQ: EXCEPT FOR THE BUBBLE, A SIMILAR PATTERN

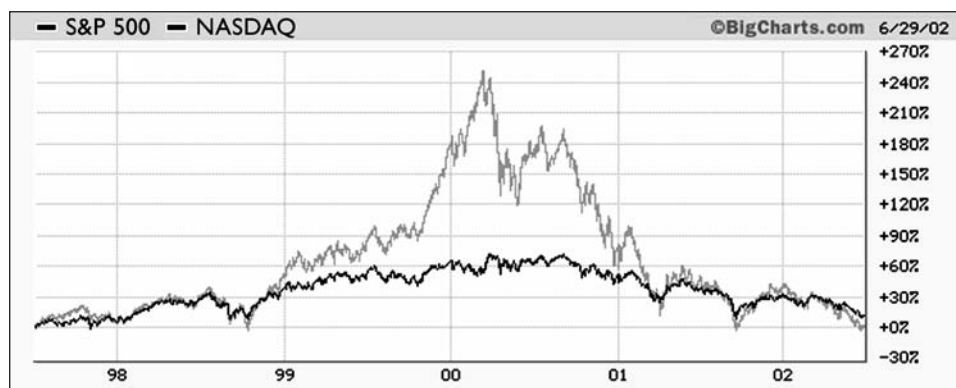


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stable but bonds—supported by the cushion of their interest rate coupon payments—managed to provide modestly positive returns for the quarter and year-to-date. Performance was very much correlated with credit quality as lower grade corporate bonds and high yield (“junk”) bonds significantly lagged. Overall, bonds, while likely to outperform stocks for the third straight year, are seen as having limited further upside potential if the economy does indeed recover and the equity market begins to improve.

Real estate is another asset class that continued to be a strong diversifier relative to equities. National property indices for direct real estate investment as well as composite returns for real estate investment trusts both continue to register positive returns despite the fact that real estate fundamentals in most markets are decidedly weaker in sympathy with overall economic trends. To some analysts, real estate has held up so well in the face of falling equity markets that it may now represent a market with above-average risk.

For venture capital, the situation appears

to be going from bad to worse. In response to a slow market for new investment and complaints about high fees amid disappointing returns, at least twelve venture partnerships have slashed the size of their funds by about \$4 billion, with most of the reduction occurring during the second quarter. Performance continued to be poor as the IPO window remains essentially closed and general partners continue to mark down the valuation of existing investments. For the year 2001 (the latest data available), Venture Economics reported a composite loss of 27.8% for venture capital and -18.5% for all private equity. Cambridge Associates reported a 38.9% loss for venture capital and an 11.4% loss for all private equity.

Looking ahead, it is not easy to predict when the good times will roll again for the US equity markets. After 2000, not many strategists saw a second year of losses on the horizon. After a dismal 2001, the prospect of a third down year seemed unthinkable. With 2002 now shaping up as at least as bad as the two prior years, a turnaround in market psychology appears as elusive as ever. The issue of corporate credibility is a new factor weighing on investor sentiment, but perhaps even more worrisome is the fact that even after their horrific decline, equity prices still appear rich by most traditional standards of evaluation. For instance, Price/Earnings Ratios have adjusted only modestly from their historically high levels as corporate profits have also plunged significantly along with stock prices. With the investment outlook likely to remain challenging for pension fund trustees over the near term, it is vitally important that plan sponsors make sure that portfolio asset allocation is well diversified and that all investment managers are satisfactorily fulfilling their mandates. Retirement boards may also want to consider

whether current market conditions represent an opportunity to rebalance the portfolio.

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, 2002

INDEX	SECOND QUARTER, 2002	YEAR-TO-DATE, 2002
US EQUITY MARKET		
Dow Jones Industrial Avg.	- 10.71%	- 6.91%
Standard & Poor's 500 (Large Cap)	- 13.40%	- 13.16%
NASDAQ Composite	- 20.73%	- 24.98%
Wilshire 5000 (Broad Market)	- 12.66%	- 12.14%
Standard & Poor's Mid-Cap 400	- 9.31%	- 3.21%
Russell 2000 (Small Cap.)	- 8.35%	- 4.70%
GROWTH VS. VALUE		
S&P 500 Growth	- 16.26%	- 16.92%
S&P 500 Value	- 10.64%	- 9.46%
S&P Midcap 400 Growth	- 13.01%	- 10.00%
S&P Midcap 400 Value	- 5.87%	+ 3.48%
Russell 2000 Growth	- 15.70%	- 17.35%
Russell 2000 Value	- 2.12%	+ 7.26%
INTERNATIONAL EQUITY		
M.S.C.I. - E.A.F.E.	- 1.94%	- 1.38%
M.S.C.I. - Emerging Markets	- 8.39%	+ 2.07%
FIXED INCOME		
Lehman Brothers Aggregate Index	+ 3.69%	+ 3.79%
Lehman Brothers Government/Credit Index	+ 3.75%	+ 3.26%
First Boston High Yield Index	- 2.30%	+ 0.16%
REAL ESTATE		
NAREIT - Equity Real Estate Investment Trusts	+ 5.01%	+ 13.68%
NCREIF Property Index	+ 1.57% (Q1)	+ 6.54% (Trailing)