

ECONOMIC AND CAPITAL MARKETS COMMENTARY AND OUTLOOK

April 2003

MARKET REVIEW AND STRATEGY SUMMARY

Stock Market Volatility Rises With War in Iraq. Daily stock market movements have increased dramatically over the last several months, as investor emotion has dominated stock buy and sell decisions. This increased level of uncertainty is the result of geopolitical events leading up to the Iraq war, the actual conflict in Iraq, and tension with North Korea. Longer-term markets are fairly efficient in terms of discounting underlying fundamentals. Shorter-term market movements are clouded by emotion and irrational behavior, as evidenced by the fair number of stocks that are cheap relative to their actual earnings growth. In a more rational market, investors would recognize these gems and prices would rise in measure. In this market, most stocks have traded lower—the good and the bad. Investors are either buying “the market” or selling the market and, of course, most have been selling.

Many of the pundits are suggesting that once a victory is clear in Iraq, the markets will trade higher. Some base their analysis on the “war bounces” of years past and

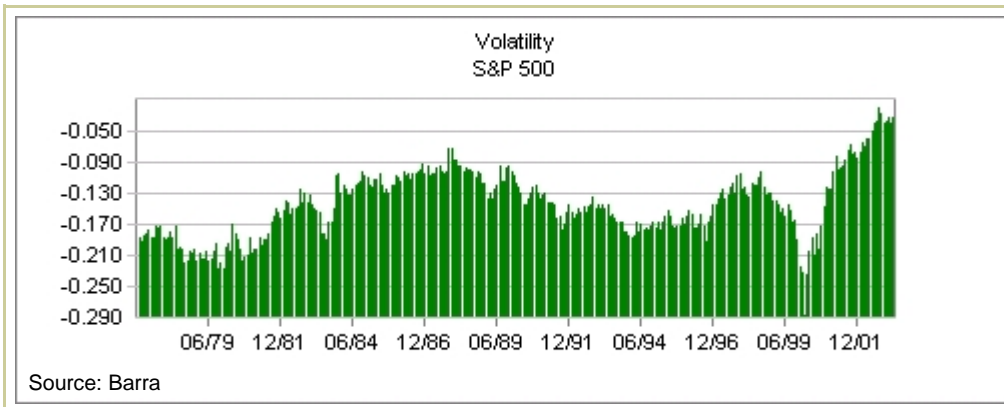
others feel businesses and consumers will return to pre-2000 spending levels. Because short-term market movements are a reflection of emotion, whether it is overconfidence or underconfidence, the stock market will probably trade higher for a short period of time. Once market participants recognize that underlying economic growth is rather weak and corporate earnings absent, stocks are likely to trade lower. A full and sustainable stock market recovery will require that: (1) stock market valuations become more attractive; (2) earnings growth shows signs of a sustainable recovery in many sectors based on higher top-end sales growth; (3) businesses return to normal levels of capital spending; and (4) consumers return to 2000 and 2001 spending levels.

Interest rates are already at 50-year lows and short-term interest rates have moved closer to zero. The Fed has little wiggle room to ease monetary policy. However, the Fed has been aggressive in the past during times of crisis and will be ready to act again if indications continue to point to lower economic growth. Shortly

after 9/11, the Fed aggressively lowered interest rates to help stimulate the economy. The Fed will be closely watching money growth, as well as inflationary indications such as increased government deficit spending and higher oil prices.

The heightened level of uncertainty in the market is obvious given the extreme day-to-day changes in stock prices quoted on many stock exchanges. Many theorists have proposed that, for short periods of time, markets are irrational and inefficient, and the theorists appear to be correct. Longer-term, the stock market does tend to discount underlying fundamentals. Occasionally, there are prolonged periods when markets do not appear rational and when investors react inappropriately to the information they receive. A good example would be during 1998 and 1999 when technology stocks were trading at multiples as high as 200 times expected earnings growth. In this case, the investing public ignored the underlying fundamentals and invested based on the belief that the technology sector represented the next big discovery and that the benefits of such rapid change would eventually be rewarded. We all know what happened to technology stocks beginning in early 2000.

Investors pay too much attention to day-to-day absolute changes in the market, specifically the Dow. While there has been a rapid increase in daily volatility over the last several months, the percentage changes have been much smaller than the greatest percentage swings posted since market records began to be kept in 1885. The largest one-day drop in the market occurred on October 19, 1987, when stocks declined over 20%. The largest one-day increase of 16.61% was posted on March 15, 1933. Some of the biggest one-day moves in the stock market were back in the 1930s. Today's daily market moves, by comparison, have been quite small. Even the highest and lowest monthly returns over the last three years fall well short of the month-to-month volatility that investors experienced in the late 1800s, 1920s and 1930s. Part of the reason for the difference is that, today, the U.S. is the largest stock market in the world and much more responsive and efficient. In the period from 1885 to the 1930s, the U.S. stock market was still considered a developing market with lower levels of liquidity and volume.



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It's the Fundamentals That Matter – Not the Outcome of the War. The conclusion of the war will help investors regain their focus and act one way or another. In this market, the individual investor has been on the sidelines. Most of the trading activity has been by institutional investors, from mutual fund complexes to hedge funds. Also, a fair amount of trading volume has been speculative with short sellers covering short positions or event-driven money managers trading on technical information or news. Once the geopolitical situation settles and confidence builds, investors will begin to focus on economic fundamentals and corporate earnings.

Economic and investment fundamentals are the most important factors that impact the longer-term direction of stock and bond prices. For higher stock prices, com-

panies need to deliver profits based on increased cash flows from operations, and for higher bond prices, interest rates must decline from their current levels and credit quality must improve. Corporate profit growth will depend on higher nominal GDP growth and manageable inflation. Higher economic growth will depend on an increase in output from the consumer, business and government sectors, and a lower trade deficit. Inflation, disinflation and/or deflation will depend on the forces of supply and demand.

Many on Wall Street speculate on the direction of the stock market after the war. The optimists suggest that the rebuilding of Iraq will provide long-term benefits to foreign-contracted construction and engineering firms, and that consumer and business leadership confidence will soar once the post-war uncertainty is mitigated. This group is not concerned with the growing federal deficit or the cost of war and rebuilding based on comparisons to previous wars. The pessimists subscribe to the notion that the cost of the war and the war itself will place forward pressure on interest rates and that an already weak pre-war economy will be pushed back into recession. We subscribe to elements of both theories, but probably lean toward the side of the pessimists. There will be a significant cost for this war and for future potential conflicts that will surely arise out of the need to protect the American people. There will be some benefits to foreign companies as the rebuilding begins. However, interest rates might creep slightly higher over the coming months, but not much. There is still too much excess capacity around the globe and weak demand. Oil prices will most likely remain volatile, but eventually settle near a price range that reflects underlying supply and demand. Stocks and bonds are still expensive and corporate earnings are

uncertain. Until stock and bond market valuations improve and a sustainable recovery becomes evident in both economic growth and corporate profits, stock and bond prices will not sustain any one trend.

The Economic and Psychological Costs of War. The biggest cost of war is in human lives, not dollars and cents. This high tech war has kept coalition casualties to 61 thus far, a small number in comparison to previous wars. The cost per soldier may be higher in this war than previous conflicts, but you can't argue with the fact that this war will make history in terms of lives saved. The U.S. economy cannot afford another economic or psychological blow similar to 9/11. The estimated cost of September 11 is measured in the hundreds of billions of dollars. The administration's \$75 billion supplemental appropriation recommendation for this war may seem large, but is small in comparison to previous conflicts and potential lives saved.

The biggest potential costs of this war will come in two forms. One, how long the current conflict will last with over 250,000 troops deployed in the region; and two, how long the rebuilding process will take and how much assistance the U.S. will receive from coalition partners. Some studies, such as one released by the Council on Foreign Relations last month, estimate that occupying and reconstructing Iraq could cost upward of \$20 billion a year. From an economic point of view, a quick victory is crucial, but firm commitments from coalition partners to help rebuild may be even more vital. This increased cost comes at a time when the U.S. budget is already \$246 billion in the red. In addition, state and local government budgets are in the red. This shortfall will have to be financed from somewhere, whether it's through higher taxes or higher interest rates. The Gulf War in 1991 lasted six weeks at a total cost of \$80 billion in today's dollars, and America's allies paid for much of it. After the Gulf War, the U.S. economy recovered, oil prices moved lower and stock prices began their long trend upward. The problem now is that the global economy was weak before the war in Iraq, and America has yet to com-



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plete its post-bubble adjustment. Consumer debt is high, job insecurities are high, and businesses are not spending. Savings rates have improved, but are still below historical average levels, and the U.S. trade deficit continues to bulge.

The emotional damage to the stock market is clear. Even though stocks are already down 40%-plus from their peak in early 2000, the anxieties of 9/11, combined with the growing tension leading up to the war in Iraq and now questions about the success and duration of this

conflict, have kept many investors on the sidelines. Those that are buying or selling are doing so on the day-to-day ups and downs related to the perceived progress in Iraq. This volatility will most likely continue, as other global conflicts most certainly arise. Investors must now accept that the risks are higher in the capital markets based on the defining moment in history of 9/11 and due to the 24/7 nature of the global marketplace and information flow.

In Search of Investment Returns. Three years of a bear market in stocks, volatile commodity prices, heightened political uncertainty, the ongoing threat of terrorism, the recent outbreak of SARS and a fledgling global economy have investors weary and desperate in their search for investment returns. In the traditional securities markets, the short-term outlook for higher-than-average stock and bond returns looks less than promising. Many investors have fled the stock market seeking the perceived safety of high-quality bonds and money market funds. Others have redirected their capital to real estate, and still others have chased those markets that have recently performed the best, such as hedge funds, high-yield bonds and emerging market debt.

One would assume that most stock market investors have learned their lesson in risk management after three straight years of losses in the stock market. Many have either ignored risk altogether by chasing the recent hot hand of hedge fund and high-yield managers and others have attempted to avert risk altogether by moving all of their assets into money market funds. Neither move reflects sound and prudent money management. With volatility in both stock and bond markets at recent highs and alternative investments, such as hedge funds, grow-

ing at their fastest pace ever, investors would be wise to broadly diversify their investments.

In the stock market, valuations are still high by historical standards and corporate earnings are depressed. In the bond market, yields are near their 50-year low, and for corporate bonds, yields have already narrowed significantly relative to U.S. Treasury bond yields. Short-term money market yields currently trade at levels of less than 1.5% before inflation and are negative after accounting for inflation. Over the last three years, the average hedge fund has provided investors with superior returns relative to stocks and bonds. However, not all hedge funds are alike and choosing the right one can be more difficult than selecting a superior traditional money manager.

The hedge fund market has grown exponentially over the last three years with investments being bought by institutional and individual investors alike. While a record number of hedge funds have been created over the last several years, many have lost most of their assets this year and subsequently shut down. The first quarter was the first time in recent memory that there were net redemptions in hedge funds. The rapid growth in the hedge fund industry, especially in the retail sector, has drawn intense attention from regulators. The biggest complaints in the hedge fund business have been a lack of transparency, high fees, high potential tax costs, higher-than-anticipated correlation relative to long-only equities and excessive risk. Regulators now require hedge funds that wish to market to retail investors to register the investment vehicle with the SEC. While this oversight is welcome, it may also give investors a sense of false comfort. The transparency issue still exists. Many hedge fund managers take big investment bets, using leverage or concentrating their investment decisions in a small number of securities. Many hedge fund managers treat their portfolio positions as proprietary, making it difficult for existing and prospective investors to evaluate what's really going on. Fees can be an issue as well. Average hedge fund fees can run nearly three times as high as traditional equity investments.

War chests

Cost to the US of major wars

Conflict	Direct cost of war, \$bn 2002 prices	As % of GDP*
Revolutionary war (1775-83)	2.2	63
War of 1812 (1812-15)	1.1	13
Mexican war (1846-48)	1.6	3
Civil war (1861-65)	62.0	104
Spanish-American war (1898)	9.6	3
First world war (1917-18)	190.6	24
Second world war (1941-45)	2,896.3	130
Korean war (1950-53)	335.9	15
Vietnam war (1964-72)	494.3	12
Gulf war (1990-91)	76.1	1

*At time of the war

Sources: William D. Nordhaus, Yale University; Al Nofi, Statistical Summary: America's Major Wars, www.cwc.lsu.edu/cwc/other/stats/warcost.htm

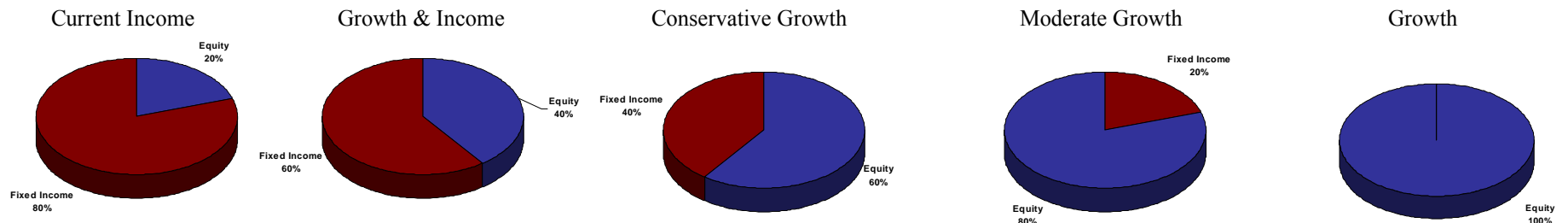
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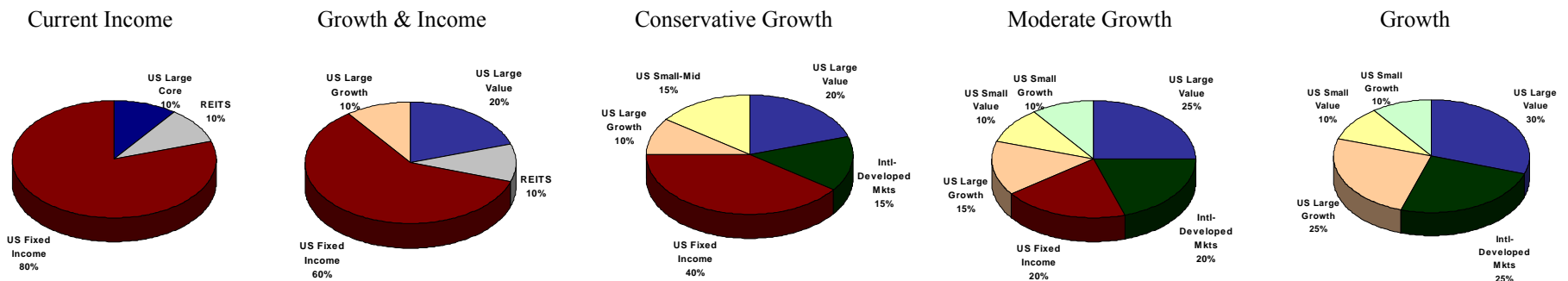
Lockwood Investment Strategies as of March 31, 2003

Lockwood's recommended investment strategies are designed to meet the financial needs of most rational investors within a reasonable level of risk. Each strategy is designed to provide an estimated level of return with varying degrees of confidence over targeted time horizons. The selection of these diversified investment strategies reflects the widest distribution of potential target returns and the associated level of risk based on our long-term forecasts of risk and return. The actual investment strategy selected for the investor is based on that investor's specific financial objectives, time horizon and, most importantly, understanding of and tolerance for risk. Lockwood's recommended investment strategies include (from the least risky to the most risky): current income, growth & income, conservative growth, moderate growth and growth.

Strategic Asset Allocation



Investment Style Allocation



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Despite the concerns surrounding hedge funds, many of these funds do provide investors with the best opportunity for portfolio diversification and return enhancement when combined with traditional stock and bond investments. The rapid growth of the hedge fund market has meant that some “rotten apples” have surfaced in the recent past but, on the whole, these investments are still an attractive method to balance holding long-only stocks and bonds.

Even though stocks are still slightly expensive and bonds expensive, there are still opportunities for returns in this market environment. Our long-term forward return expectations for most asset classes are below the long-term average returns in those markets. For instance, most professional investors assume that the current equity risk premium (expected reward advantage for assuming equity risk vs. risk-free asset) is the actual difference between the historical average return in equities less the average return of a risk-free asset such as

Treasury bonds. Based on this methodology, the current risk premium is 8% vs. Lockwood’s 2.5%-3% expected equity risk premium. We favor stocks of companies that pay dividends, increase their dividend payouts, generate free cash flow from core operations, adhere to conservative accounting practices and are cheaper than the broad market based on lower price to reported earnings, price to sales and higher yield. Excess returns in this market environment should most likely be derived from well-diversified portfolio strategies that include exposure to U.S. equities including large-cap value and growth, small-to-mid-cap stocks and REITs, international equities, high-quality corporate bonds and alternative investments such as hedge funds and managed futures. The next stage of the market cycle will require that investors have the knowledge and experience to be selective in terms of security selection and/or manager selection in order to generate excess return over the market benchmarks.

Lockwood Investment Strategies – Diversification is Critical; Value, Income-Producing, Absolute Return and Low Correlation Strategies Are Favored. Lockwood’s investment strategies focus on balancing proprietary long-term capital market risk and return forecasts with investors’ long-term financial objectives and risk tolerances. The diversified investment strategies range from the most risk-averse, with an emphasis on income generation, to the riskiest, with an emphasis on maximum growth of principal. The following is our current outlook with respect to each recommended strategy ranging from the most risk-averse to the riskiest.

Current Income: The primary objective of this strategy is to provide total nominal returns slightly above the yield of a relatively risk-free 10-year Treasury bond

while minimizing the loss of principal. A majority of total return is generated through income return. Currently, we recommend a diversified mix of bonds and stocks, with emphasis on the highest quality, intermediate-sector of the bond market. Specifically, we currently recommend an 80% allocation to high-quality U.S. bonds, 10% to U.S. large-cap equity, and 10% to the REIT sector of the stock market. The expected target return for this strategy falls between 5.5% and 6.25% and target risk, as measured by standard deviation of return, between 5% and 7.5%. Lockwood suggests that there are potential opportunities to earn extra return within this strategy without incurring additional risk. These include a predominantly active management approach with a bias toward intermediate Treasury notes/bonds and a slight exposure to high-quality corporate bonds in the fixed-income portion of the portfolio (credit spreads over Treasury securities are still slightly higher than underlying fundamentals warrant). For the equity portion, we recommend a bias toward high-quality, lower-valuation and less-volatile, income-producing assets.

Growth and Income: The primary objective of this strategy is to provide total nominal returns between the long-term expected return of a diversified high-quality bond portfolio and that of a broad stock market index portfolio with a level of total risk closer to a diversified bond portfolio. Nearly 50% of the portfolio’s projected return should be generated from income return and the rest from capital gain return. Currently, we recommend a diversified mix of bonds and stocks, with emphasis on the highest-quality intermediate sector of the bond market. Specifically, we currently recommend a 60% allocation to high-quality U.S. bonds, 20% to U.S. large-cap value equity, 10% to U.S. large-cap growth equity, and 10% to REITs. The expected target return for this strategy falls between 6.25% and 7.5% and target risk, as measured by standard deviation of return, between 7.5% and 11.5%. Lockwood suggests that there are potential opportunities to earn extra return within this strategy without incurring additional risk. These include an active management approach with a bias toward intermediate Treasury notes/bonds and a slight exposure to high-

Lockwood's Proprietary Long Term Estimates		
Asset Class	Range of Expected Return	Expected Risk*
Equity:		
Core Equity	7.5 - 8.8	21.99
Large Cap Value	8.5 -10.0	20.41
Large Cap Growth	6.5 - 8.0	23.43
Small Cap Equity	9.5 -12.5	35.30
REITS	7.8 - 9.0	18.55
International Eq - Dev	8.5 10.5	23.66
Fixed Income:		
Convertibles	7.5 -9.0	16.36
US High Qlty Bond	4.5 - 5.5	4.56
US High Qlty Tax Free	4.5 - 6.0	3.64

*Risk estimates for time series starting after Jan. 1926 are adjusted based on risk relationship to either core equity and/or US HQ bond. Source: Lockwood Advisors, Inc.

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quality corporate bonds in the fixed-income portion of the portfolio. For the equity portion, we recommend a bias toward high-quality, lower-valuation and less-volatile, income-producing assets.

Conservative Growth: The primary objective of this strategy is to provide total nominal returns near the expected return for the U.S. stock market with the potential for slightly less downside risk versus the total stock market. The total return from this strategy is derived from a balanced mix of income and capital gain return. Currently, we recommend a diversified mix of bonds and stocks, with a slight emphasis on a diversified mix of global equities. Specifically, we currently recommend a 40% allocation to high-quality U.S. bonds, 20% to U.S. large-cap value equity, 10% to U.S. large-cap growth equity, 15% to U.S. small-mid cap equity, and 15% to international equity. The expected target return for this strategy falls between 7.5% and 8.5% and target risk, as measured by standard deviation of return, between 11.5% and 15.5%. Lockwood suggests that there are potential opportunities to earn extra return within this strategy without incurring additional risk. These include an active management approach with a bias toward intermediate Treasury notes/bonds and a slight exposure to high-quality corporate bonds in the fixed-income portion of the portfolio. On the equity side for the core portion of the portfolio, we recommend a bias toward large-cap, high-quality, lower-valuation and less-volatile, income-producing assets. This strategy should also include moderate exposure to core small-mid cap stocks and moderate exposure to international stocks, with an emphasis on the developed markets of Europe and minimal exposure to Japan and the emerging markets.

Moderate Growth: The primary objective of this strategy is to provide total nominal returns slightly above that expected for the total U.S. stock market with the potential for slightly less volatility than a 100% S&P 500 Index-like portfolio. Currently, we recommend a diversified mix of bonds and stocks, with emphasis on a diversified global stock portfolio. Specifically, we currently recommend a 20% allocation to high-quality U.S. bonds, 25% to U.S. large-cap value equity, 15% to U.S. large-cap growth equity, 20% equally split between U.S. small-mid cap value and growth stocks, and 20% to international equity. The expected target return for this strategy falls between 8.5% and 9% and target risk, as measured by standard deviation of return, between 15.5% and 18.5%. Lockwood suggests that there are potential opportunities to earn extra return within this strategy without incurring additional risk. These include an active management approach with a bias toward intermediate Treasury notes/bonds and a slight exposure to high-quality corporate bonds in the fixed-income portion of the portfolio. In the core equity portion, we favor a bias toward larger-cap, high-quality, lower-valuation and less-volatile, income-producing assets in both the U.S. and abroad. International equity exposure should emphasize the developed markets of Europe, with minimal exposure to Japan and the emerging markets. Small-to-mid-cap exposure in the portfolio should be split between active small-value and small-growth approaches.

Growth: The primary objective of this strategy is to provide total nominal returns above the expected return for the total U.S. stock market (1.5% to 2.5% gross extra return) with the potential of equal or slightly higher risk than a 100% diversified U.S. equity portfolio. The majority of expected total return is

derived from capital gain return. Currently, we recommend a diversified mix of global equities. Specifically, we currently recommend a 30% allocation to U.S. large-cap value equity, 25% to U.S. large-cap growth equity, 20% equally split between U.S. small-mid cap value and growth stocks, and 25% to international equity. The expected target return for this strategy falls between 9% and 10% and target risk, as measured by standard deviation of return, between 18.5% and 24.5%. Lockwood suggests that there are potential opportunities to earn extra return within this strategy without incurring additional risk. These include an active management approach with a slight bias toward large-cap U.S. core equity. We also favor a bias toward lower-valuation and less-volatile, income-producing assets in both the U.S. and abroad. International equity exposure should have an emphasis on the developed markets of Europe with minimal exposure to Japan and the emerging markets. Small-to-mid-cap exposure in the portfolio should be split between active small-value and small-growth approaches.

THE ECONOMY AND INTEREST RATES

The U.S.

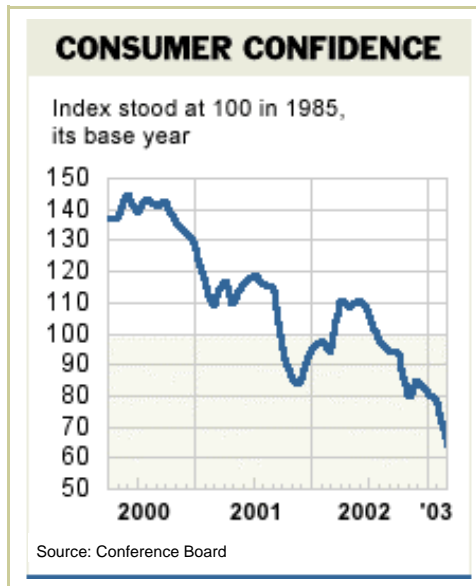
Economic growth has been slowing since the third quarter of last year when real GDP was growing at a 3.8% annual rate of growth. Recent estimates have been revised lower, with many expecting the first quarter results to range between a 2.2% and 2.4% annual rate of growth. Positive contributions from government spending and personal consumption have been offset by a widening trade gap. Recently, with the exception of the government sector, expectations for future growth have worsened, especially in the household and business sectors. Consumer confidence has worsened to levels below that recorded immediately following the terrorist attacks of 9/11. Businesses are not increasing their capital spending budgets for 2003, but rather continue to cut costs in an environment of excess capacity and falling demand. The biggest discussion among economists recently has been whether the economy will fall back into recession. The labor market has weakened and consumers are cutting back on their purchases, especially on items such as

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autos and electronics. Currently, the market is discounting sluggish economic growth for the remainder of 2003 and low inflation.

We have not changed our view on the U.S. economy and our estimated growth rates over the next 12 months. The consensus forecasts have actually moved closer to our 2% to 2.5% rate of growth for 2003. Businesses can no longer blame constraints on capital spending on the war, as the end of the Hussein regime looks imminent. Consumer spending has slowed, but there is not yet clear-cut evidence that this is indicative of a trend. The consumer still rules the economy in terms of total economic output. Recent retail sales suggest that consumers are still buying autos and furniture. Low interest rates continue to be the driving force behind this behavior.



The biggest factor for future household consumption will be the health of the labor market. Interest rates can't move much lower, so the benefit of cheaper financing at this point in the cycle is minimal. Debt is still a slight concern, as absolute levels have risen dramatically over the last several years. This should be kept in check, as real income growth seems to be growing at a faster rate than outstanding debt obligations. Consumer confidence is still at low levels and that certainly will have an impact on future spending.

One area that appears to be getting little media attention is the ever-growing goods and services trade deficit. The U.S. trade deficit currently stands at \$44.2 billion and export growth is at an eight-month low. The U.S. cannot maintain a deficit indefinitely. This trade gap will dampen real GDP growth until the gap narrows. Inflation remains tame with the core inflation (ex-energy) rate at 1.9% through January. Some sectors are experiencing price inflation, but the inflation is not persistent. Energy and medical costs have been rising, but oil prices, for instance, have been fluctuating with the day-to-day direction of the conflict in Iraq. Overall, inflation risk is low and the market may already be pricing in a risk of deflation. There still remains a lack of pricing power in the corporate sector. A lack of productivity, strength and decelerating wage costs also act as constraints on inflation.

In the household sector, the employment numbers are important. The recent trend has shown a decline in those employed and an unemployment rate that masks the true labor picture. Many displaced workers have been out of the work force for more than 12 months. Many have given up the search for new jobs in an environment where companies are more focused on cost-cutting than

increasing their payrolls. Many of these statistics do get counted in the weekly job numbers. In February, for example, non-farm payrolls declined by 354,000 and, over the two-month period (January and February), job losses amounted to 465,000. There have been job declines in both the goods and services sectors and February marked the thirty-second consecutive decline in jobs in the manufacturing sector. The drag in the services sector was mainly due to job losses in the retail and government sectors. One bright spot has been a steady increase of workers in the construction industry sector. Some of the severe weakening in the jobs market recently has been influenced by the removal of military reservists.

Real personal income growth has been positive as spending has declined. Even so, consumers are still keeping the economy afloat. Modest spending gains have offset profit-led declines in business investment and interest rates remain low. Low interest rates have been the primary catalyst behind the boom in the residential real estate market and have led to a record amount of mortgage refinancing—the one driver in this economy that, essentially, has kept growth from slipping back into recession.

Europe

Economic growth has been in decline in the region since 2000, with Germany, the region's largest economy, leading the way. A number of common themes have pervaded in the Euro region over the last several years. High rates of unemployment, high social costs, weak exports and a weak manufacturing sector have impacted growth in Germany, France and Italy. The weak global economy has hurt Germany's export-oriented economy and high social costs continue to constrain growth in France. In Germany, Chancellor Schroeder has promised to strengthen job prospects by implementing reforms in the labor market and, in France, the local government is being forced to consider more austere fiscal measures in order to keep its fiscal deficits under control.

In Germany, GDP has gone from a 3.2% rate of growth after inflation during 2000 to a 1.2% annual rate of growth during the first quarter of 2003. The contributors to economic output have all fallen in the last two years with

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household consumption moving from a 3.5% change in 2000 to 1.2% in 2002. Industrial production was negative in 2002 and is expected to remain flat during 2003. Business investment peaked in 2000, growing 8.9% from the previous year, and finished 2002 1.3% lower than the previous year. Business investment in 2003 is expected to fall even further from 2002 year-end values. Business spending has been weak worldwide, but especially so in Germany. Weak global conditions, weak exports and rising labor costs have kept businesses from making new capital investments. The burst in the stock market bubble, especially in the telecommunication sector, and remaining excess capacity in the sector have left a dent in the German economy. The same concerns that have confronted U.S. consumers have left their mark on German consumers. Consumer confidence has worsened significantly, due to poor labor market fundamentals, geopolitical uncertainty and volatile energy prices.

The economic problems affecting the U.S. and Japan are also present in Europe. Of the three major regions, the U.S. economy is the most stable, Japan's economy is essentially in recession again, and Europe's economy is nearly in recession. There are more similarities in the European region and Japan in terms of ineffective economic policies, cultural roadblocks and the inability to address the eroding business sector. Many of the economic problems that have impeded growth in Japan over the last decade were partially the result of ineffective fiscal policies, lax monetary policies and the inability of the local political machine to extract itself from its old habits. Some of what is happening in Europe today is similar to what the Japanese have lived with over the last 10-plus years. Fiscal policy has been ineffective and policymakers slow to act. The European Central Bank (ECB) has not been aggressive enough to lower interest

rates and stimulate the economy. Many of the economic decisions being made in the Euro region appear to be politically driven. Deregulation and reform have occurred in the region, but at a slower-than-expected pace. Another similarity between Japan and the Euro region is their bank-dominated financial systems. In Japan, we have been discussing the bank debt problems over the last several years and the subsequent drain they have had on the local economy. In Germany, bank profits are weak, reserves are eroding and bad loan debt is rising. Falling equity has obviously been the main culprit, but other factors have played a hand as well. Overcapacity in the telecom sector, heavy lending in the telecom sector and corporate insolvencies hurt the banks as well.

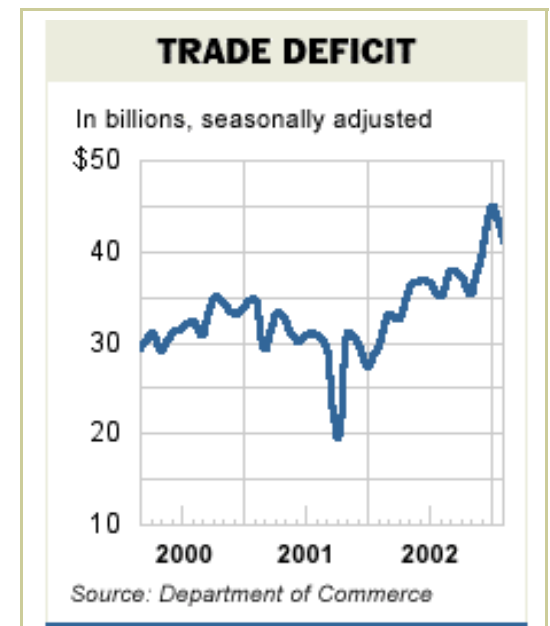
With growth prospects in the Euro region less than promising over the next several months, the ECB has only recently cut its benchmark interest rate by 25 basis points to 2.5%. Inflation is low, near 1.9%, and the ECB has still been slow to react. Growth and inflation are currently running at rates south of those in the U.S. economy, but short interest rates are still nearly 1.5% higher than similar benchmark rates in the U.S. Consumer confidence continues to fall and unemployment continues to rise. Even though the ECB intends to keep inflation under 2%, it is doing so with blinders on. The central bank needs to act swiftly or all hopes of a regional economic superpower may be a distant memory.

Japan

In Japan, it's more of the same old story—weak economic growth, price deflation and ineffective fiscal and monetary policies. There has been a glimmer of hope in Japan over the last few months. Business investment has moved higher in recent months and the currency re-

mains strong relative to the dollar. Growth has remained flat on an annual basis since 2001. Interest rates are near zero and the budget deficit continues to climb. Most worrisome has been the continued decline in the general level of prices for goods and services. Structural problems are still pervasive and changing demographics are not favorable. Political change has been slow and ineffective, and the banking crisis is still very much alive. The current economic environment in Japan is bleak and the outlook is not much better.

The consensus expects real GDP to end 2003 at a 0.3% rate of growth and 2004 at 0.7%. Household consumption has been flat and is expected to remain so well into 2004. Private consumption grew 1.8% in the fourth quarter of last year (year-over-year percentage change) and is expected to grow 0.8% in the first quarter of 2003, 0.4% during the second quarter, -0.4% during the third quarter and -0.3% in the fourth quarter. Business investment is expected to fare slightly better in 2003 and 2004. Industrial production is expected to improve in 2003 and



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2004. Industrial production fell 7.5% in 2001 and 1.5% in 2002. Analysts expect this number to improve to a 2.1% rate of growth in 2003 and a 1.4% rate of growth in 2004.

One of the biggest problems facing Japan is deflation. Consumer prices and wholesale prices have been falling since 1999. Deflation impedes growth and makes it extremely difficult to emerge from recession or a low-growth environment. Companies have no pricing power, demand continues to fall, and the cost of debt obligations tends to exceed deteriorating asset values. This deflationary spiral is difficult to arrest, especially in Japan. Japan is a nation of savers and many Japanese are nearing retirement age. These two

factors make it difficult for a demand-led push to lift the deflationary overhang. Many argue that Japan has not been aggressive enough in tackling the deflationary problem. The Bank of Japan has frequently argued that monetary policy alone cannot lift Japan's deflation problem. Yet, the central bank has failed to set inflation or monetary targets and been forced to intervene frequently in the currency markets to prevent the Yen from rising against the U.S. dollar. Despite all this, the Yen remains strong relative to the dollar and the yield on the 10-year benchmark government bond has hit a recent low of 0.74%. This suggests that the market has little confidence that the monetary authorities will be able to reinflate the economy anytime soon.

Falling prices have not helped the already sick state of the Japanese banking and insurance sectors. Both sectors closed out another bad year with record levels of bad loans still on the books. Falling equity prices have certainly contributed to this problem. Equity markets in Japan are down 75% from their peak levels in 1989. Many estimate that the top 8-10 banks in Japan are sitting on some \$38 billion in equity losses—some realized, some not. The insurance sector is not much better. Equity loss estimates for the top 10 insurers range from \$15 billion to \$19 billion. The banks are now flirting with the 8% average capital adequacy ratio that international rules require. The numbers may be even worse than what is being reported. In the insurance sector, the problem is compounded due to the high “lock-in” payout ratios at a time when interest rates are near zero. The insurers hold a record level of bank shares and subordinated debt. In turn, the

banks have propped up the insurance companies with a record level of loans.

PERFORMANCE

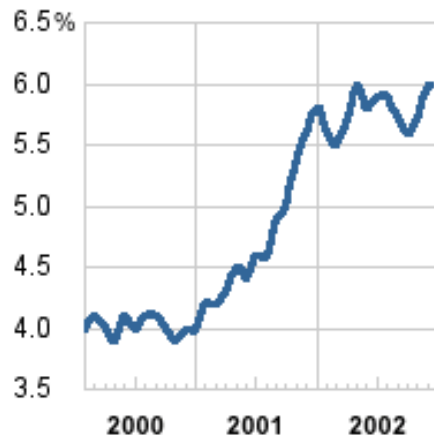
U.S. Equity

The U.S. stock market, as measured by the S&P 500, fell slightly over 3% during the first quarter, extending its 12-month loss to nearly 25%. No major sectors of the stock market were spared during the quarter with the exception of health care and energy-related shares. Despite encouraging pockets of earnings news, most stocks traded lower during the quarter as investors shunned equity risk. The war in Iraq consumed most investors' attention, as did fears of higher oil prices resulting from possible supply disruptions. Daily market volatility followed 24/7 live reports from the action in Iraq, with the market moving higher on reported successes, only to fall on reported setbacks. Performance during the quarter did not reflect the underlying fundamentals in the economy. Longer-term performance has discounted a global economy that was already weak prior to the commencement of war with Iraq. On a 12-month trailing basis, results suggest that the bear market is still intact. No one major stock group, such as large-cap, small-cap, growth or value, has escaped double-digit losses over the last 12 months, nor has any one economic sector.

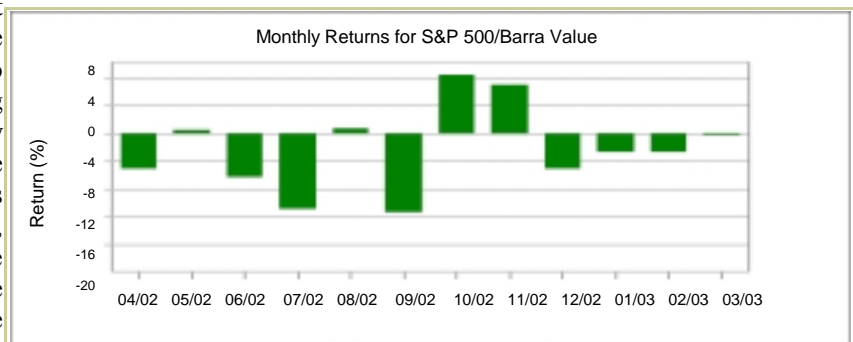
The first quarter of 2003 marked one of the most volatile quarters in the stock market in recent memory. Even

UNEMPLOYMENT RATE

Seasonally adjusted



Source: Bureau of Labor Statistics



Source: Barra

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though the market moved lower during the quarter, the week of March 24 was one of the best since 1983. Extreme volatility was not limited to the stock market. During the quarter, oil prices moved to near \$40 per barrel and fell as low as \$25 per barrel. Meanwhile, record numbers of equity investors have repatriated stock losses to home mortgages and money market accounts. Record low interest rates have spurred cash-out mortgage refinancings and a record level of money sitting in liquid money market accounts. Those who have transferred assets to real estate are already sitting on an inflated market, and those in money market funds have been losing money after fees and inflation.

Another phenomenon occurred during the quarter. There was a renewed interest in technology stocks, specifically Internet stocks. The Dow index of Internet stocks was up over 12% during the quarter. Stocks such as Yahoo and eBay were up over 25% during the quarter. Investors have bid the prices of these stocks higher in hopes of a technology recovery. Don't expect the rise to continue though. Even with those companies that have increased sales revenues and earnings, many are still trading at 80-90 times expected earnings growth. Sounds reminiscent of the late 1990s. These inflated valuations don't even account for option expense, which, for many Silicon Valley companies, is a significant number.

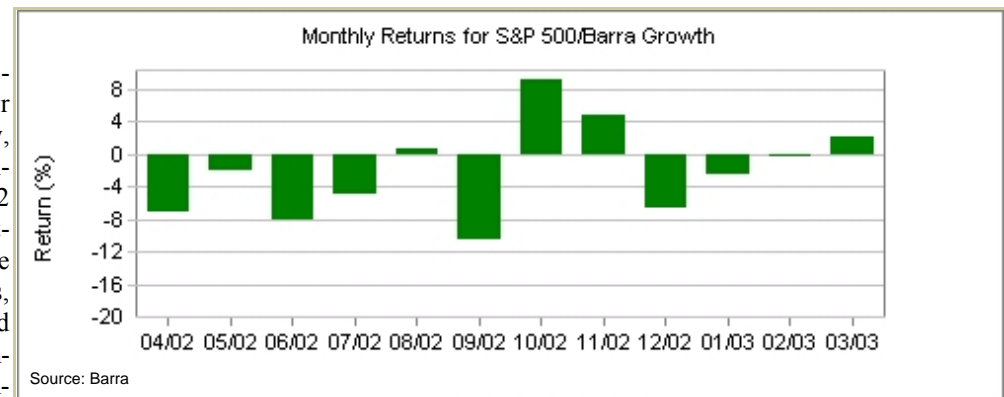
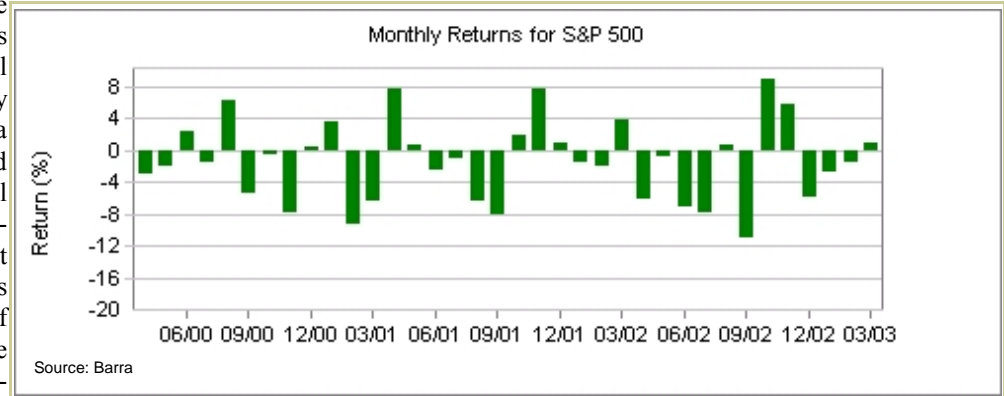
Another recent trend has been the reversal of style leadership. In recent months, growth stocks have outpaced value stocks by a ratio of nearly 5 to 1. Is this style change permanent? Conventional thought suggests that, during times of economic recovery and scarce corporate growth, investors are willing to pay a premium for future earnings growth and, conversely, value

stocks tend to do well when investors can be more selective when shopping for earnings growth. This market is anything but conventional. Recent corporate malfeasance and the lack of confidence in both reported and estimated earnings have investors leery. As a result, investors have focused on a company's demonstrated ability to generate free cash flow from core operations without masking profitability by avoiding proper accounting for stock option expense and pensions costs.

We believe that the longer-term trend favors value over growth. Real economic growth is only expected to grow in a range between 2.5% and 3% over the next several years with very low inflation. This suggests that growth-stock investors will be disappointed if they continue to believe the optimistic earnings estimates coming out of Wall Street.

The best-performing sectors during the quarter were multi-industry, health care, retail and energy. Over the past 12 months, the best-performing sectors were consumer non-durables, health care, energy and shelter. A number of companies escaped the system-

atic sell-off in the broad stock market during the quarter. Those that did were either recession-resistant businesses, such as drug companies, or the beneficiaries of higher energy prices and the still-buoyant housing market. One of the best-performing stocks during the quarter was GE, up over 75% during the quarter due to better-than-expected earnings results. GE's television and media subs, NBC and MSNBC, performed well due to increased viewership and subsequent ad sales during the coverage of the Iraq war. In the drug stock sector, the big three (J&J, Merck and Pfizer) all posted double-digit gains during the quarter on the heels of higher sales revenues. Energy giants ExxonMobil and ChevronTexaco also posted double-digit gains during the quarter due to higher energy prices and higher customer demand.



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The worst-performing sectors during the quarter were consumer durables, capital goods, utilities and raw materials. Over the past 12 months, the worst-performing sectors were consumer durables, utilities, capital goods and business & equipment services. The biggest losers during the quarter were stocks in industries that are dependent on demand from the household and business sectors. Even with strong auto sales demand in the latter part of the first quarter, the big automakers struggled to increase their overall profit margins. Sales incentives, including zero-percent financing and attractive rebates, have kept demand strong, but the high cost of these incentives has not helped boost the bottom line. In the capital goods sector, low capacity utilization rates and falling prices have made it difficult for companies such as Emerson Electric and Illinois Tool Works to increase their profit margins. Tyco, also in the sector, continues to suffer the ill effects of corporate malfeasance from its former management team. In the utilities sector, telecom stocks dragged shares lower. Companies such as SBC Communications saw their stock prices fall nearly 25% during the quarter. Most of the telecom sector still suffers from the excess capacity buildup in services during the 1990s.

U.S. Bonds

Bond prices moved slightly higher during the first quarter, mostly a reflection of a flight to safety and a worsening economic outlook. Bonds moved higher in most all sectors and duration ranges. The biggest gains were in the corporate bond sector, especially in lower-credit-quality issues. While yields moved lower, as economists revised their 2003 and 2004 growth estimates lower, corporate bond yields narrowed relative to Treasury bond yields, suggesting that some improve-

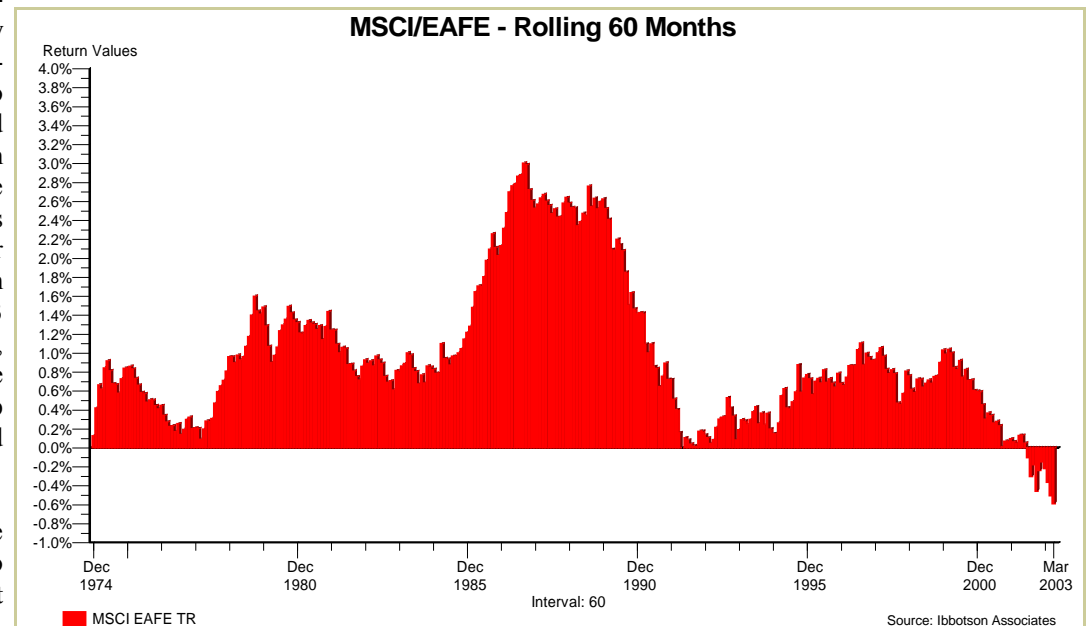
ments in corporate earnings were forthcoming. Meanwhile, the municipal bond market moved higher even as most local governments are running budget deficits and lower tax revenues.

The yield curve has flattened over the last three months, as the consensus continues to revise its economic growth forecasts lower for 2003. Short-term interest rates have trended near 1% and longer-term yields, such as the yield on the 10-year Treasury bond, have been trading between 3.8% and 4%. From 1999 to 2002, 10-year Treasury bond yields moved from a level of 6.4% to 3.8% and three-month Treasury bills, from 5.5% to 1.2%. Forecasters currently expect 3-month Treasury yields to end 2003 near 1.3%, and 2.1% in 2004. Longer bond yields are expected to move slightly higher with the 10-year Treasury bond yield expected to move to 4% by year-end 2003 and 4.7% in 2004. At the same time, forecasters expect consumer inflation to finish up 2.3% in 2003 and 2.1% in 2004, and wholesale prices to finish up 2% in 2003 and 0.9% in 2004.

The Fed has some wiggle room to lower interest

rates, but not much. The fed futures markets suggest that the odds are better than 50% that the Fed will lower the benchmark rate by 25 basis points by the end of June. There is ample liquidity in the market sitting in money market accounts. We believe that there continues to be a greater risk of deflation as opposed to inflation. Corporate pricing power is weak worldwide and the U.S. continues to import lower inflation from emerging markets such as China and India. This, combined with a risk of lower demand from both the household and business sectors, poses the greatest risk in the coming months. It will be up to the U.S. consumer and U.S. businesses to keep the global economy moving forward.

The best-performing area of the bond market during the first quarter of 2003 was clustered in longer-dated and lower-credit-quality issues. It was a seesaw ride for investors in the bond market during the quarter, marked with a 30% slide in the price of oil in March and weaker-than-expected economic growth. Spot rates on the 3-month T-bill remained relatively unchanged over the three months ending in March. Rates did move as low as 1.16% in early February, only to end the quarter



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at 1.2%. Ten-year yields moved as low as 3.58% during the quarter. Corporate yield spreads also narrowed over the quarter, indicating the market was confident that the U.S. economy would begin to show signs of improvement following a short and successful conflict with Iraq.

International Equity

Equity markets outside the U.S. fared poorly during the first quarter, with many European markets posting double-digit losses even after the Euro appreciated nearly 4% relative to the U.S. dollar. Japanese stocks also fell nearly 8% on a U.S. dollar-basis during the quarter. Many of the same problems confronting investors in U.S. markets have been evident in the European and Asian markets. Slow growth, depressed corporate earnings, lower exports, low inflation (lack of pricing power), high rates of unemployment and unsuccessful monetary and fiscal policies have helped to depress stock prices. Volatile financial and commodity markets, along with geopolitical uncertainty, have kept stock market buyers on the sidelines. The Euro region has been distracted by the war in Iraq and structural economic problems closer to home. In Japan, the only buyers have been those with the stomach willing to buy selectively and early. Stock prices in Japan have been in decline since 1989. Deflation continues to depress local growth, as does the still-existent bad loan problem in the banking sector.

The biggest markets in Europe, Germany and France posted double-digit losses during the quarter as measured on a U.S. dollar-basis. The same ills affecting the U.S. markets have also been present in Europe. The comparison stops there. High social costs, falling price levels, high rates of unemployment and ongoing structural problems have plagued the Euro region. In addition,

monetary and fiscal policies have been ineffective, more so than in the U.S. In Germany, Chancellor Schroeder has been slow to enact labor reforms. Deregulation has been forthcoming, but slow. Tax revenues have slowed and deficits keep climbing. The stronger Euro relative to the U.S. dollar has also hurt the export sector. Add to this, a non-accommodative central bank that has been resistant to cut interest rates for fear of higher inflation down the road. The story is much the same in France. Unemployment rates are climbing and the manufacturing sector is back in recession. Consumer confidence has been falling and household consumption is weak. France's decision not to support its allies on the war in Iraq has also had a negative impact on the export sector. Deficit problems confront France as well. The finance minister recently announced that this year's deficit is now expected to be 3.4% of GDP, above the Euro's Stability and Growth Pact's 3% target. Stock prices in both markets have suffered due to falling demand and depressed corporate earnings.

Japanese stocks fell over 7% on a U.S. dollar-basis during the quarter. The corporate sector in Japan continues to suffer from a lack of pricing power and an inflated Yen relative to the U.S. dollar. Structural problems and deflation aside, internal and external demand in Japan remain weak and corporations have been forced to focus on the expense-side of the balance sheet. Business investment has improved, but many doubt the trend will last. There still remains scant demand for Japanese equities inside Japan and only minor interest from contrarian investors abroad. Local investors are wary from years of a bear market in equities, higher energy prices, climbing unemployment and concerns over impending retirement. Outside investors are not yet convinced

that politicians in Japan have fully addressed internal structural problems, including the bad debt problem in both the banking and insurance sectors.

Stock prices in the emerging markets also traded lower during the first quarter. Results in the Far East and Asian markets generally lagged the results posted in the emerging Euro markets. The uncertainty of war, volatile energy prices and SARS all weighed down economic activities in most of these markets. As a result, investors exited many of these markets during the quarter. There were, however, some exceptions. Stocks posted strong gains in Thailand and the Czech Republic during the quarter.

In emerging Asia, almost all stock markets traded lower during the first quarter, with the exception of Thailand. Geopolitical uncertainties in the region, specifically North Korea, had a major negative impact on stock prices in the region. Stocks in South Korea were nearly 20% lower during the quarter. Stocks in the largest country in the region, China, fell only 1.5% during the quarter, but hope for a recovery in stock prices is questionable given the late March discovery of the new SARS virus. In fact, the biggest deterrent to economic growth and business activity for the foreseeable future in the region will be the effects of the SARS crisis. Economic activity has plummeted in the region in just the last 30 days and the lasting effects could knock an additional 1% to 2% off of GDP in 2003.

The emerging markets of Europe and the Middle East posted mixed results during the first quarter. The best performers were the Czech Republic and Israel. The worst-performing markets included Poland and Turkey. The markets that traded lower in the region were more closely tied to the war with Iraq. For example, stocks in Turkey posted some of the worst results during the quarter primarily due to a sell-off caused by Turkey's refusal to allow the U.S. to station its troops in the country for deployment to northern Iraq.

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The U.S. dollar has been in decline relative to both the Euro and the Japanese Yen over the last 12 months. The Euro has appreciated 25% relative to the U.S. dollar over the last 12 months and the Yen, 12%. One of the main reasons for the weaker dollar has been that less foreign capital is being invested in U.S. stock and bond markets. In addition, the large goods and services trade deficit in the U.S. suggests that the U.S. dollar is poised to fall even further versus the Euro and Yen in the coming months.

MARKET VALUATION & EARNINGS

Most discussions on valuation and earnings have recently taken a back seat to talk of a “war bounce” in the stock market, the impact of lower oil prices, and other external events surrounding the close of the war with Iraq. Now that the war is unofficially over, the market has begun to reassess corporate earnings and stock market valuations based on various earnings estimates over the next 12 months. For months we have been discussing the various valuation models being used by analysts as well as the different methods being employed to account for corporate earnings. Valuation measures can be somewhat subjective and

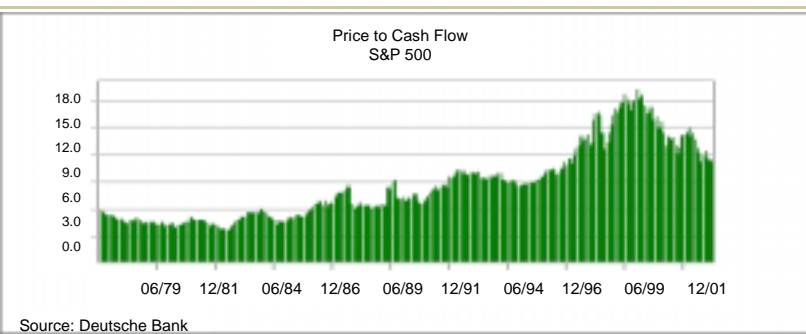
are sometimes deemed more art than science. Relative valuation methods are also important, as investors tend to make investment decisions comparing one investment to another. There are several issues surrounding stock valuation and earnings measures. Some methodologies include the comparison of earnings yields on stocks versus yields on bonds. Some analysts consider dividends important (we concur) and some do not. The key variables used to determine stock valuations include dividends, earnings growth and price. Price levels and dividend yields are easy—they’re a given. Estimated earnings are not. Due to a general lack of accounting standards for computing earnings and balance sheet manipulation during the 1990s, investors are leery when it comes to Wall Street earnings estimates. Some analysts use trailing reported earnings in their stock valuation models, but most use forecasted earnings.

There are several methods of accounting for earnings currently being employed by analysts, ranging from the most optimistic (operating earnings) to the most conservative measure (core earnings). In spirit, estimated earnings are an important input to the more robust valuation models. The basic tenets of finance postulate that discounting the asset’s future cash flows back to today’s

price derives the future value of any asset. Expected returns are a function of dividend growth and earnings growth. There are different valuation models being used and many are acceptable. The real issue is not the models, but rather the data inputs. The market needs to agree upon a consistent and complete method of accounting for earnings, including write-offs, pension expense and stock

option expense. Unfortunately, the market has not yet accepted one standard for the measure of estimated earnings. Lockwood endorses the most conservative measure of accounting for earnings—core earnings. We have discussed the core earnings measure in detail in prior commentaries and highlighted the benefits of adopting such a measure versus the other, widely used methodologies.

Current earnings forecasts are the least reliable that we have seen in several years. Many market watchers have sworn off sell-side earnings estimates and have fallen back on reported or trailing earnings. Despite this movement, we still believe that the stock market is an excellent discount mechanism for future performance of the economy and corporate earnings. We subscribe to the idea of using analyst earnings estimates, but only after they are adjusted for things like pension costs, write-offs, stock option expense, etc. Currently, the market is cheap, fair-valued or expensive depending on which methodology for earnings accounting you believe in. Will the real P/E please stand up! Measures of valuation range from a P/E multiple of 16 based on bottom-up expected operating earnings to a P/E multiple of 29 based on top-down core earnings estimates (Lockwood views this measure as the most appropriate). On the other hand, stocks are cheap if you subscribe to the methodology of comparing earnings yield (estimated earnings/price) versus bond yield. We would contend that these models tend to fall apart during periods of extreme risk aversion, as is the case now. The core earnings measure is conservative, but also attempts to comply with the work that the Accounting Standards board is doing to properly account for employee stock option and pension expense. Accounting for stock options has been difficult. No standard measure has yet been adopted. Too much flexibility in terms of valuation method, timing of data and availability of data are just a few of the complaints. The core earnings measure does reflect stock option expense and usually reports it as a percentage of overall earnings. Additional work is being done by Standard & Poor’s and others to move toward a more accurate and standardized method of accounting for



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actual and estimated earnings. Sector-specific valuation models have helped, as specific sectors and their subsequent earnings results are influenced more by stock option expense than others.

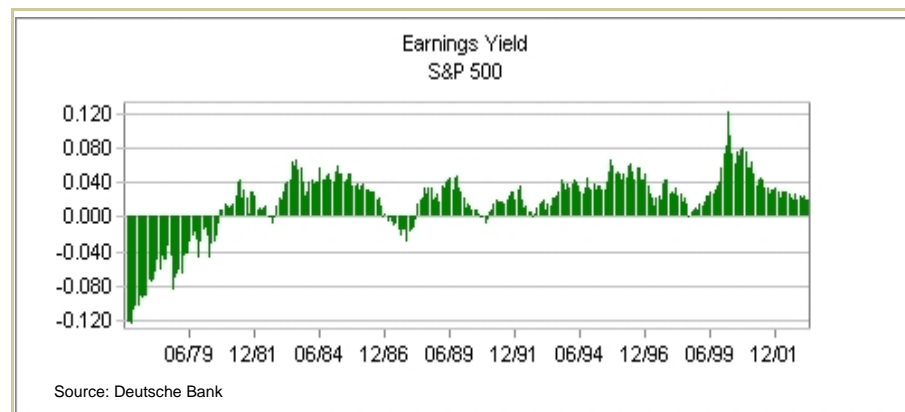
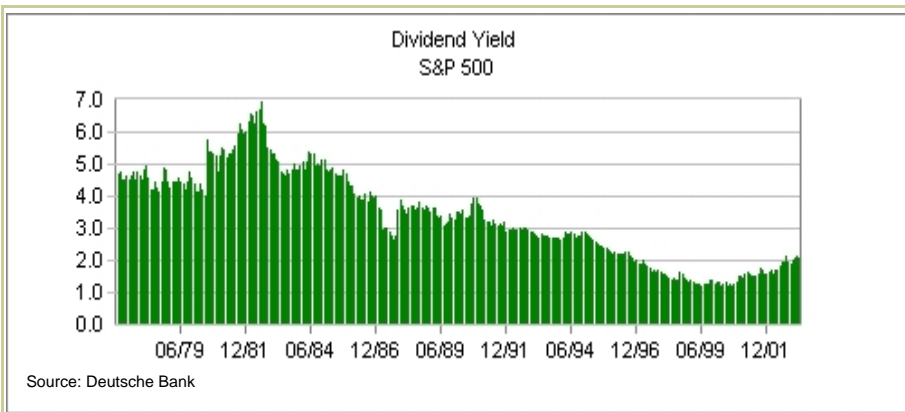
The accounting treatment of pension expense has also been a timely topic with analysts recently, given the large number of corporate pension plans that are currently underfunded. This is a concern due to the balance sheet impact of stepped-up pension contributions needed to meet future unfunded pension obligations. An additional cost for many of these pension funds has been the increase in insurance premiums as required by the Pension Benefit Guaranty Corp. (PBGC). Many of these underfunded pension plans were the same plans running surpluses during much of the 1990s. These same companies also used such surpluses as a method to boost earnings, overstating financial results. The net pension credit/charge is currently accounted for in operating income, but is not yet a separate item. Those companies that do report their pension funding status do so in an untimely manner and bury it in the footnotes of their 10k. Companies also have abused results by smoothing their assumptions so that it appears that

future benefit obligations are adequately being met. Many pension funds discount their future pension benefit payout obligations by using a constant 30-year Treasury yield rate as opposed to adopting a more accurate discount rate based on the changing shape of the yield curve. Also, many companies are required to increase their contributions to their pension fund if the funding ratio falls below 90% (assets/liabilities) and are not required to do so with cash, but have the flexibility to use company stock and/or plant and equipment, all of which can blur the true earnings picture. The Standard & Poor's core earnings estimate includes the most accurate accounting for pension charges/credits.

The stock market has a long history of discounting the most accurate picture of corporate profit health over longer time horizons. We have no reason to believe that this time around is any different. Until stock market valuation levels based on earnings measures that properly account for items such as employee stock option expense and pension expense are universally adopted, Lockwood will continue to rely on the core earnings measure as the most accurate input for valuation models.

The future performance of the bond market is dependent on three factors: starting yield, default risk premium (corporate bond yield vs. Treasury bond yield) and the effects of a change in interest rates. The starting point yield is the largest contributor to future bond returns, especially near peaks and troughs of the interest rate cycle. Default risk premiums are important as well and are usually negatively correlated to stock price return. For example, when corporate bond yields narrow (decline) versus Treasury securities, equity prices tend to move higher and just the opposite occurs when corporate bond yields widen relative to Treasury yields. The general level of interest rate change or shift in the yield curve impacts future bond returns and is a reflection of anticipated inflation.

Short-term interest rates are near 50-year lows and long bond yields are near their lows in the interest cycle. Corporate credit spreads have also been narrowing relative to Treasury yields after months of large gaps. The yield curve has shifted downward due to weak economic activity, a flight to safety and investor anticipation of lower inflation. Treasury bonds are more likely near the top of the cycle with little room for appreciation in the near future. Interest rates appear to be poised for trading near their current levels until further evidence of growth is present. The recent narrowing of corporate bond yields over Treasury issues indicates that investors expect the economy and corporate profits to recover in the near future.



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APPENDIX

Lockwood's Five-Factor Model

This chart shows the different factors that Lockwood examines to develop its proprietary capital markets outlook for the next three to five years. The factors are grouped into five broad categories—valuation, earnings, the economy, risk and technical indicators. Various characteristics within these categories are evaluated and rated on a best-to-worst scale of one to five (one being the best, five being the worst). The characteristic ratings in each category are then averaged to arrive at an overall rating for the category. Each category is then weighted according to Lockwood's proprietary model to arrive at an overall estimate for the direction of the capital markets.

US Five Factor Model (3 to 5 Year)

Apr-03

Factor (1=best case; 5=worst case)	Rating	Comment
Valuation (40%)		
3 Yr Valuation Models	3	Valuations Improving - Still not Cheap
DCF/ERP (Disc Cflow/Eq Risk Prem)	3	Low Dividend Yld, Normal Growth Rates & P/E Contracton
DDM (Dividend Discount Model)	3	Same as 3 & 5 Yr
Fed Model (Earnings Yield vs 10 Yr Yield)	2	High Level of Risk Aversion Suggests This Measure Irrelevant
Average	2.75	Stocks are Still Expensive - Earnings do not reflect options/pension cost
Earnings (20%) Consensus View		
Earnings Outlook	3	Street too Optimistic - Large Gap between Exp Profit & Econ Growth
Earnings Revision	3	Downward Revisions are slowing
Earnings Surprise	4	Negative Surprises Still Outnumber Positive Ones
Earnings Dispersion	4	More Accounting Re-Statements Expected
Long Term Growth Rate	3	Expect Reversion to Long Term Trends
Average	3.4	Earnings Recovery for 2003 is still in question
The Economy (20%)		
Growth		
Real GDP Growth	3	Below long-term trend rate - but still in the positive column
Consumer Spending	4	Strained due to employment pic and higher debt
Industrial Production	4	Sector falling back into recession?
Employment	4	Layoff cycle and unemployment rate have not yet peaked
Corporate Profits	3	Business & Consumer Spending Still Weak-Some Improvement
Housing	3	Signs of weakening - regional phenomena
Auto/Truck Sales	2	Strong Sales - Weak Profits
Interest Rates		
Monetary Policy	3	Fed on the Sidelines
Short Rates	3	Near the bottom
Long Rates	3	Will only rise when stock mkt vol eases and recovery is in place
Inflation		
CPI	3	Core Inflation below 2.0%
PPI	3	No pricing power
Commodity Price Index	2	Volatile - but lower oil prices are a plus
Taxes		
Fiscal Policy	4	Receipts down, spending up - higher taxes ahead in Local Govs
Other		
US Dollar	4	Dollar hits three-year low vs Euro
Net Exports	4	Large trade balance deficit
Average	3.3	
Risk (10%)		
Fundamental risk improving - Volatility risk still high		
Corporate Debt	3	Default rates slowing - expect consolidation
Consumer Debt	3	Levels are Rising
Govt Debt	4	No more budget surplus!
Margin Loans	1	No speculation in this market
Average	2.8	
Technical (10%)		
Investors are not embracing stocks yet		
Bull/Bear	2	Bearish Sentiment is Pervasive
Mutual Fund Redemptions	2	Record Equity Fund Redemptions
Cash Balances	2	Money Market Assets Up - Large Cash Balances on Sidelines
Consumer Sentiment	4	Weak
Average	2.5	
Total Weighted Ranking:	3.0	Flat to slightly higher stock market in 2003 with High Volatility

Source: Lockwood Advisors, Inc.