

February 9, 2001

There is an important story to be told about last year's markets, and it's much bigger than the "tech wreck" covered by much of the mainstream media. We hope you'll find our enclosed *Market Summary 2000* includes some perspectives you haven't seen before.

One popular misconception is that all stocks had an exceptionally bad year. Yes, the technology sector lost over 50%, and yes, shareholders of several well-known companies suffered losses in excess of 85%, but the broader markets didn't have a disastrous year. In fact, the markets as a whole demonstrated some rather normal behavior; asset classes which had been down in 1999 were generally positive in 2000 and visa versa. Asset classes with the greatest returns in 1999 turned in some of the worst performances in 2000.

It's also interesting to us, since we deal with the personal component of investor behavior, to observe the short-term perspective of the media coverage. Over the last several weeks, as the markets experienced something of a rebound in certain asset classes (such as technology stocks), we detected some folks in the media writing as though the markets were well on their way to recouping 2000's losses in the technology sector and growth-style stocks. For example, a *Wall Street Journal* article last week asserted that mutual fund casualties from 2000 were quickly reviving, presenting this as evidence:

"MFS Emerging Growth Fund has rebounded 12.2% after falling 25.4% last year."

The inference most readers draw from the statement is that the fund is half way back to recovering all of last year's losses. The quote may lead a reader to presume the fund position only has to go back up 25% this year to make-up for a 25% loss last year. Actually, a position that lost 25% last year needs to rise 34% to compensate for last year's loss. The math isn't that intuitive, until one considers the fact the starting point this year is lower than the starting point last year. A clearer example is a stock that started the previous year at \$100 and ended the year at \$50 lost 50%. If it goes up 50% this year, it would only gain \$25 and end at \$75, not \$100 where it started the previous year.

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The example points to a deeper investment concept, more significant than the riddle of the math: it is that volatility can hurt your portfolio's return in ways that are not intuitively apparent. In the long run, a portfolio experiencing more consistent annual returns will outdistance one with more volatile annual returns, even if their averages are the same. Since diversification reduces volatility, we typically recommend a broad spectrum of investments.

Finally, a note about the year ahead. It's possible the worst is not over because the US economy may be coming in for a harder landing than many anticipated even three months ago. Consumer spending, the engine of both economy and the stock market, is slowing. At the same time, foreign investors, who were happy to put their money in US stocks a year ago, are showing more caution and putting downward pressure on the US stock market. Stay tuned for more interesting times, and stay diversified.

Sincerely,

A handwritten signature in cursive script, reading "Frederic T. Kutscher". The signature is written in black ink and is positioned above the printed name.

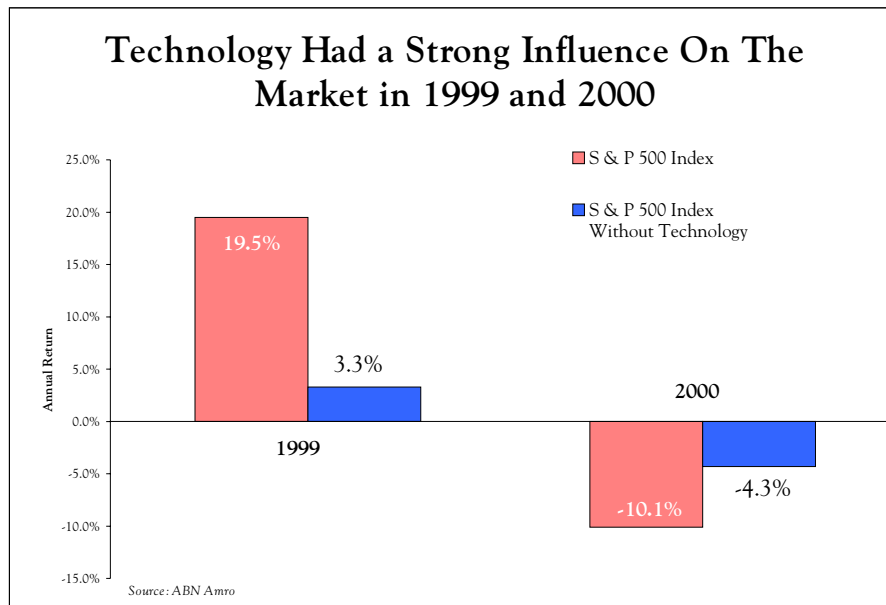
Frederic T. Kutscher

Enclosure

CAPITAL MARKETS SUMMARY

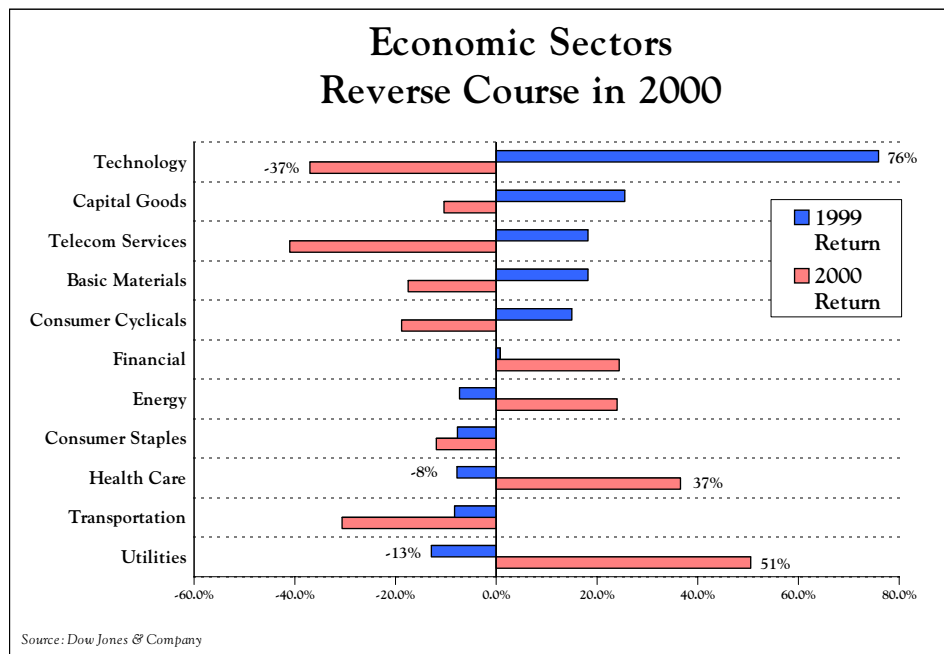
US Stock Market – Contrasts from 1999 to 2000 Abound

In 2000, we witnessed the end of a stock market mania driven primarily by speculation in technology companies. Investors closed the year with a 37% drop in the tech sector and over a 50% decline from the sector's high in April 2000. The broader market (excluding technology), which had been experiencing relatively flat returns since 1998, did not suffer significantly in 2000. Without technology companies, the Standard and Poors 500 Index (a measure of large US companies' stock prices) would have only lost 4.3% rather than the actual 10.1% loss, suggesting that technology companies had gained an undue influence on the markets.



Technology's reversal in 2000 of its 76% return from the prior year typified the character of the markets. What went up in 2000 had been down in 1999 and what had been down in 1999 went up in 2000. Two dramatic examples of reversals were the utility and health care sectors. The utilities sector was down 12.9% in 1999 but was up 50.5% in 2000. Health care was down 7.8% in 1999 but was up 36.6% in 2000.

There were many examples of these year-to-year reversals, as illustrated below:

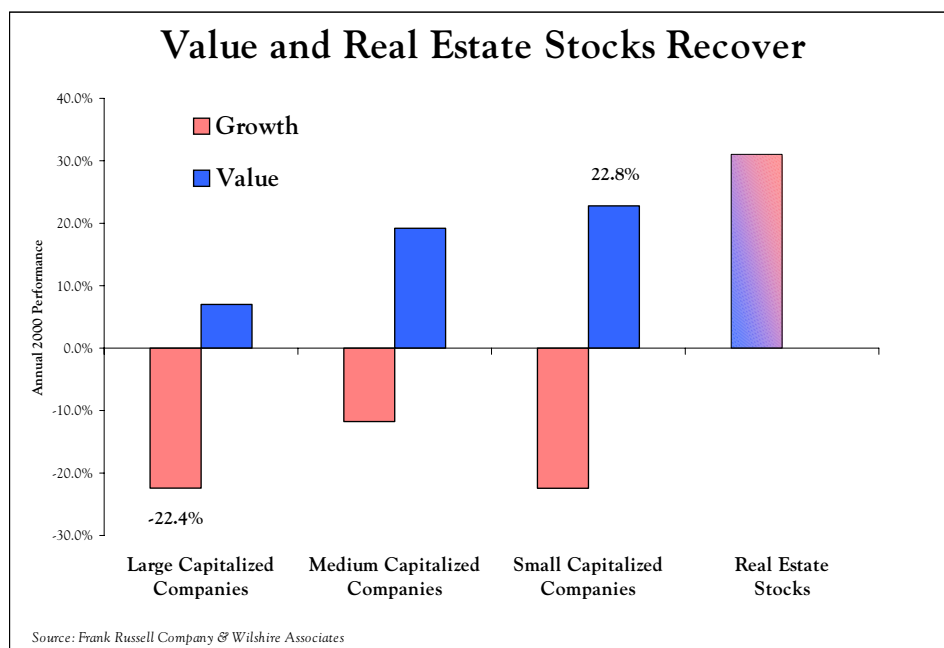


Going after the “hot” stock, fund, or economic sector did not pay off. If it seemed safe to focus investments in large capitalized and technology companies in 1999 and early 2000 because of their long unbeaten record, it wasn’t. Things turned around after the first quarter of 2000. This turnaround typified a more normal or traditional way for markets to behave. It also emphasized the importance of diversification.

Even after the significant decline in the prices of many stocks in the S & P 500, the prices remain very high for a few securities in the Index. Although the price-to-earnings ratio (a measure of the relative value of a stock) of the Index dropped by year-end to 23 from a year 2000 high of 26.5, this is still high compared with the historical median of 18.1. This has led many to believe there is still room for further losses in a number of high-flying stocks, which would pull the Index down further (e.g., Veritas, Verisign and Siebel Systems all with price to earnings ratios over 100).

Not all US equities suffered. Investors have been focused on large capitalized growth companies for a number of years, almost to the exclusion of other asset classes. For four or five years prior to 2000, entire classes of stocks and equity management styles languished due to being left out of the “popularity contest.” In 2000, many of those

ignored stocks were recognized as bargains. Not only did some economic sectors, such as utilities and healthcare increase dramatically, but whole asset classes recovered due to their severe under-valuation – investors realized they were too cheap to pass up.



When the price of a company's stock is low compared to its assets and earnings growth, rate the stock is generally characterized as a "value" stock. Value companies of all sizes had positive returns in 2000. The most dramatic comparison was between the performance of large growth companies (down 22.4%) and small value companies (up 22.8%) which reflected a movement toward correcting the bifurcation that grew to extremes in 1998 and 1999. The real estate market also experienced a rebound from prior under-valuation as investors realized that real estate securities were cheap in relation to the underlying real estate holdings.

International Stock Equity Market Performance and Perspective

Foreign equity markets suffered in 2000 due to a variety of factors including concerns about the US economy (which purchases foreign goods) and the euro's poor performance. The Morgan Stanley EAFE Index was down 15.2%, it's worst showing in nine years. Some developed country's indexes were down over 30%, while emerging markets fared even worse – many Asian and far east country indexes were down 40% and 50%.

International markets had their first down year since 1992:



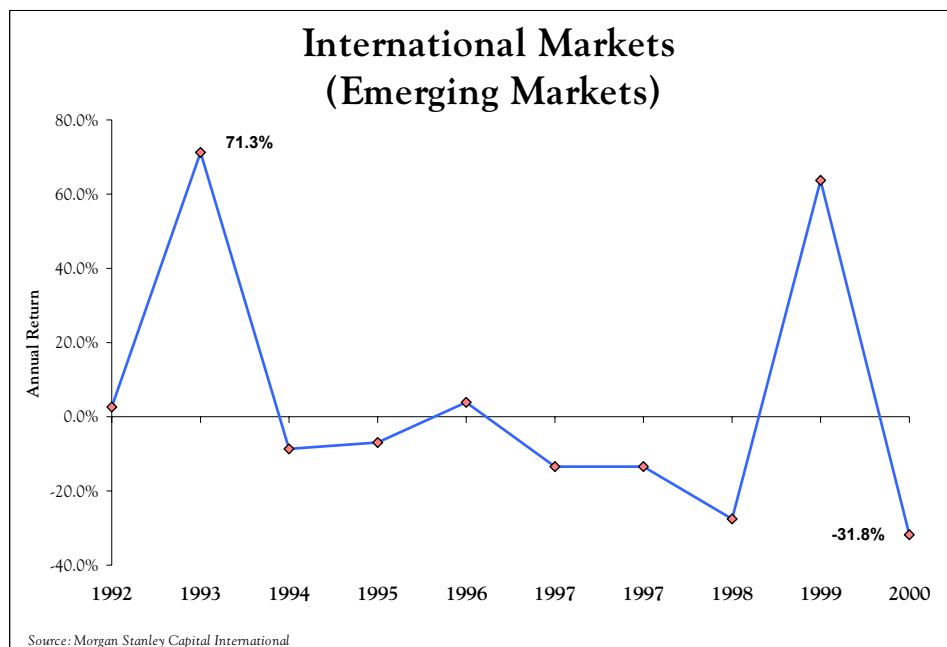
Canada (5% return) and Venezuela (0.8% return) were the only winners in the Americas. Despite strong economies in many of the Latin American countries, most of their indexes declined dramatically. Most analysts attribute this to political turmoil and the volatility induced by the US stock market.

Europe's stock markets did not have a good year either. The Morgan Stanley European Index ended the year with a 9.6% loss, which was similar to the performance of the overall US stock market. Their markets' pain was largely caused by a dramatic drop in the technology, media and telecom sectors. Although some countries escaped the fall, many experienced losses even greater than the Index's average. Some blame may be put on the monetary policy of the European Central Bank, but more significant influences were Europe's cultural biases, lack of governmental reform and the impact of US market activity.

Emerging International Markets – A Disaster for Many Less Developed Countries

Emerging markets are inherently volatile and although they are influenced by developed countries' stock markets, they often do not behave exactly like developed countries' stock markets. However, this year they did. Unlike last year's spectacularly positive returns, the majority of emerging markets had a disastrous year as reflected in the 31.8% loss in the Morgan Stanley Emerging Market Index.

Emerging markets were as volatile as ever:



Many less-developed countries, which are vulnerable to downdrafts in the US and developed world's economies, experienced negative market returns of forty to sixty percent. Regional and local turmoil affected these markets as well, particularly in Indonesia and Columbia, but perhaps these influences were less dramatic than the global issues. The details are far too voluminous to discuss here, but needless to say, emerging markets suffered universally in all regions across the world.

ASIA		LATIN AMERICA		EUROPE, MIDDLE EAST & AFRICA	
CHINA	-32.2%	ARGENTINA	-26.1%	CZECH REPUBLIC	0.7%
INDIA	-22.8%	BRAZIL	-14.2%	EGYPT	-45.8%
INDONESIA	-63.0%	CHILE	-17.0%	GREECE	-42.5%
KOREA	-50.3%	COLOMBIA	-41.2%	HUNGARY	-27.7%
MALAYSIA	-17.3%	MEXICO	-21.5%	ISRAEL	24.7%
PAKISTAN	-13.8%	PERU	-26.7%	JORDAN	-24.7%
PHILIPPINES	-45.3%	VENEZUELA	0.8%	MOROCCO	-23.9%
SRI LANKA	-43.9%			POLAND	-4.6%
TAIWAN	-45.3%			RUSSIA	-30.4%
THAILAND	-56.7%			SOUTH AFRICA	-19.6%
				TURKEY	-46.2%

Source: Morgan Stanley Capital International

US Bond Market – The Defensive Asset Class That Did Its Job

Bonds are often added to portfolios as a defense measure to moderate stock market risk. Portfolios containing bonds were cushioned against 2000's falling stock market. Most bond indexes were up between 9% and 20% despite the Federal Reserve Board raising discount rates three times early in the year. (Increased discount rates generally decreased bond prices.) The increase in bond prices was due largely to investors seeking safety from tumultuous markets and supply/demand issues stemming from the government's budget surplus. The budget surplus caused the Treasury to issue far fewer bonds than in recent history. In addition, the US Government began buying back Treasury bonds from the market which created investor concern over a lack of supply. This concern caused investors to buy even more Treasury bonds, which sent the prices even higher.

Another interesting feature in the 2000 bond markets was the importance of credit quality. As concerns increased about corporations' ability to repay bondholders from future earnings, bonds with poorer credit quality were punished and those with better prospects were bid up. High yield bonds experienced the worst year since 1990 due to investors' concerns over credit quality. These concerns also negatively influenced the investment grade corporate bond market, but not nearly to the same extent that the high yield market was impacted. Since US Treasury bonds benefited significantly from both credit quality and supply/demand influences, the price differences between corporate and treasury bonds were at a historic high.

