
FREDERIC T. KUTSCHER ASSOCIATES, INC.

Comprehensive financial counsel for individuals, families and trusts

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We enclose our 2002 year-end market summary for your perusal and reflection. When we wrote our annual market review for 2001 a year ago, we hoped the speculative bubble-popping events had passed. Few would have predicted an additional -23% loss in the US stock market.¹

From 2000 through 2002, equity market declines of -40% in the US and -45% internationally were brutal, both for their duration and severity, making them comparable with declines during the 1930s.

The good news for 2000 through 2002 is that portfolios that were diversified in various asset classes fared better than concentrated portfolios.

As always, if you would like to discuss the implications of any of our observations on your financial plan, we welcome your thoughts.

Sincerely,

FREDERIC T. KUTSCHER ASSOCIATES, INC.



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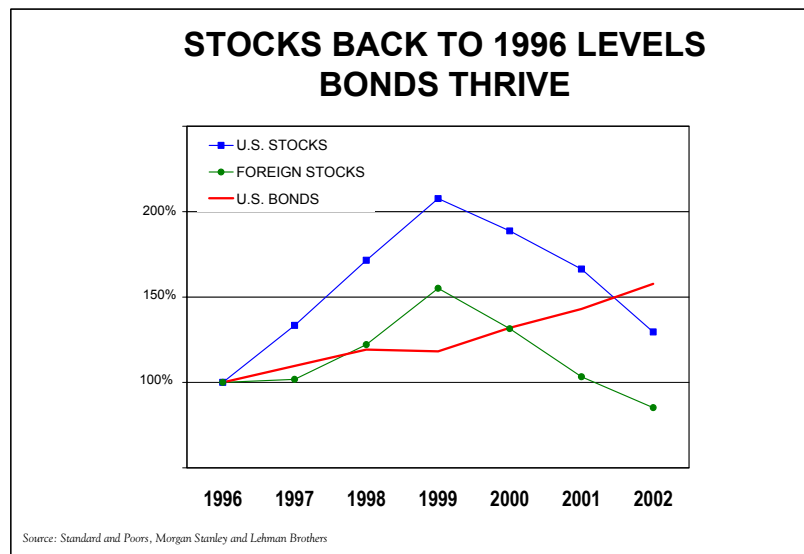
¹ Standard & Poor's 500 Index, representing the largest 500 domestic companies by capitalization.

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CAPITAL MARKETS REVIEW

2000 – 2002 in Perspective

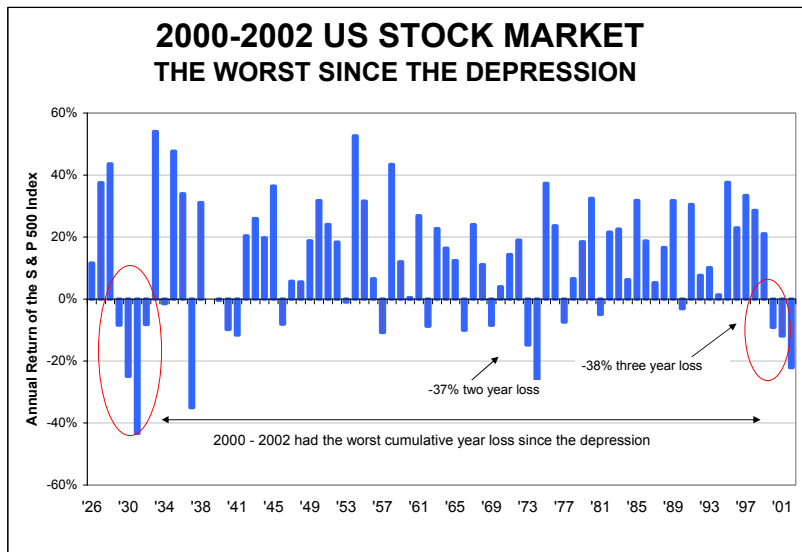
Just as the last years of the century will be associated with phenomenally high returns in the capital markets, the first three years of the millennium will be remembered as a persistent hangover. Domestic and foreign stock markets suffered a third straight year of losses which hadn't occurred domestically since 1939 – 1941. In terms of severity, cumulative damage rivaled only market losses in the depression. Losses accelerated as stockholders moved their money into other asset classes, primarily real estate and fixed income securities.



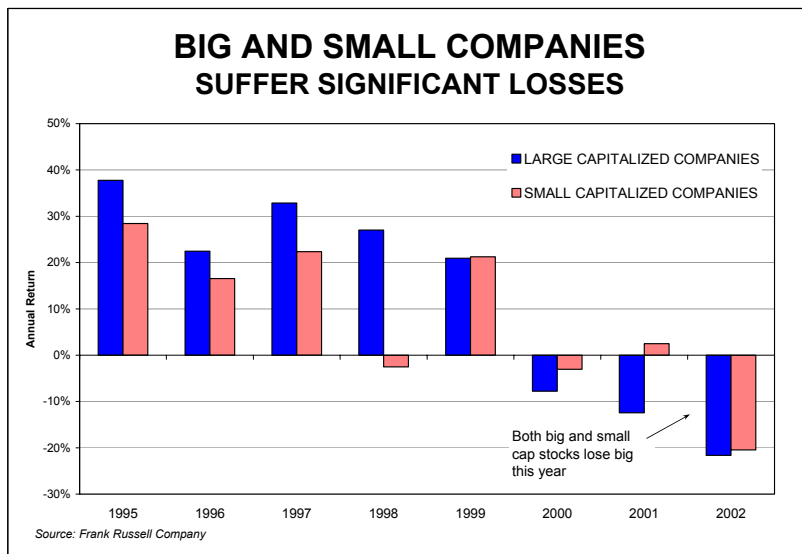
As a result, the US bond market and real estate securities fared well over the past three-year period. Gains in real estate, however, slowed and the opportunity for above-average returns in the bond markets waned.

US Stock Market – The Worst Years Since The 1930s

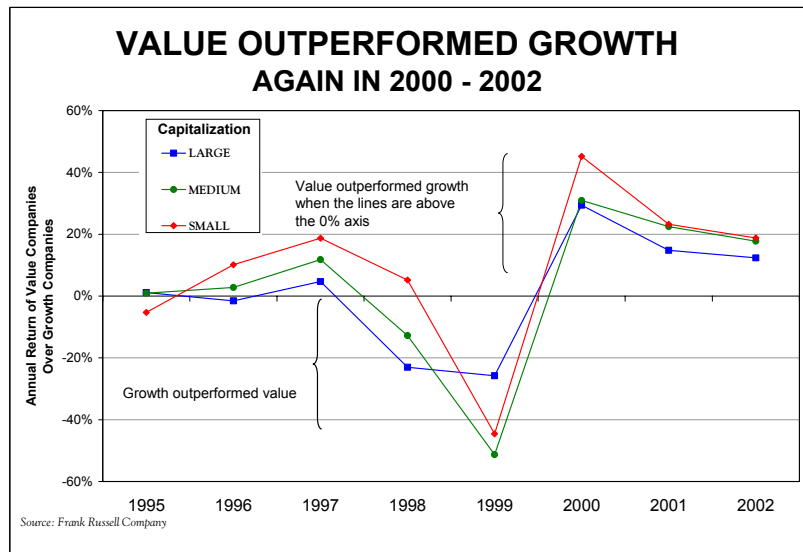
A shaky economy, corporate scandals and war fears combined to make 2002 the hardest hit of the last three years, delivering a -23% loss in the S&P 500 and a cumulative three-year loss of -38%. The NASDAQ was down -32%, culminating with a three-year loss of -67%.



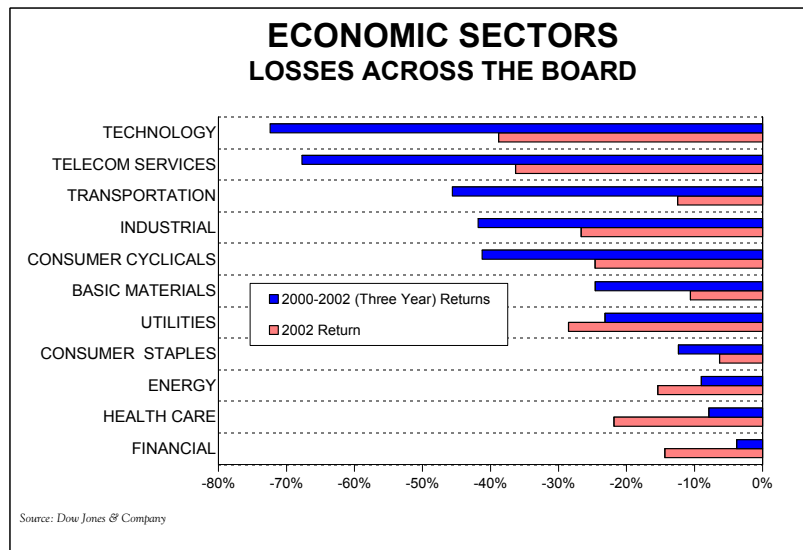
The market began 2000 by facing the reality of a bursting technology bubble. This was followed by a mild recession, unprecedented domestic terrorism attacks, emerging high profile corporate accounting and governance scandals, and the mounting likelihood of a middle-eastern war. Any one of these events would normally have had a negative influence on the markets, but their cumulative impact was considerable. Cushioning these forces were unflinching consumer spending and Alan Greenspan's adroit use of monetary policy. Working against consumers and the Fed's stimulus policies was investor pessimism.



Unlike 2001, when some investors avoided or mitigated their losses by diversifying into smaller capitalized companies, there was no escaping the bear in 2002. All stocks lost, with mid-cap stocks delivering the least losses at -16%. Prices for large cap stocks improved relative to smaller cap stocks, but at the end of 2002 large cap stocks were still expensive relative to their intrinsic value.



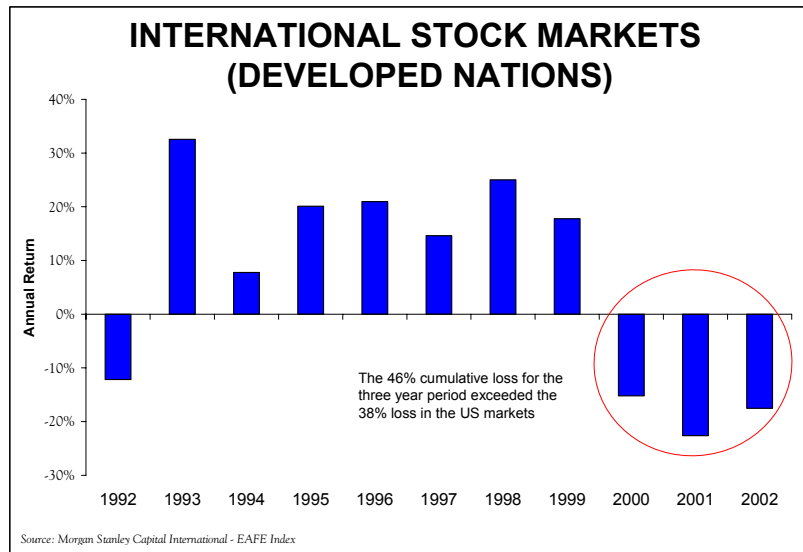
The market's perception of what kind of stock is attractive changes over time. In addition to size, a stock's return in various environments is highly influenced by whether it is considered a growth stock (often with a high price relative to its estimated value) or a value stock (low price relative to estimated value). In the "new economy era" of 1998 and 1999 growth significantly outperformed value after three years of value meeting or beating growth returns. In 2000-2002 value stocks won out. And although value outperformed growth in 2002 as reflected in the *relative* return chart above, both value and growth indexes declined. This pricing trend may have balanced relative pricing disparities between the growth and value styles. This probably lessened the opportunity over the near term to benefit from overweighting one or the other.



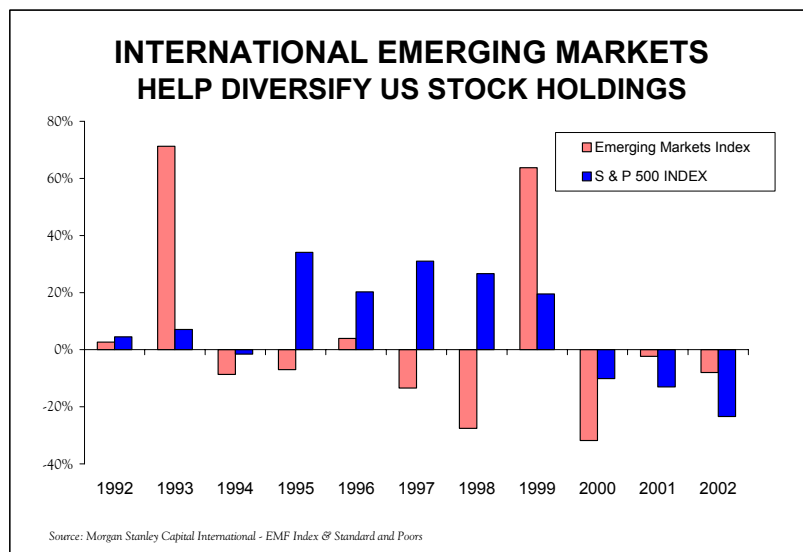
Not only did all major economic sectors have losses in 2002, all also had cumulative losses over the three years. The technology and telecom services sectors suffered the worst and financial and health care the least.

International Stock Market Performance and Perspective

Diversification into foreign markets generally benefited portfolios in 2002 since most foreign markets did not lose as much as domestic markets. Compared with the -23% loss in the US, developed international markets lost -18% and emerging markets lost -8%. However, over the three years, foreign developed markets lost -46% compared with a three-year US stock market loss of over -38%.



In Europe companies continued to struggle with regulation and rigidities in the labor markets and, as a consequence, were generally less efficient and responsive than those in the US or Asia. The fact that EU policy makers focused on deficit limits rather than stimulus policies did not help. Adding to these strategic influences were supply and demand forces. Insurance companies, weighed down with equities they purchased in the late 1990s, were forced to sell to maintain their legal solvency levels. Their “fire sales” contributed to the -50% plus loss in the European insurance industry sector.



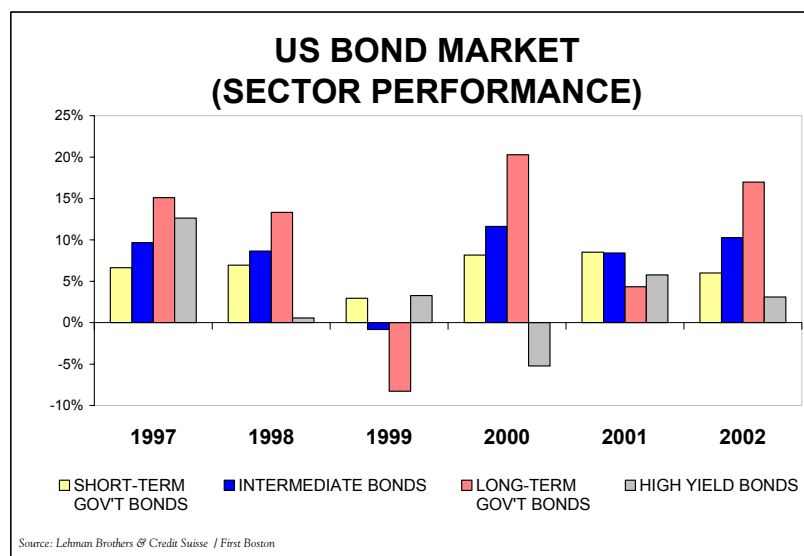
Asian markets, despite losing ground, looked pretty good relative to Europe. Pacific and Far East Indexes ended the year with losses of less than -12% compared with losses of -34% in France and -44% in Germany. Pakistan gained +119% benefiting from lessened

tensions on its borders with both Afghanistan and India. India's market was up +3% as was Saudi Arabia's. Some key points of the Asian markets: Japan continued with its 11th year of losses and the Nikkei ended near a nineteen year low; South Korea finished the year with almost a +5% gain – down from much higher levels earlier in the year before tensions with North Korea mounted; Singapore's stock market was down around -10% while Taiwan's lost -22% and Hong Kong, failing to benefit from China's robust economy, lost -20%.

Country-specific crises and global economic woes left Latin America smarting. Largely influenced by the US economy, Mexico's stock market fell -15%. Argentina's market increased dramatically (78%) but fell -50% against the dollar as the country let its currency float freely for the first time in over ten years. Venezuela and Brazil suffered a similar fate being up +32% and down -2% respectively in local currency but down -28% and -36% in US dollar terms.

US Bond Markets

From 1997 through 2002 bonds had stable performance and during 2000-2002 bonds significantly outperformed stocks. The unusually hearty gains came from a flight to safety by investors and the steady reduction in interest rates starting in 2001. Many believed the US economy would strengthen early in 2002 leading investors to move out of US Treasuries into corporates and even junk bonds. But news of corporate scandals caused investors to return to Treasuries. This fact, along with the Fed lower short-term rates, caused yields to move lower with the yield on the ten year Treasury note hitting a forty four-year low during the year (price moves opposite of yield).



Almost all bond sectors did well from 1997 through 2002 with losses only in long-term bonds in 1999 and high yield bonds in 2000. Adept monetary policy by the Fed kept inflation at bay which was good for the credit markets. At the end of the year, the consensus was that interest rates couldn't go much lower and a firming economy with attendant inflationary pressures might cause yields to rise and bond prices to fall relative to stocks.