FREDERIC T. KUTSCHER ASSOCIATES, INC.

Comprehensive financial counsel for individuals, families and trusts

February 4, 2004

Once again it's time for our annual Capital Markets Summary, which you'll find enclosed. In this we cover each of the major asset categories represented in our typical client portfolios, with a short synopsis of themes or events for 2004. We also provide data on returns for the one, five and ten year periods.

The last calendar year was a humdinger in the stock, real estate and high-yield bond markets. For example, US and international stocks made astounding gains of around 35% and 51%, respectively, from March through December 2003, leaving some shell-shocked investors behind, and proving once again the importance of adhering to an investment policy rather than attempting to time the markets.

While basking in the glorious returns of 2003 is tempting, we deliberately add the returns for the five and ten year periods to provide some perspective. The last five years especially have been an odyssey for market participants. On the high side, returns reached +29% in 2003 and +21% in 1999 while losses cumulated at over -41% in the US stock market from 2000 through 2002.

With swings like those, we anticipate the sirens of market timing will again entice investors. We can hear it now -- "Wouldn't a really smart investor have exited the market in late 1999 and re-entered in early 2003?"

The truth is: If (and that's a big IF) you had hit it just right, you would have been very smart or very lucky, or both. Your timing would have involved two very acute, visionary and prophetic decisions: when to sell and when to buy. Very few people are capable of making these calls consistently. How do we know this? Well, in our professional practices we've heard many real-life stories about failed timing efforts. And our experience is confirmed by this eye-opening conclusion from a study conducted by Dalbar, a Boston-based research firm: while the average equity mutual fund produced an average return of 14% per year from 1984 to 2000, the average mutual fund investor in those same funds benefited from only a 5% average annual performance, a difference of 9% per year.

> *While the average stock fund returned a total of 841% from 1994 through 2000, the average investor in those same funds realized total returns of only 141%.*
>
> *Dalbar Study*

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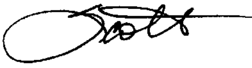
How does this happen? Driven by a cycle of emotions, investors buy funds after the market has had a good run (i.e., they buy high) only to sell out after the market has had a bad run (i.e., they sell low). Thus, convinced they can successfully time the markets, fund investors are inclined to exhibit behavior producing unintended and destructive consequences.

The long-term penalties of these misguided actions are dramatic. While the average stock fund returned 841% from 1994 through 2000, the average investor, cycling in and out of those same funds, received returns of 141%.

As the charts in the Capital Markets Summary show, even in a bear market such as we've experienced so recently, the steady investor can tough it out and get tolerably decent returns as long as he or she remains an "investor" as opposed to a "speculator." Stocks have historically delivered returns in the range of 10-11% annually (from 1925-2003).

Clearly, persistence and patience are important qualities for a serious investor (perhaps even more important than being "smart").

Cordially,



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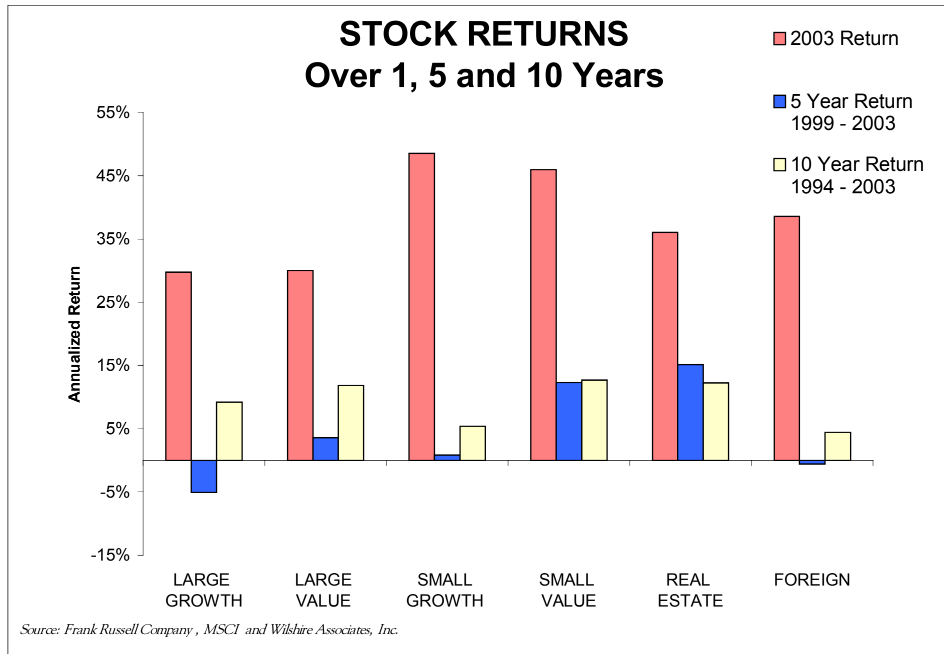
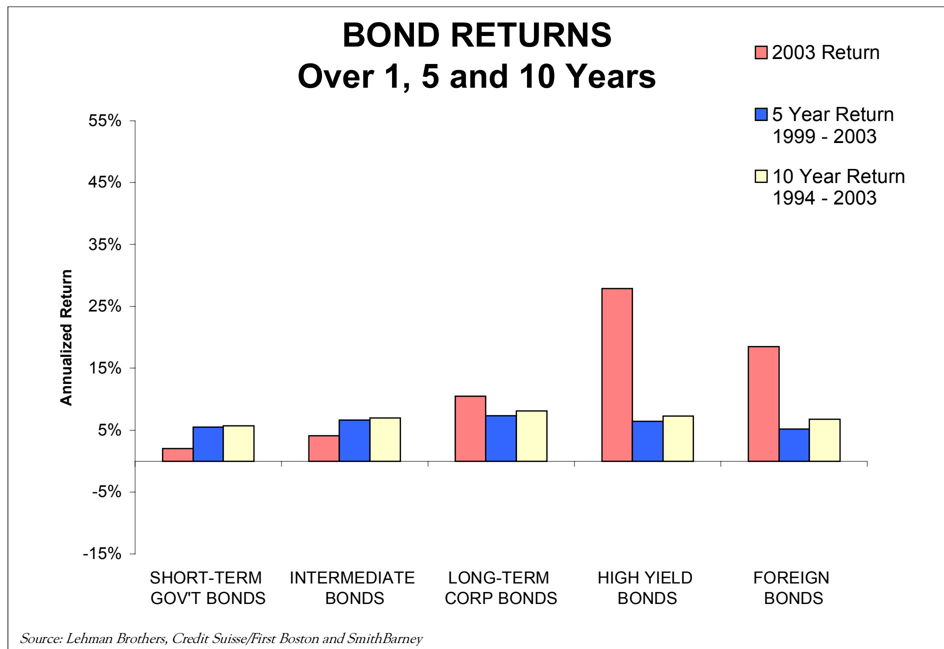
Capital Markets Summary

(for periods ending December 2003)





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TOTAL RETURNS
(annualized)

	1 year (2003)	10 years (1994-2003)	5 years (1999-2003)	COMMENTS
EQUITIES (Stocks & Real Estate)				
US LARGE-CAPITALIZED GROWTH COMPANIES	29.8%	9.2%	-5.1%	Large-cap growth stocks finished 30% up for 2003, boosted by a 49% return in the technology sector. Interestingly, companies comprising the lower end of the large-cap growth group had a 100% average return.
US LARGE-CAPITALIZED VALUE COMPANIES	30.0%	11.9%	3.6%	Like their growth cousins, large-cap value stocks also finished the year with a 30% return, but the smallest capitalized companies only doubled the return of the largest stocks in the index.
US SMALL-CAPITALIZED GROWTH COMPANIES	48.5%	5.4%	0.9%	Small-cap growth stocks finished a spectacular year with a 48% return, beating all other asset classes and investment styles. As was the case for all of the indexes, the smallest stocks performed particularly well, creating a disadvantage for active stock managers who typically focus their research and investments in larger companies.
US SMALL-CAPITALIZED VALUE COMPANIES	46.0%	12.7%	12.3%	Small-cap value stocks produced excellent returns like their growth cousins. Leading the index were the technology, industrial and health care economic sectors.
REAL ESTATE EQUITIES	36.1%	12.2%	15.1%	Real estate stocks and REITs finished the year with a 36% gain despite a soft economy that increased vacancies in commercial real estate and low interest rates that fueled a hot housing market and sapped apartment leases.
FOREIGN STOCKS	38.6%	4.5%	-0.1%	Foreign stocks rose like US stocks; however, about 22% of the year's 39% increase came from currency fluctuations as stocks denominated in foreign currency enjoyed a tailwind from euro and other currency increases.

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TOTAL RETURNS
(annualized)

	1 year (2003)	5 years (1999-2003)	10 years (1994-2003)	COMMENTS
CASH EQUIVALENTS				
CASH – MONEY FUNDS	1.6%	3.2%	4.1%	Federal Reserve action forced yields on cash and short-term rates to reach lows in 2003 not seen in over 40 years, steepening the yield curve (the variation between short and long rates). Also noteworthy: for the first time in recent memory, real returns (after adjusting for inflation) on cash equivalents were negative.
BONDS				
SHORT-TERM GOVERNMENT BONDS	2.0%	5.5%	5.7%	From historically low interest rates, short-term bond yields started to rise during 2003, resulting in decreased bond prices.* But the short-term segment of the bond market still managed to squeak out a 2% total return for the year.
INTERMEDIATE BONDS	4.1%	6.6%	7.0%	Inflation expectations (either positive or negative) tend to be the primary factor in determining bond prices. Although inflation fears surfaced in 2003, which increased interest rates and depressed bond prices, the 4.1% annual total return in intermediate bonds was quite respectable.
LONG-TERM CORPORATE BONDS	10.5%	7.4%	8.1%	Bond investors felt more confident about the economy in 2003, motivating them to sell government bonds and buy corporate bonds. This buoyed long-term corporate bond prices and contributed to a 10.5% total return for the year for this segment of the bond market.
HIGH-YIELD BONDS	27.9%	6.4%	7.3%	The much-anticipated and glorious recovery of high-yield bonds occurred in 2003, as this asset class delivered a whopping 27.9% total return, again reflecting how much an improving economic climate can benefit low-credit-quality companies.
FOREIGN BONDS	18.5%	5.2%	6.7%	Foreign bonds had an annual total return of about 18%. However, only about 2% of that return was attributable to the performance of the bond market. The remaining 16% came from currency fluctuation as foreign currencies gained against the US dollar.

** Market interest rates and bond yields move inversely.*

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