Investment Watch

4th Quarter, 2001

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"DAZED AND CONFUSED"

For those of you who don't know me, I work in an office with 11 women and one man—me! Being in the company of women all day who try to get me in touch with my feelings, puts me on the top of the list of the ***Dazed and Confused***. But these days I have a lot of other company — from individual investors to the market gurus. No one knows where the markets are going.

So what's new? **Nothing!** Any investment professional worth his salt would tell you, trying to predict the direction of the markets in the short-term is impossible. However, they also tell us that over a long period of time the markets are very predictable. So for the moment let's forget about the uncertainty of the last-minute market chatter and try to find some solace in what ***we do know***.

We are <u>long-term</u> investors saving for our retirement. ***We do know*** long-term investing smoothes out short-term risks and enhances performance. We are not speculating on short-term swings in the market; but rather, we are faithfully investing in the long-term success of the U.S. economy and the world's financial markets. The U.S. economy has weathered recessions, depressions, wars, inflation, deflation and the transition to a global economy. It will overcome terrorism!

We do know that fund returns which deviate, either high or low from the historic norms, will eventually revert back to the historic averages into the future.

Why do we find it so hard to believe today? Because we have let our emotions get the best of us and exaggerate our perception of risk. The recent severe market losses cloud our minds and we forget the healing power of time.

So now that we have a modest sense of stability and security, let's see why our emotions have left us ***Dazed and Confused*** and why we have difficulty coping with the market's volatility and the uncertainty of our future. Psychologists have analyzed our perception of risk and today their main three conclusions are not only useful but seem prophetic.

We overestimate the severity, the duration and the frequency of both bad and good events. Remember our feelings at the end of the bull run of the late 1990's? Irrational exuberance, Price/Earnings ratios bid to crazy levels and dot-com mania, all demonstrated the unrealistic excessive enthusiasm we all felt. On New Year's Eve in 1999, we were all caught up in a manic whirlwind that we thought would never end. And led by the pundits, explaining away the excesses, many investors wrongly took on more risk.

We place too much weight on the recent past. This New Year's Eve we are at the bottom of that emotional roller coaster. Our retirement savings have been ravaged by the market downturn and our emotions have

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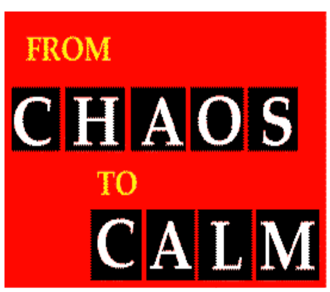
(cont'd)

been shattered with the loss of our personal freedoms. We don't have any faith that the markets will return to normal levels nor our lives return to innocence. The media's drums beat it home—*"Everything's changed"*. **It hasn't!** We are placing too much emphasis on the recent hurtful past. We underestimate our powers of recuperation.

We underestimate risk when we feel in control. We would rather be behind the wheel of a car than be a passenger. As a passenger, our safety is outside of our control and therefore we experience more anxiety. In our ever-increasingly complex society, it is difficult to feel in control. There is too much information to process, and the complexities yield mixed signals. We are overwhelmed. We are frozen with fear, the fear of regret. We think any decisions we make will be wrong.

We are ***Dazed and Confused***. However, now we know that our perceptions can be exaggerated, our rearview mirror short-sighted, and our control limited. So let's discount these nonproductive emotions because long-term investing has nothing to do with our feelings. Ultimately the stock market is driven not by emotions, but rather by corporate earnings, and the bond market not by perception, but by interest rates.

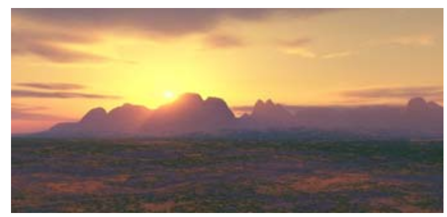


This is why we should have hope, even faith, because the U.S. economy will come out of recession and the markets will return to normal levels. When this will happen is *not* known, but remember we are not speculators we are long-term investors. Time is on our side. Stay *calm.*

As the year ends, it's usual to look back and review the significant events. Because so much of 2001 was negative it's hard not to over react. Let's try not to inflate 2001's effect on our entire future. Let's have faith in our resilience and the inherent strength of the U.S. economy to rise above these challenges.

The United States, and the world, have survived an unprecedented terrorist attack. We are engaged in war, the results of which are unknown. The U.S. economy has fallen into recession, jobless claims mount, shortfalls in earnings projections seem endless.

Despite all this, the fourth quarter staged an impressive comeback, gaining 10.3% as measured by the S&P 500. However, the U.S. markets finished down for the second consecutive year. This New Year's Eve marked the end of the worst two-year period in the stock market since 1974-1975. The financial pain is real to all of us, but let's not dwell on the bad news too long—let's look forward. It's always *darkest before the dawn*.



Almost everyone is pulling together in the same direction (Congress, like usual, got tangled up in the rope). Greenspan has done everything in his power to stimulate the economy. The consumer continues his spending spree keeping time with the retailers chant "Keep America Rolling". Cash is abundant.

Our economic infrastructure is sound. Interest rates and inflation are low. Gas prices are down. Inventories have been depleted which may require companies to begin hiring, rather than laying off employees. P/E ratios, although still a little high, are more near normal levels.

The long-term outlook for the U.S. economy is bright. Good news for the long-term investor.

And now all of us are more in touch with our feelings. In fact, I think I'm actually looking forward to seeing Kate & Leopold tonight with my family. Did I mention they're all women, too?

Keith Kowalczyk