

## INVESTMENT UPDATE

### Executive Summary

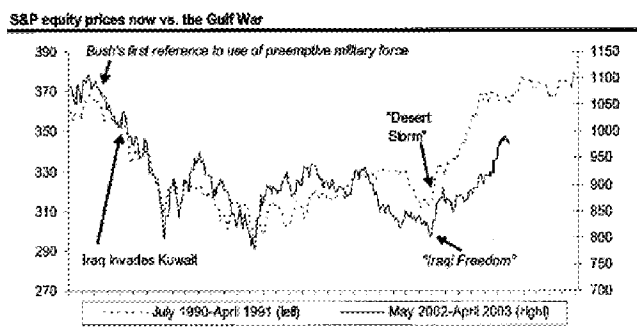
The stock market experienced a sharp rebound in the second quarter, driven by the successful conclusion of the Iraq War, better-than-expected corporate profit growth, the largest and most stimulative tax cut since the Reagan years, and a Federal Reserve that is willing to err on the side of growth for the first time in nearly 25 years.

The economy is still fighting high energy prices and intense competition from cheap overseas labor, which will offset some of the stimulus. Nonetheless, the economic recovery appears to be gaining strength and should be strong enough to drive corporate profits higher, which will support higher stock prices. We continue to worry about the bond market, as a stronger economy and a weaker dollar are likely to push interest rates higher over the next year. The extremely low yields are not enough to compensate for this risk, indicating a shorter-than-average duration for our bond portfolios.

### War in Iraq

The successful conclusion of the Iraq War has renewed investor confidence, removed another restraint on economic growth, and sparked a significant rally in the stock market. Oil prices have not fallen as much as expected because of the damage done to the Iraqi oil fields by years of neglect, looting, and sabotage. We still expect significantly higher Iraqi oil production to lead to lower oil prices in the next 6-12 months. The stock market reaction to the Iraq War has been very similar to that of the first Gulf War (Chart I). The market reacted negatively to the initial uncertainty and then responded positively to the successful conclusion.

CHART I: Stock Market Rally Similar to Last Gulf War



Source: DCK Haver, Bear Stearns & Co. Inc.

### Economy

Economic growth appeared to improve modestly in the second quarter after first quarter growth slowed to +1.4%. War fears, the severe winter weather in the East and Southeast, and higher energy costs contributed to the slowdown.

We continue to believe the combination of rapid money supply growth created by the Fed, extremely low interest rates, increased government spending, additional tax cuts, and the weaker dollar should provide more than enough stimulus to boost economic growth over the next twelve months. We expect above-average growth of +4% through the first half of 2004 and then a return to a more sustainable +3% growth rate.

After fighting inflation for the past quarter century, the Fed has determined that deflation is a greater threat to sustaining economic growth than inflation. As a result, the Fed recently reduced the Fed Funds rate another 25 basis points to 1%, representing the lowest level in 45 years.. In the short-term, this means that the Fed will be creating even more economic stimulus by keeping short-term interest rates well below zero on an inflation-adjusted basis. While we look forward to healthy economic growth during the next few years, there is a potential cost. We are concerned that this may eventually lead to a more volatile boom-and-bust economic cycle. This will continue to put pressure on the dollar and increase inflationary pressures. Nonetheless, with core inflation running at only +1.6%, the Fed has the flexibility to err on the side of growth for some time before inflationary pressures build.

The dollar has fallen back to a more normal level after excessive strengthening in 2000 and 2001 (Chart II). A weaker dollar helps U.S. companies compete against foreign competitors both domestically and internationally.

