



## 2<sup>ND</sup> QUARTER 2003

Another quarter passes and once again the financial chicken little's were wrong. Their mantra was that a declining dollar, massive fiscal stimulus coupled with a ballooning deficit would put bonds into a Bear Market tail spin. Yes, rates are off their lows but the economic recovery lacks the conviction the stock market has attributed it. The culprits; continued loss of jobs and no emergence of corporate capital expenditures. But don't count on that lasting very much longer.

Our financial markets have experienced the biggest monetary and fiscal stimulus since World War II. Economic growth is better this year than last and 2004 GDP growth will exceed this years. As the real economy (not the stock market) revives, rates will increase.

We do not foresee a bloody Bear Market in bonds but interest rates have seen their 45 year lows. This is why for investment grade corporates and municipal bond portfolios, you must take notice of the "Average Weighted Duration" we post every quarter on your "Portfolio Appraisal with Yield to Worst" report. This number appears on the last page of your report preceding the "Performance

Report". Junk bond and distressed portfolios focus less on duration because these portfolios are more credit rather than interest rate sensitive.

Your portfolio is a low duration portfolio, meaning, the value will move in a subdued manner when interest rates shift. Specifically, the value of your portfolio rises and falls by its duration in percentage terms. In simple English, if your portfolio has an average weighted duration of 3 years and if interest rates rise 1%, the value of your portfolio will decline 3%. Short duration bond portfolios maintain their value much better than long duration portfolios. Each year that passes your bond maturities "roll down" the yield curve and become shorter by one year. This ameliorates portfolio volatility due to shifting interest rates.

As the last stock market "hold outs" can no longer suffer the pain of missing this rally, many will sell their bond funds and race back into equities. Bond fund investors will get very hurt whereas separate accounts like yours won't be affected by the bond fund outflows.

No Bull Market lasts forever and our bond bull is definitely going into hibernation. Since January 2003 we have been shortening your portfolio duration in order to prepare for the next cycle. It appears that with the new accounting oversight board and Sarbanes Oxley, corporate blow-ups have dissipated. Corporate America continues its balance sheet repairs which we bond owners love. Next, the States, Counties and Cities need to do the same.

Never bet against American economic growth for too long. We are a nation of builders and spenders. And ....we are without exception, optimists.

Wishing you a wonderful rest of your summer.

### Still Stagnant

Monthly capital-goods orders, excluding defense and aircraft, in billions of dollars.



Source: Commerce Department