2003 Fourth Quarter

MARKET REVIEW—January 12, 2003

2003 was like a professional bicycle race; I hope that you didn't blink. For several years the Tour de Trump (and later the Tour du Pont) bicycle race stormed through Newark. I could typically take an hour off from work, walk to a great vantage point, and for a fleeting moment see the world's best cyclists whiz by at amazing speeds. I'd then mozy over to the office and get back to work. Well, the markets whizzed by in 2003. The stock markets gains averaged more than 30% in 2003. There is a risk, however, that if you blinked you missed it, that the well-deserved rebound (think of a phoenix's ascent from the ashes) that began in earnest in March 2003 is coming to a close.

The world remains a crazy place. The US and its allies continue to lose soldiers in Iraq and Afghanistan. The US dollar has been falling, and there is no end to that decline in sight. Job growth in the US appears to be on the endangered list. Mutual fund companies and brokerage firms are making headlines every week or so with violating investors' trust. Any yet, the markets rose 30% in 2003, and 40% since September 2002. This apparent discrepancy reinforces the fundamental nature of the stock markets—they rise and fall based on <u>expectations</u> of <u>future</u> events. Compared with a year ago, the US appears to be closer to a solid economic recovery. While the 'situation' in Iraq and Afghanistan are far from resolved, there is less uncertainty than there was this time last year.

Granted, they began from a very low starting point, however stocks both in the US and abroad had a wonderful year, in most cases the best since Mallard began in 1996. Foreign stocks were absolutely on fire. While the rebound began with speculative growth stocks leading the charge, surprisingly, value stocks had a better 4th quarter than growth (this is quite unusual when the markets are rising so strongly).

Broad-based US stock funds rose 10 to 15% during the quarter. Steady real estate funds rose almost 10%, and with the high level of oil prices, natural resource funds rose 17%. Technology funds cooled, rising only 13%, and yet finished the year up over 55%. Only a few types of funds did better than tech in 2003: emerging market stocks, and international small-cap funds each rose 55%, gold rose 58%, Latin American funds rose 62%, and China funds rose 63%. After carrying investors' portfolios for the three year bear market, bonds finally took a rest, and rose only 5% during 2003. High-yield bond funds, which are very economically sensitive, soared 24% during the year, and emerging market bonds rose even more.

The following average mutual fund performance figures come from the January 12th edition of Barron's and from Morningstar Principia Pro:

Category	**4th Quarter '03**	**12 Month Return**	**5-Year Avg**	**10-Year Avg**
Money Market—Taxable	+0.12%	+0.54%	+1.99%	+2.47%
Intermediate Term Inv Grade Bond	+0.51%	+4.92%	+5.67%	+6.08%
Intermediate Term Tax-Exempt	+0.93%	+4.14%	+4.72%	+5.00%
Large-Cap Core Stock	+11.48%	+26.72%	-0.43%	+9.24%
Mid-Cap Core Stock	+13.30%	+36.42%	+7.78%	+11.48%
Small-Cap Core Stock	+14.70%	+42.77%	+10.83%	+10.76%
Int'l Stock (Large-Cap Core)	+15.90%	+33.32%	+0.49%	+4.65%
Real Estate	+9.74%	+36.88%	+14.04%	+11.32%
Natural Resources	+17.39%	+32.28%	+14.40%	+10.52%
Technology	+12.77%	+55.87%	-3.10%	+12.38%
Multi-Cap Growth Stock	+10.80%	+35.34%	-1.26%	+8.84%
Multi-Cap Value Stock	+13.17%	+30.80%	+4.95%	+11.00%
Balanced	+7.68%	+19.09%	+2.35%	+8.09%

MORE INVESTMENT COMMENTS

What to do? Market returns in 2004 will depend on two major factors: their current values (are they currently bargains or over-priced), and how, by the end of 2004, we think that 2005 and 2006 will unfold. Current valuations can not be considered bargains, given the strong 2003 returns. Real estate provided steady returns in the difficult past few years; it is reasonable to expect them to slow down and lag other markets. Conversely, large-company stocks have been lagging their smaller-cap brethren; it is likely that they will play some catch-up in 2004. I expect value- and growth-stock funds to continue their horse race, alternating their leads from quarter to quarter. Foreign stocks seemed to be dormant volcanos for several years; they may have re-awakened, and may continue to offer compelling returns due to their continued reasonable valuations.

How we feel this December will undoubtedly depend on the Presidential election campaigns, whether the economic recovery includes growth in jobs in the US, and the military results in Afghanistan and Iraq. It is nearly impossible to make predictions here without appearing partisan. Yet at this time, while there is uncertainty about exactly how the year will unfold, it currently appears that we are likely to take a few more steps forward than backward in 2004.

With bond yields fairly low, about the best that you can hope with high quality bonds for to receive the coupon yields. As it turned out, that is exactly what happened in 2003. As long as the economy avoids a dramatic weakening, lower-quality bonds should help boost bond returns, and as long as the dollar continues to weaken, non-US bonds should also help fixed-income results.

Regardless of your approach (aggressive, conservative, US-only, global, etc), 2003 brought some very strong returns. It is highly likely that you should review your portfolio and **consider rebalancing** (see the article on gardening on pages 3-4). This will better prepare the portfolio for the uncertainty we face at the start of each year.

Theory, Meet Practice

In response to feedback from the survey, here I examine a recent move or two, explaining the rationale and method.

I sold all shares of Columbia High Yield Fund (ticker CMHYX) in Mallard client accounts in the second half of 2003. This was due to two factors: the fund's declining fortunes, and the presence of an attractive alternative. Its 2003 performance trailed its peers, primarily due to the fact that it invests in higher quality bonds than most of its peers, and in 2003's rally, the stinkier the company, the stronger has been its rebound.

CMHYX's sub-par performance was only one factor in my decision for the sale. At a conference in February 2003, I met Ken Taubes, the manager of Pioneer Strategic Income (PSRAX). What struck me about the fund is that it invests in high quality and high-yield bonds, both in the US and abroad. Ken is the quarterback, deciding how much of the fund goes into each sector, while others at Pioneer, specialists in each particular sector, select the actual bonds.

It took me several months to get comfortable enough with the Pioneer fund to recommend its purchase. For many clients in the past I had created a bond complement of both high-yield (Columbia) and foreign (Payden & Rygel Global Fixed Income fund, ticker PYGFX). I had originally created this approach to provide clients' bond money with diversified exposure beyond just high-quality US bonds. Yet the more I looked at the Pioneer fund, the more I preferred having Ken Taubes make this bond sector allocation decision, rather than me.

I therefore began with the clients who already had both high-yield and non-US bond exposure, and recommended that we sell those positions, and place the proceeds into the Pioneer fund. I next identified those with only high-yield, and recommended that we sell their high-yield and move the proceeds to Pioneer.

It will take some time to see whether this change was worthwhile. I hope that this example helps explain better how I make some mutual fund selection and implementation decisions.