December 30, 2002

Dear clients,

Greetings and Happy New Year to all! If your envelope includes an additional report called "Realized Gains and Losses," please give a copy to your tax preparer, as this report will be helpful in preparation of your 2002 returns. If you have any questions, please call me anytime and I'll be happy to explain.

The end of 2002 brings to close the third year in a row that almost all major stock market averages have incurred losses. Conversely, this is the third year in a row that most bond market returns have been quite strong. What should we do? Abandon stocks? Load up on bonds? I am confident you all pretty much know that neither move would be prudent, but a little reassurance certainly can't hurt.

Why not abandon stocks? Because the fundamental economic principles as to why a portfolio of highly diversified stocks should comprise a significant portion of a long-term investor's portfolio have still not changed - nor do I expect them to any time soon. In the long-term, stock market returns reflect corporate earnings. Corporate earnings in turn drive our economy, and to bet **against** our domestic (or global) economy in the long run is a bet much riskier than we should ever be willing to take. I know very well that short-term portfolio hits can be awfully hard to stomach, but recoveries always happen and richly reward those of us patient enough to wait. Diversification alone isn't a wonder cure but when combined with a long-term time horizon, the two make a very formidable team.

How about the idea of loading up on bonds (at least for now) – after all they're supposedly "safer" than stocks and their returns have been so much better over the last few years? Bond returns are made-up of two components – interest paid and capital gains (or losses). Interest paid is a simple concept but the capital gains element is a little trickier. Always remember that as interest rates rise, bond values go down, and as interest rates fall, bond values rise. There is an inverse relationship between the two. The trend in interest rates has been down for several years now and thus the total return on bonds has been very strong. This can't and won't last forever. The ten-year U.S. Treasury bond now yields just under 4% and corporate bonds a little higher. This may seem like an attractive rate when stock values are plummeting, but at the very best, if a bond owner holds a bond until maturity he or she receives a rate of return only equal to the initial interest rate of the bond. If a bond is sold before maturity, in an increasing interest rate environment, the total return will be lower than the initial rate. No matter what you hear or read, know that bonds are no sure thing, nor miracle cure, and that they carry with them their own unique set of risk and return characteristics.

Where does this leave us? We all must maintain a healthy mix of **both** stocks and bonds in our portfolios. More aggressive long-term investors may want a somewhat higher percentage of stocks in their mix than conservative investors, but nevertheless all portfolios need a prudent mix of the two. I know this conclusion comes as no great surprise to you but as I indicated in the opening a little reassurance can't hurt.

Lastly, you may note some changes in the "Income Projections and Probabilities" section of your reports as I have recently updated these for many clients. If this section is blank on your report, or needs updating, please call and we can create a customized analysis based on your particular situation and circumstances.

Regards and be well,

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