

# P E R S P E C T I V E

A Quarterly Review of Economic and Market Developments

Fourth Quarter 2002

## What's Inside

### ***U.S. and International Economies***

Although it could experience a traditional recovery or slide back into a recession, the U.S. economy is most likely to move haltingly forward. Europe and Japan are also likely to continue to struggle in the days ahead.

### ***Global Fixed Income***

We review the bond market's volatile but generally positive performance during the fourth quarter of 2002 and consider whether interest rates have bottomed.

### ***Domestic and International Equities***

The fourth quarter was a bright note in an otherwise dismal year for global equities. In this section we explain why, despite significant risks, we believe investors should remain invested in stocks.

### ***Real Estate***

After reviewing some major real estate trends in 2002, we discuss the outlook for 2003.

### ***Global Investment Strategy***

In this section, we explain why we have a bias to sell bonds and buy stocks. We also discuss why we are more likely to make tactical asset allocation shifts in U.S. stocks.

## Real Estate: Still an Attractive Asset Area Today\*



Ronald W. Kaiser  
Co-Founder, Director

*Because of the stock market's volatility over the last three years, many investors are looking into other types of investments. One of the asset classes that has been receiving much attention recently is real estate. Are there reasons why investors should consider adding real estate to their portfolios?*

Definitely. Any otherwise diversified portfolio that doesn't have a substantial allocation to real estate is inefficient. By that, I mean the investor is passing up a major opportunity to improve the portfolio return while reducing the risk through diversification. Most people don't realize that, over the long term, investment real estate has produced the same 9% to 10% total annual return that people have realized from investing in the stock market from 1926 to 1997. In terms of risk, real estate has almost no correlation with other investment assets, a very low statistical volatility and a very low risk of losing money.

I want to interject here that I am talking about institutional-grade (\$5 million and larger) investments in apartment buildings, offices, shopping centers and industrial properties. Most people automatically think of the single-family house market when they think of real estate. *That* market marches to a different drummer and actually feels a little over-priced and risky to me these days.

Not only has the generally accepted NCREIF NPI Index of fully-leased institutional properties generated a better than 9% annual return since its 1978 inception, but studies I have found dating back to 1919 indicate that long-term returns on urban properties have indeed been about 10% per year. And this was accomplished with only two periods of negative returns — the late 1920s to early 1930s and the early 1990s — both of which resulted from massive over-building brought on by investors seeking to cash in on the rising trends following a general inflation spike in the economy. Those conditions don't exist today. Furthermore, it is possible to obtain returns in excess of 10% by using only moderately more risky *value-added* strategies

such as buying fixer-uppers, developing new in-fill projects or using a modest amount of leverage, which today has a very low interest cost.

You might wonder how real estate could consistently generate positive historic returns, when we know that prices do go up—and down—with the various economic and market forces. The answer lies in real estate's high current income, which generally runs around 5% or more on current market value. That means you need a more than 5% price decline to produce a negative total return. And property prices historically haven't changed that much. Most of the time, real estate has traded between an 8.5% and 9.5% capitalization rate (or a P/E range of 10.5x to 11.7x). Compare that with the U.S. stock market, where the S&P 500 has ranged between 8 and 35 times earnings during my career. By these measures, real estate has been a low-risk asset, provided, that is, that you're reasonably diversified by property type and economic region, and that you are firmly on top of the management of the properties on a day-to-day basis.

Finally, for the taxable investor, real estate can offer two advantages not available to common stock investors. One is the avoidance of double taxation of income, whether through direct ownership or through a REIT structure, and the other is the deferral of capital gains taxes via the section 1031 tax-free exchange mechanism (which works, of course, only if you have a good project ready to be purchased at the time of sale).

As a result of all this, BB&K has generally recommended a 20% or better allocation to real estate in mixed-asset portfolios. Only in the mid-to-late 1980s, when real estate was becoming massively over-built as a result of the inflation-shock of the late 1970s, did we recommend a substantially less than 20% allocation to our clients.

*How can investors be sure they won't be caught in a major downturn, such as the one that happened in the early 1990s? Vacancy rates reportedly are rising quite high and rents are falling in many markets.*

I'm not saying that real estate doesn't go through cycles, and, yes, we are in a down-cycle right now. This one is the result of a collapse in demand, largely brought on by the bursting of the high-tech bubble. It is not the result of a blind over-building boom funded by foolish money. Lenders have been very reluctant to make new development loans in areas with over-building risk. Further, owners are better capitalized now, so there is little pressure or panic to sell. In some markets, prices have come down dramatically as vacancies have driven rents lower. In others, such as Southern California apartments or Philadelphia industrial parks, occupancies and rents have remained stable. Overall, I would say this has been a modest down-cycle, more characteristic of what we would expect in real estate. Depending on the rate of economic recovery, I would expect rental rates and property prices to stabilize this year and begin to move higher some time in 2004 or 2005.

*What about real estate investment trusts (REITs) traded on the major stock exchanges? Aren't these a good way for an investor to get real estate investments and yet still have liquidity?*

In the very long run, publicly-traded REITs have generated the same types of returns as similarly-leveraged, privately-held property portfolios. For portfolios held since the inception of the NAREIT Index in 1972, this has been the case. However, for shorter-term investors, public REITs have behaved distressingly like common stocks. Over any five-year period (generally considered *long term* by most investors), from 1972 to 2002, publicly-traded REITs have had a relatively high (better than 0.5) correlation with small-cap value stocks. If small-cap value stocks are the place to be...great. If not, look out. For example, for the five years ending in 1997, the NAREIT Index generated an 18.1% annual return. For the five years ending in 2001, the NAREIT Index returned a paltry 2.6% per year. What this says is that the entry point for investors in publicly-traded REITs is nearly as important as it is for stocks in general. This is *not* the real estate I have been talking about.

*So, how can one invest in real estate without either having to own property directly, being at the mercy of an illiquid partnership or investing in publicly-traded REITs?*

There is an alternative. Open-end real estate funds (whether in group trust or private REIT format) usually allow investors to buy or redeem shares at the current asset value, subject to some constraints, such as how often this can happen and whether or not there is sufficient liquidity in the fund to redeem all who want out at any given time. Generally, the record over the past decade for such liquidity has been good. This gives investors control over which fund advisor to work with and (potentially) how much to be in real estate at any point in time.

*Finally, what can an investor reasonably expect from real estate compared to equities and bonds in today's market environment?*

Private market real estate today is trading at around a 8.5% cap rate, which means investors have the opportunity to realize a spendable cash flow of about 5% after capital reinvestment. That may be all that can be expected (subject to some potential benefit from a value-added strategy) until an improving economy begins to soak up some of the excess vacant space around the country. Compare that to stocks, where P/E's are still not cheap by historic standards and where the current dividend yield is less than 2%. And, 10-year U.S. Treasury bonds only yield 4.2%, with no prospect for future appreciation if you hold to maturity. At these market entry points, we believe investment property is very attractive.

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\* The historic real estate and U.S. stock performance, risk and correlation information presented in this section of Perspective is based on NCREIF (National Council of Real Estate Investment Fiduciaries) National Property Index data since 1978; NAREIT Index data since 1972; Ronald W. Kaiser, "The Long Cycle in Real Estate", *Journal of Real Estate Research* (Vol. 14, No. 3, 1997), pp. 233-257; Ronald W. Kaiser, "Using Capital Markets' Value Cycles in Allocating to Real Estate vs. Stocks or Bonds", *Journal of Real Estate Portfolio Management* (Vol. 5, No. 1, 1999), pp. 1-22; and BB&K's analysis of the correlation between the NAREIT Index and the Wilshire Small Value Index from 1972 to 2002. Past performance is no indication of future results. Like any investment, real estate has risks, including illiquidity, changes in supply and demand, and inexact valuation. This interview does not constitute an offer to sell, or a solicitation of an offer to buy, any securities. Such offers and solicitations can only be made pursuant to the offering documents of a particular investment. Bailard, Biehl & Kaiser cannot provide investment advice in any state or jurisdiction in which it is not registered or exempt from registration.

## U.S. Economy

The economic and market volatility seen over the last few years continued into the fourth quarter of 2002. After rebounding to a 4.0% growth rate in the third quarter, U.S. growth decelerated to around 2.0% in the fourth quarter. Industrial production, retail sales and employment all slipped as consumer and business confidence faltered. Toward the end of the quarter, worries about job conditions, equity market volatility, the outlook for corporate profits, rising oil prices and heightened geopolitical risks all weighed on business, consumer and investor psyches. With economic signals again losing momentum, a confrontation with Iraq looming ever closer and the situation with North Korea adding more tension, uncertainty and volatility in the marketplace is likely to continue in 2003.

Looking forward, we still see three potential scenarios for the U.S. economy:

1. *Traditional Cycle/Accelerating Growth (20% probability)*: Although this scenario is currently difficult to envision, it is the type of scenario that historically has typically followed periods of sustained weakness. During economic downturns, excesses are wrung out of the economy, setting the stage for the next expansion. Today, many positive cyclical forces could help boost economic growth. Inventory excesses have been reduced and are in line with the current level of sales. After years of overexpansion, capital spending has gone through a long dormant period and could finally be ready to turn up as companies replace outmoded equipment. Fiscal policy shifts favoring capital investment could also provide a boost to the economy. Tax relief is on the horizon for the consumer. With both monetary and fiscal policy pushing growth, consumer spending could provide a solid platform for an economic recovery.

What is needed most is a shift in confidence. Although better economic news would help, rising stock prices could provide the catalyst for restoring confidence. A successful resolution to the Iraq crisis and an easing of North Korean tensions could remove a couple of hurdles for the market. Fiscal policy changes that give hope for stronger growth and the elimination of the double taxation of dividends could also rekindle investor spirits.

2. *Vicious Cycle/Double Dip (30% probability)*: In this scenario, stock prices and consumer spending spiral downward in a self-reinforcing vicious cycle, pushing the economy into another recession. The risk of a double-dip recession is not trivial. This has not been a typical economic downturn, but one associated with the bursting of a market bubble. The sharp transition from bubble to bust has done a lot of damage to "economic spirits", exposed vast financial folly, undermined confidence and brought into question "faith in the system". It takes time to recover from this type of shock. The risks of financial accident, policy error and/or emotional overreaction are high. Making matters more complex is the global nature of the financial hangover from the market bubble. Financial risks have been aggravated in many countries such as Japan, Brazil, Argentina, and Venezuela.

A number of other secular (i.e. longer term) drags could also work against growth. Although consumer spending has been very resilient, the demand for housing and autos may be close to saturation. Auto sales and housing activity are already at high levels, and it will be difficult to push growth from these areas much higher. Given the low level of saving and rising debt levels, consumer spending would be vulnerable to additional shocks either from the equity market or regional weakness in home prices. Demographics could also play a role in saving patterns going forward.

Within the corporate sector, earnings growth remains disappointing and visibility very hazy. Given the uncertainty of corporate profits and plenty of excess capacity, a significant turn in capital spending may not be imminent. The corporate sector is also faced with weak foreign economic growth, which works against U.S. exports, while every country in the world is trying to export to the U.S. This suggests continued weakness in the trade deficit and intense global competition.

Finally, all of this is occurring at a time when geopolitical risks are high. Domestic terrorism, military confrontation with Iraq, growing tensions with North Korea, the ongoing conflict between Israel and Palestine, unrest in Venezuela and rising anti-American sentiment throughout the Islamic world could all help push the economy back into a recession.

3. *Cleansing Cycle/Muted Recovery (50% probability)*: Our most likely scenario sees the positive cyclical forces outlined in the Traditional Cycle scenario hitting up against the longer-term Vicious Cycle forces, setting the stage for the economy to move haltingly forward. In this scenario, we assume we are near the equity market bottom, but that the period of atonement and uncertainty will last for years. The economy has to deal with many post-bubble issues. The disillusionment from the market bust will take time to heal and investor memories will keep a lid on exuberance. Eventually these memories will fade, although faith and trust will take time to rebuild. In the meantime, increased scrutiny and vigilance will keep uncertainty high.

The macroeconomic legacy of the bubble-to-bust cycle has created a deflation psychology where consumers “wait to buy”. Cars will sell if aggressive incentives are in place, but demand dries up when incentives are removed. Refinancing activity and home sales increase when interest rates decline but slow when rates rise. The economy seems to be becoming increasingly sensitive to small interest rate changes, which will limit growth.

The increase in global competition has also reinforced this deflationary environment by restraining the ability of corporations to raise prices. Without pricing power, corporations have to resort to cost containment to boost margins, which means confidence-eroding layoffs and capital spending restraint are likely to continue.

In this environment, we expect the economy and the financial markets to continue to be volatile. The economy will grow in fits and starts, expanding just enough to avoid slipping back into a recession.

## **International Economies**

Growth in the Eurozone remains sluggish along with the U.S. The problems sound familiar: falling stock prices, soft labor markets, weak capital spending and geopolitical concerns. However, in contrast to the U.S., Europe’s fiscal and monetary policy response has been restrained.

Typically, the cyclical adjustment process in Europe is constrained by labor market rigidities, which keep corporations from hiring and firing. Although these labor market rigidities are still in place, economic recovery has been hampered by a new constraint — inflexible fiscal and monetary policy. When the European Monetary Union (EMU) was formed, incoming members agreed to a Growth and Stability Pact (GSP). The GSP put restrictions on the size of government deficits, debt and inflation. Fiscal deficits for the largest EMU nations are currently outside of the bounds set by the GSP. As a result, fiscal policy is being forced to retract in a time of economic weakness. Moreover, rising energy costs are putting upward pressure on headline inflation, making the European Central Bank (ECB) reluctant to ease interest rates. With both monetary and fiscal policy working against growth, the EMU is being severely stress tested.

Bad economic news out of Japan continues, but has lost its shock value. A lot of negative news is already priced into the Japanese stock market, which is near 19-year lows. With stock prices at such low levels, the capital base of the banking system remains under pressure. The capital situation is restraining bank lending, making sustained economic growth unlikely. On March 31, 2003, banks will have to mark to market their balance sheets. To help boost the banks’ capital rates at that time, the Japanese government is likely to resume its game of propping up stock prices and weakening the yen. We would still like to see a resetting of the financial system, an aggressive write-down of bad debt and a cheaper yen before moving aggressively into Japanese stocks.

## **Global Fixed Income**

The fourth quarter capped a year of excellent returns for bond investors. Ten-year U.S. Treasury bond yields, which began the year above 5.0%, ended 2002 below 3.9%.

However, the U.S. bond market witnessed a great deal of volatility during the fourth quarter of 2002. Most domestic bond sectors posted flat or negative returns in October and November, as the U.S. stock market rallied from its September lows. The bond market rebounded in December due to rising geopolitical tensions and renewed concerns about the strength of the economic recovery. By the quarter's end, most bond sectors had realized positive returns. Corporate bonds were the best performers, staging an impressive rally as the successful implementation of the Sarbanes-Oxley Act and a number of civil settlements helped ease the worst investor fears about corporate accountability. U.S. Treasury issues eked out a flat to slightly positive return as interest income offset a slight rise in yields. Municipal bonds were generally flat for the quarter.

In early November, the Fed lowered interest rates an aggressive 50 basis points (0.5%) and announced that it would be moving to a neutral stance with respect to future interest rate moves. This suggests that the Fed believes its job is done for this interest rate cycle, unless future economic data indicates that the enormous amount of liquidity added to the markets over the past two years has still been insufficient to nurse the economy back to health. Interest rates have probably hit their lows for this cycle. They are likely to decline further only if the U.S. economy slips back into a recession. Yields on the highest quality corporate debt are now at fair value, although BBB and A-rated issuers remain attractive.

International bonds also ended the fourth quarter of 2002 on a positive note. Interest rates in Europe are above those currently available in the U.S. and provide good value at current levels. In addition, the ECB may still have the scope to lower rates to spur growth on the continent.

## **Foreign Exchange**

Heightened geopolitical risks had their greatest impact on the foreign exchange markets, where the dollar accelerated a weakness that began after the 9/11 terrorist attacks. The euro, which had fallen as much as 29% from its founding versus the dollar, was down only about 10% at year end. The U.S. equity market's leadership on the downside, ongoing corporate scandals and, most recently and most importantly, the saber rattling aimed at Iraq and North Korea have undermined the dollar's safe haven status. The euro's 6.3% appreciation versus the dollar during the fourth quarter provided welcome support to non-U.S. investments. European growth is unlikely to match that of the U.S. in the coming year, and further easing by the ECB to promote growth could be a medium-term negative for the currency. That said, in the near term, there is continued scope for euro-strength. Much will depend on whether the dollar is able to regain its status as a safe haven for foreign investors.

Across the Pacific, the yen continues its malaise. Japan's Finance Minister Masajuro Shiokawa and Bank of Japan (BOJ) Governor Masaru Hayami continued to spar over the best course for the yen. In early December, Shiokawa commented to the press that he would welcome a yen as low as 160 to the dollar (a level last seen in 1990) to spur growth in the world's second largest economy. Fears of inciting similar depreciations across Asia and further weakening the yen's perception internationally have led the BOJ to hold back on liquidity, even as the Japanese economy is at risk of falling into its fourth recession in a decade. Further yen weakness is likely the result, along with even lower yields on Japanese debt.

## **Domestic Equities**

Rebounding from a very weak third quarter, the U.S. equity markets posted solid fourth quarter gains. The S&P 500 rose 8.4%, the Wilshire Small Value Index was up 8.6%, the Dow Jones Industrial Average climbed 10.6%, and the NASDAQ 100 led the pack with an 18.3% gain. Unfortunately, 2002 was another down year for the equity markets, the third in a row in fact for the NASDAQ, the S&P 500 and the Dow. The Wilshire Small Value Index held up best in 2002, declining -13.3%. The Dow was runner-up with a -15.0% decline. The S&P 500 dropped -22.1% for the year, and, even after its strong fourth quarter rebound, the NASDAQ still lost -37.5% in 2002.

With three consecutive down years behind us, what might the future have in store for the U.S. equity markets? History is not a particularly valuable guide, as there have been only two other periods since 1926 when the S&P 500 has declined three years in a row, 1929 to 1931 and 1939 to 1941. In 1932, in the midst of the Great Depression, stocks were down yet again. In 1942, as World War II began to turn for the Allies, stocks rose. While the economy is less than robust and the U.S. faces a war against terrorism and a threat of war with Iraq, current conditions do not appear similar enough to either historical instance to draw many parallels.

Over the long run, stocks remain the asset class most likely to deliver positive after-tax, inflation-adjusted returns. In any individual year (or occasionally, a series of years), stocks may disappoint, but that risk is the unfortunate though necessary cost of producing attractive long-term returns. The question facing investors is, "Do I participate in the stock market, knowing that I could continue to lose? Or do I avoid the stock market and almost assuredly lose (after taxes and inflation) over the long run?" To the informed investor, stocks sometimes feel like a necessary evil. During bear markets, it is important to remember that stocks usually aren't evil, but they are almost always necessary for long-term growth.

## **International Equities**

International markets rose on a broad basis in the fourth quarter of 2002, ending a difficult year on an up note. The MSCI EAFE Index, for example, posted a 6.45% return for the quarter. European equities rebounded strongly from their lows of early October, moving up strongly until the end of November, before giving up some of their gains in December on geopolitical concerns (particularly the prospect of U.S. military action in Iraq). Japan was the only developed market with negative returns, hitting 19-year lows during the quarter.

European insurers rebounded strongly from a very difficult third quarter as the market value of their equity holdings rose and they obtained capital infusions. Japanese banks fared very poorly as the prospects for financial reform dimmed. The best-performing sectors in Europe included technology, insurance and financials; faring worst were defensive stocks (i.e. food, tobacco, electric, beverages, pharmaceuticals) and automobile manufacturers. In Japan, basic materials and utilities performed the best, while the bank, financial, retail and construction sectors performed the worst.

Several factors helped the emerging markets broadly outperform the developed markets. The South African market soared as gold reached a multi-year peak. Poland, Hungary, and the Czech Republic benefited from low interest rates due to their coming entry to the EU, as well as aggressive upgrades to their sovereign debt ratings as a result of prudent economic and fiscal policies. Brazil, Latin America's largest market, rebounded as then-President-elect Lula calmed markets driven down in the third quarter by concerns over excessively populist policies upon his inauguration. (These are real concerns, however, and their resolution remains open.) Finally, the developing Asian economies have been benefiting from a growth in domestic demand, fiscally sound government policies and strong balance sheets.

The U.S. dollar broke out of a trading range against the euro in November, declining rapidly against almost all other currencies until the end of the year. For the 2002 calendar year, the dollar lost 17.9% versus the

euro and 10.8% versus the yen, having become overvalued as foreigners dived into U.S. equities during the late-1990s technology bubble and beyond. The decline in the dollar, brought about by the ongoing reversal in these flows, helped international equities outperform U.S. equities last year. The prospect of further dollar weakness serves as a powerful and timely argument for international diversification.

## **Real Estate**

Investment property markets continued to experience two opposing trends in 2002—deteriorating operating conditions (which would tend to decrease prices) and rising P/E multiples/falling capitalization rates (which would tend to increase prices). The economy took its toll, as tenant demand contracted in most property types in most markets. Job layoffs not only impacted office building demand, but also created conditions for doubling-up by tenants in apartments. Adding to the pressure on occupancy and rental rates was the continued completion of new projects, many of which were begun when the operating outlook was rosier.

Yet, investor interest in real estate remained strong. Capitalization rates on 2002 calendar year transactions tracked by Real Capital Analytics were either stable (office and industrial) or falling (apartments and retail centers). As a result, property prices did not decline as much as they could have. Private local investors continued to be the most important net buyers, though at a somewhat lower level than in 2001. These investors are interesting to track because they tend to be the most entrepreneurial of the investor groups, always looking to take advantage of profit opportunities. With the stock market in turmoil, real estate looked relatively quite attractive. Private local investors were most active in their net buying in office and industrial properties, where cap rates remained relatively attractive, in the mid-to-high 9% levels. Interestingly, these investors were becoming more actively net sellers in apartments and shopping centers, where cap rates moved lower to less attractive levels.

The next two strongest net buyer groups in 2002 (which had both been modest net sellers in 2001) were foreign investors and public REITs (especially retail REITs). Foreign investors had to do something with their growing accumulation of trade-surplus dollars, and, with U.S. stocks looking risky and U.S. bond yields falling to less attractive levels, they naturally turned to real estate. This trend is likely to continue in 2003. The net buying by public REITs was probably a one-time phenomenon as the purchases were financed by capital raised early in 2002 when REIT prices were high. REITs are no longer trading at a premium to net asset value.

Significant net selling in 2002 was observed in two groups, institutional investors and private national investors (many of whom were opportunity fund managers looking to cash in on their incentive fees). Both groups of managers believed that the real estate markets were not attractive enough to commit massive amounts of new capital. Yet, their investors, whether pension funds or endowments, continued to want to give them new capital to invest. There is now a backlog of pent-up buying power for real estate from these investors, as a number of institutional managers are not accepting new funds for investment. However, with the stock market punishing institutional portfolios for the third year in a row, there is likely to be even greater pressure to diversify into real estate. Managers may have no choice but to accept new money or see their market share erode.

What, then, is the outlook for real estate in 2003? If the economy stabilizes and gradually begins to recover, operating conditions will likely stabilize, though improvement sufficient to raise rents is not likely until 2004 or 2005. Prices will likely remain strong for all property types, as the pressure from institutional investors continues or even grows. Thus, the 2002 experience of softening cash income and slightly falling property values is likely to change; cash flows and prices should stabilize and could even begin to rise in 2003 if institutional interest in real estate grows beyond its former 4% to 7% portfolio allocation levels. (Office building cash flows could continue to decline as old leases are rolled over at currently lower rates.) Of course, the outlook would be less optimistic if the economy slipped into a double-dip recession.

The best opportunities for new investment initially are likely to be found in office and industrial markets, where cap rates are more attractive, especially in less than prime locations. Eventually, we would not be surprised if, by 2004 or 2005, investors will have all but forgotten the worries they had about the downside of the real estate cycle in 2002.

## Market Performance

U.S. Interest Rates				
	3/31/2002	6/30/2002	9/30/2002	12/31/2002
<b>Cash Equivalents</b>				
90-day Treasury Bills	1.79%	1.67%	1.60%	1.19%
Federal Funds Target	1.75%	1.75%	1.75%	1.25%
Bank Prime Rate	4.75%	4.75%	4.75%	4.25%
Money Market Funds	1.78%	1.66%	1.51%	1.25%
<b>Bonds</b>				
Long-term U.S. Treasury	5.80%	5.51%	4.67%	4.78%
Long-term AA Municipal	5.23%	4.94%	4.60%	4.68%

Sources: Datastream International and Bloomberg L.P.

Global Bond Market Total Returns (U.S. \$) Through 12/31/2002			
	Quarter	Year-to-Date	One Year
<b>U.S. Bonds</b>			
Merrill Lynch 7-10 year Treasury Index	0.11%	14.32%	14.32%
Merrill Lynch 7-10 year Agency Index	1.84%	16.66%	16.66%
Merrill Lynch 5-10 year Corporate Index	3.14%	11.42%	11.42%
Lehman Bros. Municipal Bond Index	0.00%	9.61%	9.61%
<b>International Bonds</b>			
Salomon Smith Barney non-US\$ WBGI (World Gov't Bond Index), fully hedged	1.56%	6.85%	6.85%

Sources: Bloomberg L.P. and S&P Micropal

Global Stock Market Total Returns (U.S. \$) Through 12/31/2002			
	Quarter	Year-to-Date	One Year
<b>U.S. Stocks</b>			
Dow Jones Industrial Average	10.58%	-15.01%	-15.01%
S&P 500	8.43%	-22.09%	-22.09%
NASDAQ 100	18.26%	-37.53%	-37.53%
Wilshire Small Value Index	8.59%	-13.29%	-13.29%
<b>International Stocks</b>			
MSCI Japan, net dividends	-5.69%	-10.28%	-10.28%
MSCI Europe (includes UK), net dividends	10.88%	-18.38%	-18.38%
MSCI EAFE (Europe, Australia, Far East), net dividends	6.45%	-15.94%	-15.94%

Sources: Bloomberg L.P., Wilshire Associates and S&P Micropal

Real Estate Total Returns (U.S. \$) Through 12/31/2002			
	Quarter	Year-to-Date	One Year
NCREIF Property Index	1.67%	6.75%	6.75%

Source: NCREIF (The National Council of Real Estate Investment Fiduciaries)

Past performance is no indication of future results.

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**950 Tower Lane, Suite 1900, Foster City, California 94404-2131 (650) 571-5800. www.bailard.com**

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