



QUARTERLY REPORT

Third Quarter 2002

The shock of stock market losses is being felt more extensively and more deeply. The third quarter of 2002 saw the S&P 500 decline by 17.3%, the NASDAQ by 19.3% and the Russell 2000 (small cap stocks) by 21.4%. This was the weakest stock market quarter since the fourth quarter of 1987. While our portfolios did not escape unscathed, declining about 1% in the quarter, they are up a few percentage points for the year to date, a period in which most portfolios have sustained very severe losses.

The two and a half year period since March 2000 has encompassed the worst stock market decline since the Great Depression. From its peak valuation over 1500 to its recent low near 760, the S&P 500 has essentially been cut in half. NASDAQ, populated by the high tech “companies of the future,” has fallen 80% from about 5100 to approximately 1100. Those declines notwithstanding, all clients who have been with us throughout that period have seen their portfolio values grow.

As longstanding clients know, we spent the late 1990’s making the point that the broad market, not just the dot coms and other high tech stocks, was in a bubble and that stock prices and the ingenious rationalizations for them simply made no sense. Unfortunately, we lost a few clients just before the market peaked as they turned away from our message of caution to managers who offered the promise of an ever growing new age of technology.

Through much of the 1990’s we said that we had no idea when the mania would end, just that no trees grow to the sky and that the prevailing maniacal desire to own large amounts of common stock at virtually any price would surely end and end badly. We made the point repeatedly that, except for traders or investors willing to lessen allocations to equities at higher levels, it made no difference how high or how long the rally went if those gains were fated to be taken away. If those gains were to be eliminated, even several years later, there would be no reward for remaining heavily invested in equities.

The declines in the major stock indexes since March 2000 have brought prices back to the levels of 1997 and 1996. Financial commentators have recently voiced amazement that prices could revert to the levels of five or six years earlier. That amazement belies a lack of knowledge of the history of the world’s stock markets. The price declines that followed prior episodes of severe overvaluation, none as serious as that of the late 1990’s, took prices back to levels of 16 years

before—even 28 years earlier in one instance. Contrary to the widespread belief that portfolios cannot possibly do well without a permanent significant allocation to equities, there have been extended periods of time in which stocks have earned minimal, even negative, returns.

In the late 1990's, investment analysts and strategists vehemently derided any comparisons of then current circumstances with periods that preceded prior major bear markets. "It's different this time" and a great variety of new era arguments led to conclusions that it was inconceivable that any significant damage could be done to the parade of stock prices to ever-higher levels. What was lost on such bullish prognosticators was that their predecessors before prior great bear markets shared similar feelings of invulnerability. Reading the financial press from past decades clearly verifies that not only the bullish beliefs, but even the language used, were common from era to era. Analysts in each era had the conceit that the particulars of their era so differentiated them from all predecessors that they were no longer bound by the outmoded valuation guidelines of the past. The consensus of experts at the time has never forecasted a major stock market decline. While most of them are intellectually honest, analysts are inevitably conditioned toward the bullish camp by their firms that benefit far more from optimism than pessimism. The reasons for major bear markets have never been foreseen by the majority. They are only understood, if at all, in retrospect.

Today's investors still do not recognize that we are not in a business as usual environment. We are going through a once in a lifetime—or at least a once in several generations—phenomenon. Confusion arises because, at least so far, overall business conditions have not collapsed to a degree that would justify the massive stock price declines we have already experienced. What is still being missed by market analysts who forecast a rising stock market on the basis of a soon to recover economy is that this decline is primarily the flip side of the insane stock price rises of the 1990's that led to unprecedented levels of overvaluation. Reversion to the mean has always brought stock valuations back to historical norms. In this instance the level of overvaluation was so egregious that the process of reversion has been catastrophic for many.

It is distressing that, as far as prices have already declined, most valuation measures have not yet approached their historic norms. Price-to-earnings, price-to-dividends and price-to-book value measures all still exceed the average highs that preceded the major stock market declines of the past century. Because corporate earnings have been cut roughly in half from their peak of two years ago, the S&P 500 stock index is still selling at about 30 times its trailing 12-month earnings. Before the late 1990's, that index had never before traded at more than 27 times earnings, and ratios above 20 were only experienced just prior to major market declines. This market is still selling at ridiculously high multiples.

Even if corporate earnings were to begin a sustained advance, it would take several years of earnings gains with no stock price gains to bring ratios near their historic norms. While it would be possible for severe overvaluation to be worked off by either earnings gains or price declines, all major past overvaluations have been eliminated by price declines. Precedent makes that the more likely path in the years ahead as well.

While bear markets can unfold in many different ways, it is normal to see stock prices reach their ultimate lows in a series of rallies and declines. Because most investors are optimists and

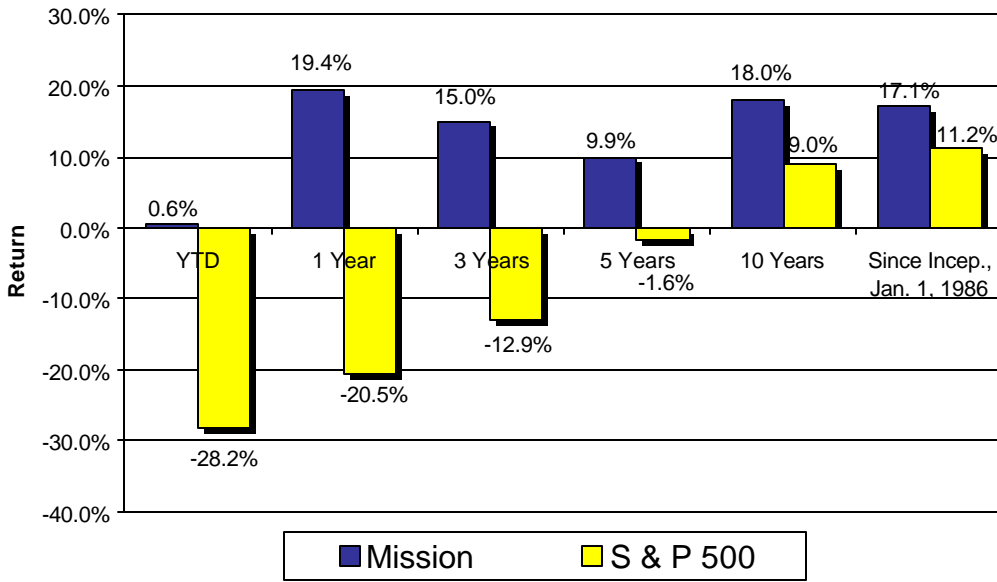
today's version has been positively conditioned by two decades of bull markets, many see each rally as the beginning of the next bull market. A helpful analogy is to view a bear market as an outgoing tide. Despite the waterline's persistent decline, waves continue to come in intermittently. In a bear market that is still dramatically overvalued, investors should use intermittent rallies to lessen exposure to overvalued stocks. As the waterline approaches levels from which it has frequently risen in the past, it is prudent to anticipate a turn of the tide. While stock valuation levels are not as predictable as the tides, there has been an unbroken precedent of reversions to the historic means, although not on an always-predictable timetable. Patient investors should profit in the long run by accepting greater stock market risk when market valuations approach increasingly lower levels. We know the lessons of history, and we are patient. While our stock holdings have done remarkably well throughout the bear market, we are awaiting far more attractive levels of valuation before committing significant portfolio assets to the equity area.

While not nearly as concerned about the fixed income picture as we are about equities, we believe that current interest rate levels are not especially attractive for long-term bond commitments unless the economy is destined to fall into a lengthy decline. We see no signs yet that that is a likely prospect.

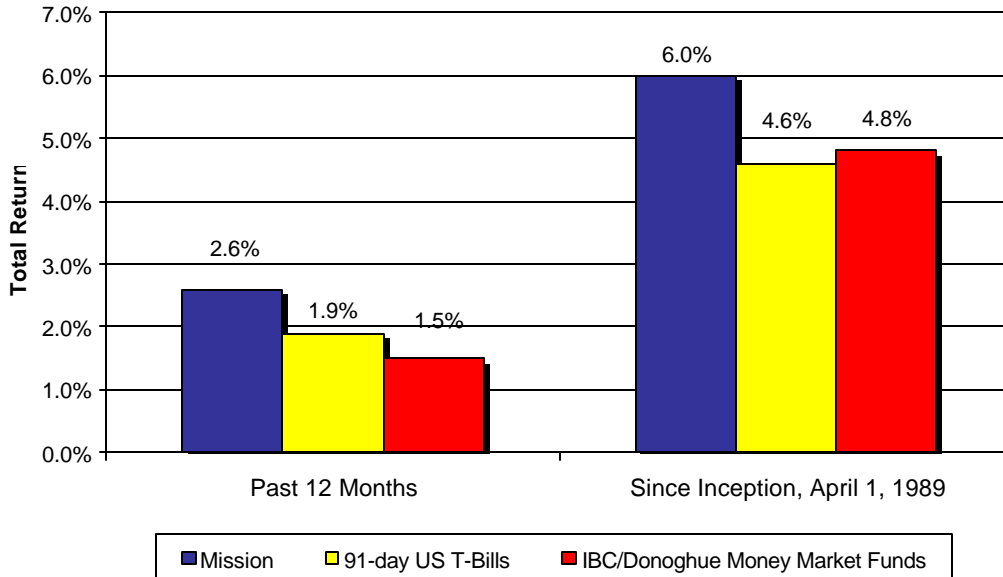
We could, however, see interest rates rise from current levels if business conditions improve. We might also see interest rates rise in a less favorable environment, should the U.S. dollar continue its decline of most of the past year. Foreign holders of dollar denominated investments will be far less likely to hold such investments if they continue to experience erosion of value in their currency exchange. Any significant withdrawal by foreign investors would put serious negative pressure on U.S. stocks and bonds.

Thomas J. Feeney
Chief Investment Officer

**Mission Equity
Performance Results
Through September 30, 2002**



**Mission Cash Management
Performance Results
Through September 30, 2002**



Past Performance May Not Be Predictive Of Future Performance
Performance Gross of Fees