



QUARTERLY REPORT

January 2002

The equity market continues to be a minefield with the S&P 500 falling by 11.9% in 2001 after a decline of 9.1% in 2000. Even more dramatic are the 39% and 20.7% back-to-back declines by the technology-oriented NASDAQ Composite. Having warned repeatedly through the late 1990's of the developing equity market bubble, we are particularly pleased that all discretionary "risk-averse" portfolios with us for the past three years have earned high single-digit annualized returns in a period in which the S&P 500 fell by an average of 1% per year and the NASDAQ by 3.5% per year.

While we would far prefer to be issuing a favorable forecast, we remain seriously concerned about very substantial risk to investor capital. The vast majority of investment analysts and other pundits, on the other hand, provide optimistic outlooks for the future near and far. What are we seeing that they are missing? The answer is "P."

Most people evaluate almost everything in their lives, whether they recognize it or not, with some form of "P/E" analysis. In investments, that refers to a price-to-earnings ratio. Elsewhere "E" might represent function, utility, taste or any number of forms of benefit. Who would not want his or her favorite meal exquisitely cooked and served? Wouldn't it be a thrill to drive any car you wished? How about a medicine to shorten the consequences of a painful injury by several days? Certainly each of us would love to realize one or all of these "goods." No matter how desirable such objectives might be, however, there is a price beyond which one would choose not to "buy." For even the wealthiest consumer, there is a price "P" for almost any "E" that makes no sense.

Curiously, when we hear or read today's investment analysts, all we hear about is "E." We hear speculation about when the recession will end and when demand will be rekindled for one product or service or another. We are told that the economy and corporate profits should pick up soon because the Federal Reserve has aggressively lowered short-term interest rates and appears intent on continuing as needed to provide the stimulus that typically leads to improved profitability. And so the analysis goes, offering one reason after another why conditions are about to improve.

No one even talks about what is a reasonable price to pay for the resulting "E," corporate earnings. At best analysts acknowledge that "Valuations might be a little rich," ultimately assigning little gravity to that concern. The spoken or unspoken assumption is that if E grows, P will go up. An interesting sidebar is that if those analysts ever said--whatever happens to E over the next few years notwithstanding--today's P makes no sense, their firms' business would dry up considerably. They have a substantial vested interest in keeping the investor bullish and buying.

In letter after letter we have argued that the prices investors have been willing to pay have made no sense for several years. We have never said, and we do not say today, that senseless prices cannot go higher and become even more senseless. They have, and they might again. Betting on that phenomenon is not, however, the province of the prudent investor but rather that of the risk-bearing speculator.

How far out of line are today's prices? The S&P 500 is currently selling at about 40 times its still declining earnings. That figure is computed by Standard & Poor's using the twelve-month trailing earnings ending in the September quarter. Using estimates for the December quarter's earnings, Ned Davis Research, a widely respected data provider, puts the multiple for the S&P 500 at about 48 times earnings. Except in the late-1990's bubble environment, which is still being unwound, the S&P 500 has rarely in 130 years sold at more than 20 times earnings. At only three prior extremes before the late-1990's did that multiple reach as high as 25 to 27 times earnings. When the multiple reached or breached the 20 level, the market was at or close to a top, not an attractive investment point.

At 40 or more times earnings, this market is in uncharted territory. Since this is a probability business, not a certainty business, anything can happen from here; but the probabilities point to lower, not higher prices.

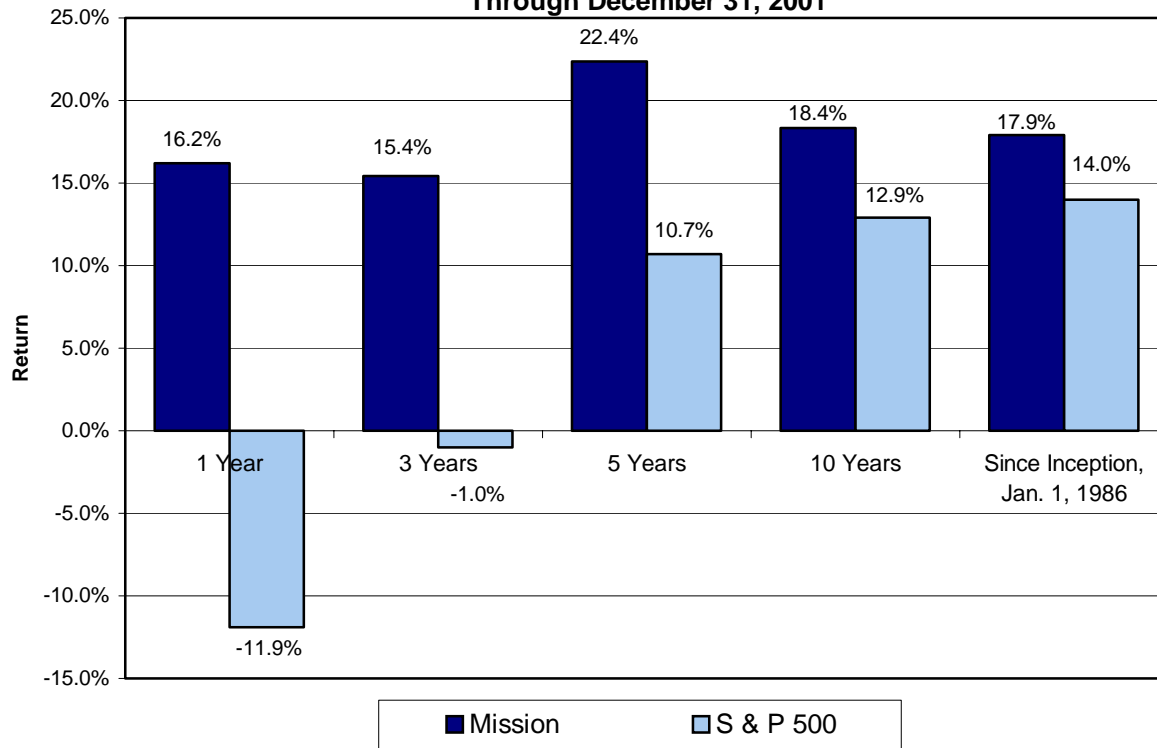
Other factors that underline the current danger include: 1) the massive, unprecedented debt burdens that pressure our corporate and personal balance sheets and 2) the growing awareness that lax accounting standards may in fact have allowed companies for years to overstate their earnings. Sector by sector we are beginning to see evidence that the late-90's bubble may not have been limited to pie-in-the-sky Internet stocks.

The CEO's of two of the largest companies in the world, General Electric and Microsoft, have this week indicated that they see no tangible evidence yet of the end of the recession. In this highly suspect environment, what is the motivation to pay about three times the historically normal price level to own common stock? We search in vain for a convincing answer. Even if the current bullish forecasts for "E" should materialize, we think "P" still matters, and we choose to preserve client capital until we can buy significantly more companies at levels of valuation from which we can project probable profits at controlled levels of risk.

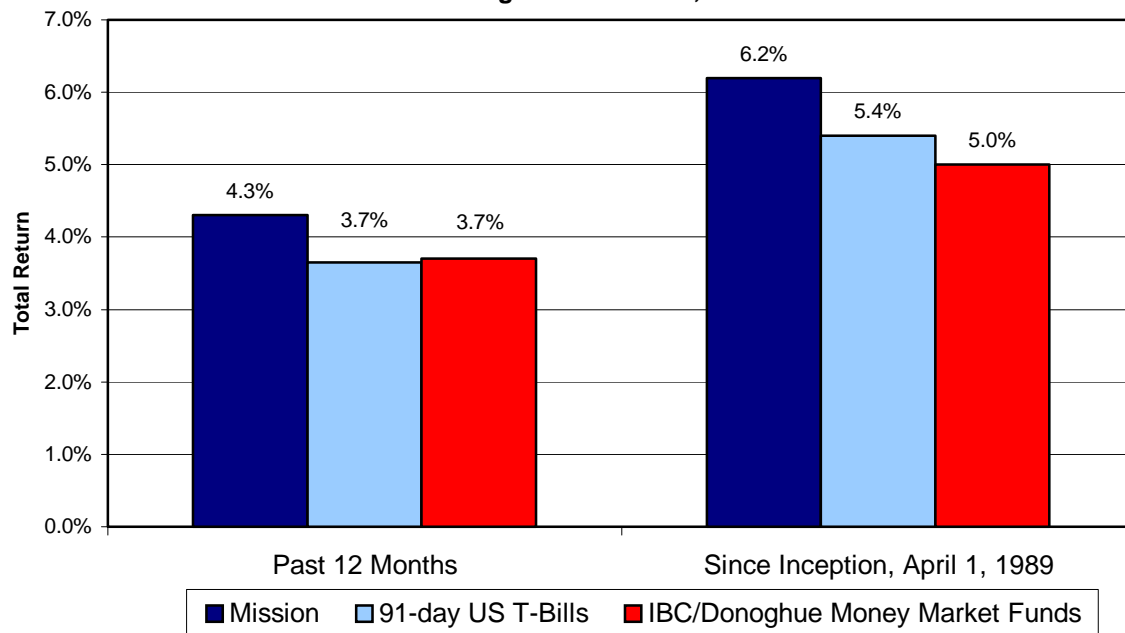
Please call if we can provide additional information about your portfolio or our investment thinking.

Thomas J. Feeney
Managing Director & Chief Investment Officer

**Mission Equity
Performance Results
Through December 31, 2001**



**Mission Cash Management
Performance Results
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Past Performance May Not Be Predictive Of Future Performance