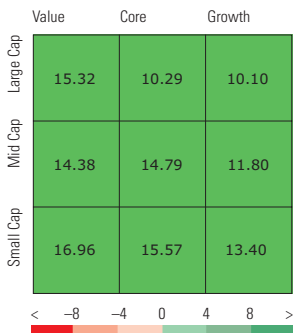


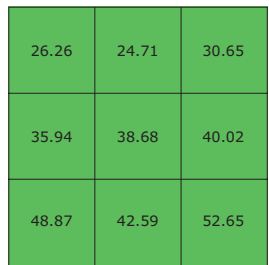
# Morningstar Market Commentary

Fourth Quarter 2003

## Morningstar Market Barometer<sup>SM</sup>



## 4th Quarter (% Return)



## 1-Year (% Return)

## 2003 Market Overview: A Decisive Rebound

After the traumatic losses of the three previous years, 2003's decisive market rebound helped make up for at least some of the pain investors endured from 2000 through 2002. Thanks to the powerful rally that kicked off beginning in mid-March, it was one of the best-performing markets in recent memory, almost across the board. Morningstar's US Market Index—which tracks the performance of the broad US equity market—gained 769 points, or 30.73%, for the year. That marked the benchmark's best total return since 1997, when it surged ahead by 36.77%. In a marked reversal of fortune from the widespread losses of 2002, every one of Morningstar's nine style indexes, which track U.S. stocks based on their investment style and size characteristics, finished the year with sizeable gains.

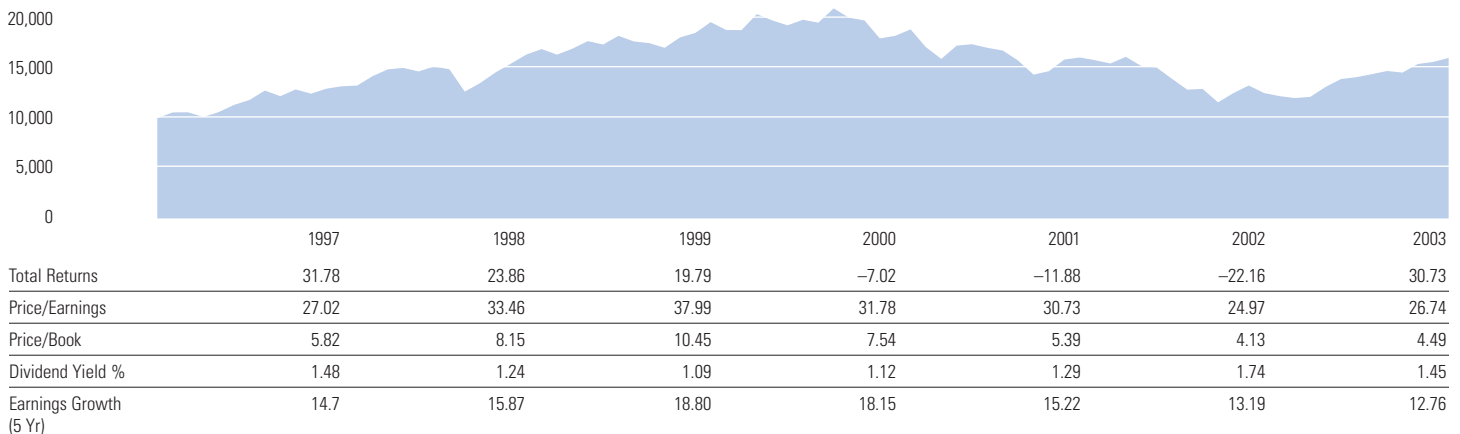
The year started out on a cautious note, with investors fretting about the strength of the economic recovery and the impact of war with Iraq. But the mood quickly changed beginning in March. The end of major fighting in Iraq, a 45-year low in interest rates, and the new tax-stimulus package helped set the stage for a potent rebound. A significant turnaround in the U.S. economy helped, too. Quarterly GDP jumped by 3.3% in the second quarter and a better-than-expected 8.2% in the third quarter.

Earnings per share also showed healthy gains during the year, fueled by both significant cost-cutting moves and top-line growth. For multinational companies that do a significant amount of business overseas, the weak U.S. dollar helped boost profits, as well.

With stocks once again on a bullish path, the most aggressive stocks surged to the top of the charts in 2003. Small stocks fared far better than large-cap issues, and growth did better than value. The best performer for the year was Morningstar's Small Growth Index, which gained 53% for the year. The Large Core index—a much better proxy for the middle-of-the-road holdings that investors usually emphasize for their portfolios—gained a more mundane 24.7% for the same period.

The dramatic rise in the stock market partly reflects improved fundamentals: One year earnings growth for the average stock in the US Market Index increased by a solid 18%. But investors have also been paying higher prices for that growth. The average price/earnings ratio for the US Market Index has edged up to 26.7, compared with about 25.0 a year ago. That's below the peak valuation levels seen in 1999's heady market, but still considerably higher than historical norms.

## Morningstar U.S. Market Index (Growth of \$10,000)



## Surveying the sectors

For the year, Morningstar's hardware sector was by far the best performer, driven by increased spending on computer equipment. The sector surged ahead by 65.5% for the year, driven by big gains on stocks such as Intel, Cisco Systems, and Texas Instruments. That was a marked reversal from previous years, when hardware stocks were among the hardest-hit in the market decline. The industrial materials group was the second best-performing sector, with a gain of 39.96% for the same period. Companies in this sector, which tend to be extremely sensitive to economic conditions, benefited from the economic recovery and firmer commodity prices.

Thanks to the brighter economic conditions and a corresponding increase in consumer spending, services stocks such as Home Depot, Lowe's, eBay, and McDonald's

were also strong performers for the year. The consumer services sector now ranks as one of the best performers for the trailing three-year period. Financial services companies such as Citigroup, J.P. Morgan Chase, and Morgan Stanley generally benefited from the rising equity market, despite a modest uptick in interest rates.

The telecommunications sector, which also brought up the rear for the past several years, continued to fall behind due to weak returns on stocks like Verizon Communications, SBC Communications, and BellSouth. The energy sector was another relative laggard, even though oil and natural gas prices have remained relatively high. Makers of old-line consumer goods, such as Procter & Gamble, Coca-Cola, Nestle, and PepsiCo fell behind during 2003's market rally as well.

### Morningstar Sectors (% Return)

	Quarter	1 Year	3 Year		Quarter	1 Year	3 Year		Quarter	1 Year	3 Year
<b>Information</b>	<b>13.74</b>	<b>41.16</b>	<b>-18.69</b>	<b>Service</b>	<b>12.09</b>	<b>32.78</b>	<b>-2.32</b>	<b>Manufacturing</b>	<b>16.87</b>	<b>32.21</b>	<b>-0.63</b>
Software	9.08	30.70	-18.50	Healthcare	10.88	26.12	-7.43	Consumer Goods	13.02	23.41	2.46
Hardware	15.01	65.51	-22.59	Consumer Services	7.35	33.49	1.11	Industrial Materials	19.57	39.96	-0.82
Media	15.03	33.51	-10.33	Business Services	13.64	32.51	-2.91	Energy	20.34	35.14	3.43
Telecom	13.76	25.52	-16.98	Financial Services	14.10	36.63	0.24	Utilities	12.15	31.36	-16.39

## Industry performance

Drilling down to the industry level, wireline equipment, electronics stores, semiconductors, optical equipment, and semiconductor equipment were among the best performers for the year. Thanks to a surge in the fourth quarter, shares of home builders and assisted-living facilities also posted impressive returns for the year. Commodity-related

industries such as coal, aluminum, steel/iron, and mining racked up impressive gains, particularly late in the year.

Low tech industries such as toys/hobbies, hospitals, discount stores, food manufacturing, and groceries lagged behind for the year, and several of these industries posted losses for the fourth quarter.

### Top 5 Industries 1 Year (% Return)

Wireline Equipment	114.66	
Assisted Living	106.37	
Home Building	99.27	
Online Retail	98.62	
Optical Equipment	93.40	

### Bottom 5 Industries 1 Year (% Return)

Toys/Hobbies	13.86	
Hospitals	13.52	
Discount Stores	9.52	
Food Manufacturing	9.12	
Groceries	1.53	

## Growth Edges Past Value

### Morningstar US Value Index: +29.75%

While growth stocks clearly benefited from the surge in hardware, software, and other tech-related stocks, value stocks were less than five percentage points behind for the year. Morningstar's US Value Index tracks stocks with relatively low prices relative to projected earnings, book value, cash flow, sales, and dividends. As a result, it has a heavy emphasis on manufacturing and services stocks, particularly financials. Those stocks didn't fare quite as well as buoyant tech issues earlier in the year, but they still did well enough to push the index to a 29% gain for the year.

Some of the biggest contributors to performance for the Value Index were FleetBoston Financial, which agreed to be acquired by rival Bank of America, and Alcoa, which benefited from both firmer aluminum prices and operational improvements. On the negative side, sluggish grocers Safeway and Kroger weighed on returns, as did Seagate Technology, Bank of America, and AT&T.

### Morningstar US Core Index: +28.63%

Morningstar's US Core Index also notched solid gains for the year. The Index finished the period up more than 28%. General Electric, which accounts for close to 6% of the Index's total value, enjoyed a solid year after making moves to address the slowing growth that dogged it in previous years. Basic materials stocks like Southern Peru Copper, United States Steel, and Phelps Dodge were star performers, posting gains of well over 50% for the year. However, health-care stocks such as Wyeth, Merck, and McKesson continued to weigh down returns.

### Morningstar US Growth Index: 34.12%

After lagging far behind in the market downturn, the US Growth Index finally went from worst to first in 2003. The growth benchmark gained 34% for the year, after losing about 30% in each of the three previous calendar years. Because the Growth Index tracks stocks that are expected to grow at a faster pace than the rest of the market as measured by growth in earnings, book value, cash flow, and sales, it tends to emphasize information and service-related stocks, with only a token weighting in the manufacturing sector. Those biases paid off in 2003, when investors bid up a wide range of tech- and service-related stocks.

Indeed, the rally in growth-oriented stocks was broad-based enough to offset sluggish returns on some of the biggest stocks in the index. Top holding Microsoft, which makes up about 7% of the Index's value, lagged the market by a wide margin for the year, as did Wal-Mart Stores, which makes up about 6% of the Index. But the sizzling gains on other stocks such as Rambus, Armor Holdings, and XM Satellite Radio more than offset the single-digit returns on these top holdings.

### Best-Performing Style Index: Small Growth

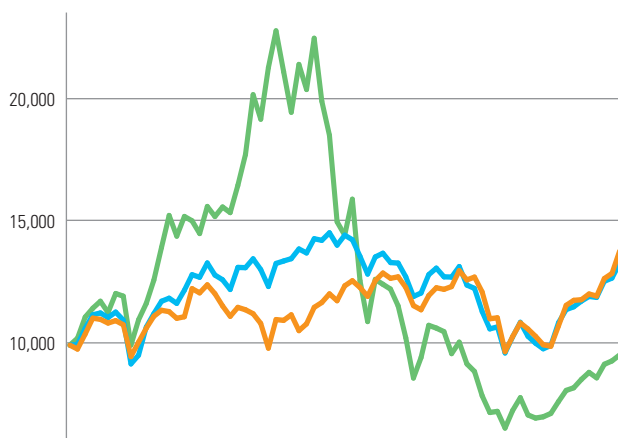
A 22% weighting in popular hardware stocks drove gains on the Small Growth Index in 2003, and major holdings such as Sandisk, Foundry Networks, and Rambus all kicked in triple-digit gains for the year. Biotech leader ImClone Systems and online broker Ameritrade Holding were also major contributors to performance on this index.

### Worst-Performing Style Index: Large Core

The Large Core Index was the weakest performer of the nine style indexes, with only a 24.7% gain over the same period. Returns were weighed down by Merck, which sank by 19% for the year due to concerns about sluggish growth and an anemic new-drug pipeline, as well as other holdings such as AT&T, Kraft Foods, and Lockheed Martin.

#### Growth of \$10,000

- Morningstar US Value
- Morningstar US Core
- Morningstar US Growth



	1998	1999	2000	2001	2002	2003
<b>Morningstar US Value</b>						
Total Returns %	14.13	-1.27	10.06	-0.68	-13.68	29.75
Price/Earnings	21.35	22.12	20.19	21.85	20.53	18.58
Price/Book	3.74	4.40	4.15	3.00	2.17	2.83
Dividend Yield %	2.52	2.79	2.30	2.74	3.40	2.69
Earnings Growth (5 Yr)	9.82	10.59	11.52	10.21	9.08	8.48
<b>Morningstar US Core</b>						
Total Returns %	17.75	14.67	7.10	-9.31	-21.18	28.63
Price/Earnings	29.75	32.05	33.53	28.24	21.46	23.75
Price/Book	6.39	7.22	8.12	6.03	4.24	4.64
Dividend Yield %	1.20	1.09	0.86	1.04	1.59	1.27
Earnings Growth (5 Yr)	13.58	14.33	14.94	14.35	12.46	12.11
<b>Morningstar US Growth</b>						
Total Returns %	39.76	44.51	-28.45	-26.32	-33.20	34.12
Price/Earnings	45.90	51.50	44.60	47.43	32.89	38.45
Price/Book	12.74	15.98	10.56	6.92	5.61	5.93
Dividend Yield %	0.39	0.19	0.13	0.17	0.50	0.43
Earnings Growth (5 Yr)	22.02	26.30	28.12	21.75	17.52	17.26

## Small-Cap Stocks Continue to Dominate

### Morningstar Large Cap Index: +27.04%

In a pattern typical of market recoveries, large-cap stocks lagged far behind their smaller counterparts, and Morningstar's Large Cap Index was well behind the Mid Cap and Small Cap benchmarks for the year. With tech stocks surging ahead, large-cap tech names such as Cisco Systems, Intel Group, and Texas Instruments had the biggest positive influence on index returns for the year. Large-cap financial stocks like FleetBoston Financial, Citigroup, and American International Group also drove returns on this Index.

On the negative side, troubled health-care names like Merck & Co., Amgen, and Wyeth were a drag on large-cap returns. Kohl's Corp. also dragged down returns as declining same-store sales took a toll on the previously highflying shares.

### Morningstar Mid Cap Index: +38.38%

The Mid Cap Index notched an impressive 38% gain for the year, driven partly by its heavy emphasis on financial services, which generally fared well for the year despite a modest uptick in interest rates. Tech-related names such as Lucent Technologies, Agilent Technologies, and International Game Technology also made a positive contribution to returns. With commodity prices continuing to make gains, Phelps Dodge and Freeport-McMoRan Copper & Gold boosted the Index's value, as well.

Disk drive maker Seagate Technology, which has been the subject of an SEC investigation because allegations made by a former employee about improper accounting practices, was one of the weaker performers in the Index. Airline JetBlue Airways, which has dropped because of declining earnings estimates, also weighed on returns during 2003.

### Morningstar Small Cap Index: +47.70%

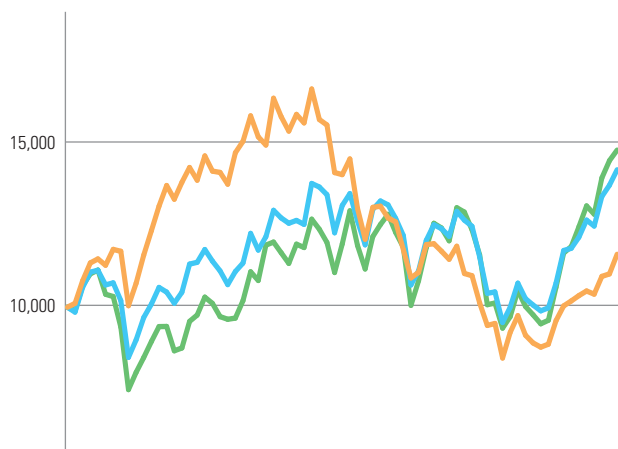
Thanks to the resurgent market, the Morningstar Small Cap Index pulled well ahead of its larger-cap counterparts. Because smaller-cap stocks also held up relatively well in 2000 and 2001, this Index now claims the best trailing returns of the three cap Indexes for the past three-, five-, and 10-year periods.

The Small Cap Index has a 13% stake in the industrial goods sector, a weighting that generally paid off as rosier economic conditions boosted cyclical stocks like United States Steel Corp., which gained close to 66% for the year. Network software maker Novell and RDRAM chip developer Rambus were also among the top-performing small-cap names in the Index, with each gaining about 70% for the year.

Despite the powerful small-cap rally, however, a few stocks fell behind. Notable laggards in the Small Cap Index included priceline.com, which has faltered with its airline-ticketing business, and Leapfrog Enterprises, a 2002 IPO that has lost steam in recent months.

Growth of \$10,000

- Morningstar Large Cap
- Morningstar Mid Cap
- Morningstar Small Cap



	1998	1999	2000	2001	2002	2003
<b>Morningstar Large Cap</b>						
Total Returns %	30.73	21.05	-11.38	-15.10	-23.47	27.04
Price/Earnings	35.13	40.06	33.75	32.03	25.14	26.93
Price/Book	9.12	11.51	8.49	5.98	4.56	4.76
Dividend Yield %	1.20	1.00	1.02	1.29	1.80	1.54
Earnings Growth Projected	15.55	18.45	18.16	14.78	12.81	12.46
<b>Morningstar Mid Cap</b>						
Total Returns %	6.01	15.55	6.94	-4.63	-18.06	38.38
Price/Earnings	27.37	31.06	27.01	26.96	25.97	25.89
Price/Book	5.15	7.55	5.35	3.96	3.19	3.86
Dividend Yield %	1.42	1.38	1.40	1.33	1.59	1.27
Earnings Growth Projected	16.46	19.81	17.74	16.14	13.94	12.57
<b>Morningstar Small Cap</b>						
Total Returns %	-6.01	17.78	7.66	5.26	-20.36	47.70
Price/Earnings	25.55	28.89	21.28	25.22	22.96	27.04
Price/Book	3.87	5.99	3.68	3.11	2.72	3.58
Dividend Yield %	1.07	1.17	1.35	1.18	1.56	1.09
Earnings Growth Projected	19.42	20.19	19.65	17.57	14.96	14.86

## Fund Categories vs. the Benchmarks

As one would expect in a market rally, the passive market benchmarks proved a tough bogey to beat for actively managed mutual funds, which have to overcome the drag of hefty expense ratios, trading costs, and keeping some cash on hand to accommodate redemptions. Moreover, Morningstar's Style Indexes are designed to be style-pure, meaning that an index like the Small Growth Index only includes stocks that clearly demonstrate a small growth style. But most fund managers have at least some degree of flexibility for buying stocks in other areas of the style box. As a result, the Morningstar Style Indexes tend to show more extreme performance characteristics, which higher returns in up markets and deeper losses in down markets than those experienced by actively managed funds.

Overall, actively managed funds only managed to beat the appropriate style index in three of the nine Style Indexes: Large Value, Large Core, and Small Core. That's likely because fund managers in these categories were willing to spike their portfolios with some exposure to growth stocks and smaller-cap fare. The toughest bogey to beat was Morningstar's Small Growth Index. Only 19% of funds in this category managed to surpass the Index's gain of 52.65% for the year. The Small Value Index was also a tough nut to crack, with only 24% of funds in this style category beating the benchmark. Returns for funds in this category were likely hurt by two things: Most funds don't

have an exclusive small-cap focus, and many funds also underweighted financial services—including top-performing REITS—relative to the benchmark.

## Conclusion

Despite this year's market rally and a healthier picture for corporate earnings, we think investors would be well-served to take this year's gains with a measure of caution. Equity valuations are still steep relative to long-term historical averages, and there's not a big margin of safety built into the stock prices of most companies. About 29% of the stocks rated by Morningstar currently earn the lowest 1-star rating, while only 2% earn our highest rating of 5 stars. That suggests that valuations may have run ahead of fundamentals for many of the market's leading stocks. Indeed, many of the fund managers we've interviewed over the past few months have also mentioned that it's been difficult to find good values. At the risk of spoiling all the fun of the recent rally, it's also worth pointing out that most investors still haven't recouped their losses from the extended bear market, even after this year's big gains. Morningstar's US Market Index has generated average annual returns of -3.57% for the trailing three-year period, and it may take a while for that number to move back into positive territory.

—Amy C. Arnott, Director of Securities Analysis

	Value	Core	Growth
Large Cap	68.8 26.3	71.2 24.7	33.0 30.7
Mid Cap	34.2 36.0	32.9 38.7	28.0 40.0
Small Cap	23.6 48.9	50.3 42.6	18.8 52.7

### Active vs. Passive, 2003

- Percent of actively managed mutual funds outperforming their respective benchmark
- Index Returns (%) for 2003

Includes the oldest share class for all U.S. diversified mutual funds with at least one-year history. As of December 31, 2003, there were 2,347 eligible funds. Morningstar classifies funds into style categories based on the average style score (using the same 10-factor methodology as the underlying benchmarks) of all available portfolio holdings over three-year period.

### Value Fund Manager Darlings

	# Funds	3 Month	1 Year	3 Year
Citigroup	292	7.43	41.06	12.15
Exxon Mobil	242	12.70	20.15	6.31
Altria Group	207	25.8	40.78	12.08
J.P. Morgan Chase & Co.	222	7.98	58.71	16.65
Bank of America	249	4.09	19.75	6.19
Fannie Mae	162	7.56	19.29	6.06
Chevron Texaco	216	21.93	34.25	10.32
Bristol-Myers Squibb	197	13.64	29.59	9.02
Pfizer	214	16.79	17.53	5.53
Verizon Com.	251	9.32	-5.5	-1.87

### Growth Fund Manager Darlings

	# Funds	3 Month	1 Year	3 Year
Microsoft	412	-0.97	6.81	2.22
Pfizer	366	16.79	17.53	5.53
Intel	399	16.53	106.36	27.31
Cisco Systems	424	23.69	84.96	22.75
Amgen	417	-4.23	27.82	8.53
General Electric	284	4.6	30.39	9.25
Dell	370	1.68	27.08	8.31
American Intl Group	265	14.98	14.96	4.76
Wal-Mart Stores	309	-4.69	5.74	1.88
Citigroup	300	7.43	41.06	12.15

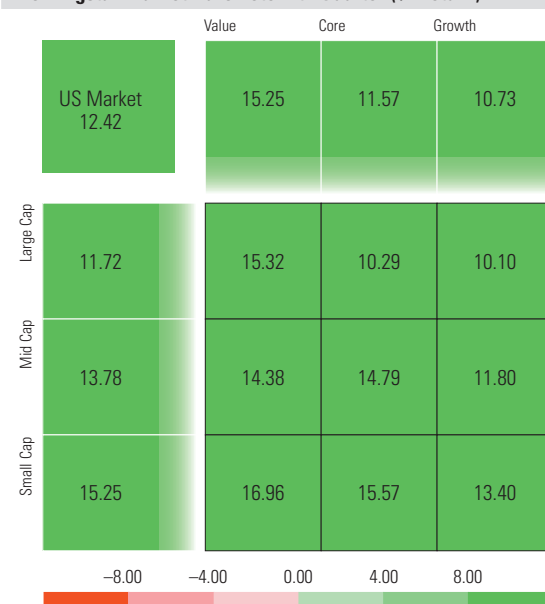
Value and Growth Fund Darlings represent the most widely held stocks held by value and growth fund managers. Rankings based on aggregate market value of stocks held. Data as of December 31, 2003.

# Morningstar Market Commentary

## Trailing Returns %

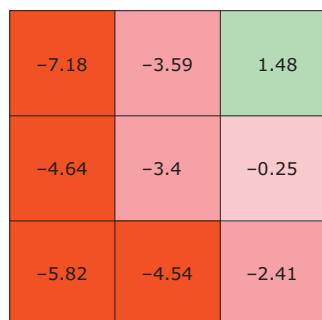
	Qtr	6-Month	1-Yr	3-Yr	5-Yr	10-Yr
Morningstar Indexes						
US Market	12.42	16.05	30.73	-3.57	-0.03	10.56
Large Cap						
Large Cap	11.72	13.99	27.04	-6.19	-2.40	10.48
Mid Cap	13.78	20.32	38.38	2.64	5.97	10.27
Small Cap	15.25	24.87	47.70	7.37	9.44	10.28
US Value						
US Value	15.25	16.95	29.75	3.61	3.87	NA
US Core	11.57	15.26	28.63	-2.76	2.46	NA
US Growth	10.73	16.15	34.12	-12.90	-7.35	NA
Large Value						
Large Value	15.32	15.13	26.26	1.19	1.95	NA
Large Core	10.29	12.44	24.71	-6.63	-0.01	NA
Large Growth	10.10	14.89	30.65	-14.73	-10.09	NA
Mid Value						
Mid Value	14.38	20.18	35.94	8.71	8.33	NA
Mid Core	14.79	22.75	38.68	8.79	8.53	NA
Mid Growth	11.80	17.26	40.02	-9.50	0.08	NA
Small Value						
Small Value	16.96	25.60	48.87	17.41	12.74	NA
Small Core	15.57	24.49	42.59	11.92	15.06	NA
Small Growth	13.40	24.63	52.65	-5.67	1.60	NA

## Morningstar Market Barometer 4th Quarter (% Return)

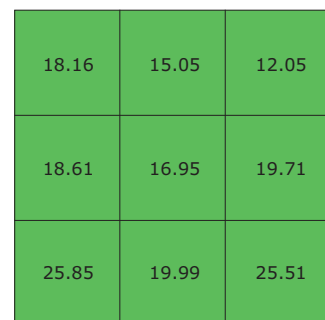


## Morningstar Market Barometer Trailing 4 Quarters (% Return)

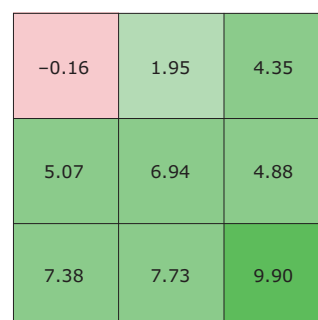
### 1st Quarter 2003



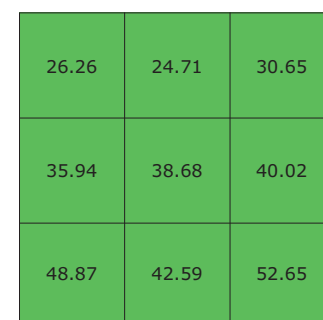
### 2nd Quarter 2003



### 3rd Quarter 2003



### 4th Quarter 2003



## Biggest Positive Influence on Morningstar US Market Index

	Style	Contribution %	3 Month	1 Year	3 Year
Pfizer Inc.	■	0.36	16.79	14.07	-8.08
Cisco Systems Inc.	■	0.32	23.69	81.60	-14.79
Intel Corp.	■	0.28	16.53	96.85	0.83
Exxon Mobil Corp.	■	0.27	12.71	16.14	-0.83
Altria Group.	■	0.23	25.80	42.02	12.39
American Intl Group Inc.	■	0.21	14.98	12.00	-13.03
Coca-Cola Co.	■	0.18	18.65	16.34	-4.90
FleetBoston Financial Corp.	■	0.17	45.94	81.69	7.76
ChevronTexaco Corp.	■	0.16	21.93	29.56	2.77
Citigroup Inc.	■	0.15	7.43	40.30	-0.26

## Biggest Negative Influence on Morningstar US Market Index

	Style	Contribution %	3 Month	1 Year	3 Year
Wal-Mart Stores Inc.	■	-0.09	-4.69	4.36	0.10
Merck & Co. Inc.	■	-0.07	-8.00	-19.06	-19.82
Wyeth	■	-0.03	-7.42	12.09	-11.82
Amgen Inc.	■	-0.03	-4.23	27.95	-1.11
Microsoft Corp.	■	-0.02	-0.97	6.77	8.46
Colgate-Plamolive Co.	■	-0.02	-10.02	-4.4	-7.34
Seagate Technology	■	-0.02	-30.37	65.33	NA
Kohl's Corp.	■	-0.02	-16.00	-19.46	-9.70
medimmune Inc.	■	-0.01	-23.16	-5.23	-18.75
Southwest Airlines Co.	■	-0.01	-8.79	14.95	-10.63

Biggest Influence on quarterly performance is calculated by multiplying stock returns for the quarter with their respective weight in the Index as of the start of the quarter.

Notes and Disclaimer: ©2003 Morningstar, Inc. All Rights Reserved. Unless otherwise noted, all data is as of December 31, 2003. Multi-year returns are annualized. NA: Not Available. All portfolio analysis data is as of the most recent month ending. Price/Earnings are based on trailing 12-month earnings. Earnings estimate data provided by Miltex. The information contained herein is not warranted to be accurate, complete or timely. Neither Morningstar nor its content providers are responsible for any damages or losses arising from any use of this information. For information visit <http://indexes.morningstar.com> or call 800-698-5933.

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