

Morningstar Index Quarterly

First Quarter 2003

Morningstar Market BarometerSM

	Value	Core	Growth
Large Cap	-7.18	-3.59	1.48
Mid Cap	-4.64	-3.40	-0.25
Small Cap	-5.82	-4.54	-2.41

1st Quarter (% Return)

-24.47	-25.56	-28.23
-20.98	-20.25	-29.23
-23.35	-22.85	-34.35

1-Year (% Return)

Morningstar Earnings Barometer

46↓	47↑	21↑
11▲	28▲	23▲
91↓	157↑	90↑
26▲	84▲	80▲
138↓	186↑	147↑
48▲	93▲	115▲

Number of companies with
 ↓ downward revisions
 ▲ upward revisions

Cumulative changes in consensus earnings estimates for FY 2003 were based on change in estimates between December 31, 2002 and March 31, 2003.

Mr. Market displayed some schizoid behavior in the first quarter.

The Morningstar US Market Index finished the first quarter down 3%, and it took a circuitous route to get there. The market dropped in seven of the first 10 weeks of the quarter, but roared back with the beginning of the Iraq war. In fact, during the week of March 17, the Morningstar US Market Index posted its best weekly return on record. The final week of the quarter, though, saw those gains evaporate.

Judging by underlying corporate fundamentals, it's no surprise the market had a rough quarter. Based on Wall Street earnings estimates, we saw almost twice as many downward revisions in 2003 earnings estimates as upward revisions. And the hardest-hit companies were those that had been posting decent returns during the bear market: value stocks. Large value stocks were the worst-performing group in the first quarter, whereas the down-and-out Large Growth Index was the best-performing of Morningstar's 16 equity indexes. It paid to be contrarian in the first quarter.

Among value stocks, we saw nearly 275 downward revisions in earnings forecasts during the quarter, versus just about 85 upward revisions. Big value stocks like Altria, Caterpillar, Schering-Plough, the Baby Bells, Ford Motor, and Alcoa watched their 2003 earnings outlooks deteriorate significantly during the quarter. The U.S. economy continued to sputter, which diminished the outlook for just about any industrial or basic-materials stock. And Altria—a value bellwether—lost 25% of its value due to worries over (surprise) tobacco lawsuits. Most tobacco firms land in the value group.

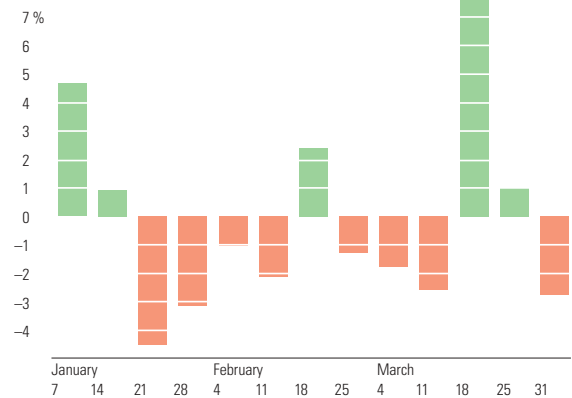
It was a very different story with growth stocks. Although downward revisions outnumbered upward revisions, the discrepancy was only about 20%. Among the companies revised upward: Internet stocks, most of which fall in Morningstar's Consumer Services sector, which was one of only three sectors out of 12 to end the quarter in the black. Amazon is in better financial shape than it's ever been, eBay reported a terrific fourth quarter, advertising revenues are rising again for Yahoo, and Expedia is getting acquired by

USA Interactive. Each of those stocks posted tremendous gains in the first quarter.

Hardware Stocks Boost the Growth Indexes

Also helping growth stocks—especially technology-related stocks—was how pessimistic the market had been in 2002. After all, the key to happiness is having low expecta-

Morningstar US Market Index (Weekly Returns)



tions, and investors had very low expectations for the likes of Sun Microsystems and Dell Computer entering 2003.

That helps explain why the biggest first-quarter winners were stocks in the Hardware sector. Dominating the Hardware sector are companies that make semiconductors and telecommunications equipment, both of which are deeply cyclical product lines. It doesn't take much to produce big swings in stock prices. Beaten-up names like EMC, Linear Technology, and Juniper Network posted double-digit gains in the first quarter, and sector bellwether Intel gained 5%. Even Lucent and Nortel—two large companies trading in penny-stock territory—gained 17% and 29%, respectively.

The rebound comes after a horrendous year in 2002, when the Hardware sector plunged 35%. Several large Hardware stocks had been beaten-down so far in 2002 that they slipped from the growth column of the Morningstar Style Box to the core column. Among them: EMC and Sun Microsystems. By the first quarter of 2003, you could find Sun Microsystems in the portfolios of Oakmark, American Funds
















Washington Mutual, and Third Avenue Value—three of the best value funds around. After its shares sank to almost book value, Sun posted a 5% gain in the first quarter.

But the rebound in Hardware stocks mainly benefited the growth indexes. Most Hardware stocks still qualify as growth stocks, despite seeing their valuations deflated over the past three years. They tend to score high on such growth factors as projected earnings growth, and low on value factors such as dividend yield. The Morningstar Large Growth Index

burned badly in technology stocks the past three years, few growth funds have been buying Hardware and Software stocks. Only one Hardware stock landed in the top-10 holdings of growth funds: Cisco. And it actually lost a little ground in the first quarter.

While growth managers had a tough time keeping pace with the growth indexes, value managers mostly outperformed the value indexes. The Large Value index, for example, lost 7.2% in the first quarter, whereas the large-value fund category shed 5.1%.

Morningstar US Market Index (% Sector Composition 3-31-03)

 Information	20.83	 Service	48.56	 Manufacturing	28.62
 Software	4.38	 Healthcare	15.13	 Consumer Goods	8.47
 Hardware	9.41	 Consumer Services	8.06	 Industrial Materials	10.69
 Media	3.65	 Business Services	4.20	 Energy	6.57
 Telecommunications	3.39	 Financial Services	21.17	 Utilities	2.89

posted a 1.5% return in the first quarter—the best out of our 16 indexes—and all the other growth indexes also did well.

Fund Categories Versus the Benchmarks

How did mutual funds do against the Growth and Value Indexes? As we'd expect, average fund performance didn't swing as far as the benchmark indexes. Almost all growth funds hold a mix of stocks in the US Growth Index and the US Core Index, which skews performance toward the middle. The same applies to value funds, which hold a mix of stocks from the US Value Index and the US Core Index.

In fact, you can find many of the same stocks among the top holdings of both growth and value funds. We looked at the top-25 holdings of both growth and value funds, and found several names in both groups: General Electric, Citigroup, Fannie Mae, AIG, IBM, and Eli Lilly. With the exception of Citigroup and Fannie Mae—which Morningstar classifies as value—each of these stocks is a constituent of the US Core Index.

So it's no surprise that the US Growth Index was a tough benchmark to beat for fund managers. The large growth fund category actually dropped 1.32% in the first quarter, versus the 1.5% positive return for the US Large Growth Index. We also saw similar divergences in the Mid Growth and Small Growth areas.

Amgen and Intel, two of the biggest contributors to the US Growth Index's positive performance, didn't even rank in the top-10 holdings of growth mutual funds in the first quarter. (They ranked 12th and 14th, respectively.) After getting

MORNINGSTAR STYLE INDEXES

Morningstar US Growth Index: +0.85%

Growth stocks held up well during the quarter. About half of the stocks Morningstar classifies as growth gained ground during the quarter, compared with just 39% of value stocks and 43% of core stocks. The Morningstar US Growth Index has a Hardware weighting that's double the market average—18% versus 9%—which helps explain the good relative performance.

Top 10 Growth Stocks

US Growth Index	Weight %	Mutual Funds	Number of Funds
Microsoft	7.71	Microsoft	473
Pfizer	6.48	Pfizer	389
Johnson & Johnson	5.50	American Intl Grp	327
Wal-Mart Stores	4.62	Johnson & Johnson	367
Intel	4.06	Viacom CI B	271
Cisco Systems	3.56	General Electric	291
Coca-Cola	3.23	Wal-Mart Stores	332
Amgen	2.27	Cisco Systems	410
Dell Computers	2.17	Citigroup	313
Viacom CI B	1.99	AOL Time Warner	183

Top 10 growth stocks held by mutual funds are ranked by aggregate assets held by all growth mutual funds

Also contributing was a healthy dose of Healthcare stocks, which alone make up 30% of the index. Among the 10 largest Healthcare stocks, five were up and five were down, but two of the big gainers have large weightings in the US Growth Index: Johnson & Johnson (which rose 8%) and Amgen (up 19%). Amgen's return during the quarter was the single largest contributor to the index's first-quarter gain.

Morningstar US Core Index: -3.62%

A rebound in GE shares helped the US Core Index stay about even with the overall market. GE makes up about 7% of the index, and its shares had dramatically underperformed the market in 2001 and 2002. But by 2003 much of the optimism had been beaten out of its stock price. GE shares gained 6% in the first quarter. On the negative side, big core stocks such as AT&T and AOL had miserable quarters.

90.45	59.6	9.23
-7.18	-3.59	1.48
43.46	48.15	28.2
-4.64	-3.4	-0.25
59.43	60.87	20.46
-5.82	-4.54	-2.41

Active vs. Passive, 1st Quarter, 2003

○ Percent of actively managed mutual funds outperforming their respective benchmark

● Index Returns for 1st Quarter, 2003

Morningstar US Value Index: -6.61%

Value stocks finally cooled off—61% of value stocks lost money during the first quarter—with some large index components tumbling badly. Tyco International was down 25%, Altria lost 25%, and Schering-Plough was off 19%. Many value stocks had posted nice runs and weren't all that cheap going into 2003. The average Price/Earnings ratio of the Large Value Index stood at 22 in the first quarter—hardly a low enough multiple to qualify as value in the traditional sense. A big blow to the US Value Index came from the Telecommunications sector. The sector makes up about 10%

Top 10 Value Stocks

US Value Index	Weight %	Mutual Funds	Number of Funds
ExxonMobil	9.53	Citigroup	293
Bank of America	4.31	ExxonMobil	249
Verizon Comm	3.93	Bank of America	247
SBC Comm	2.87	Verizon Comm	263
Chevron Texaco	2.85	J.P. Morgan Chase	215
Fannie Mae	2.65	Chevron Texaco	221
First Union	2.01	Fannie Mae	181
J.P. Morgan Chase	1.88	SBC Comm	243
Hewlett-Packard	1.81	American Intl Grp	201
Bank One	1.75	Wells Fargo	205

Top 10 value stocks held by mutual funds are ranked by aggregate assets held by all value mutual funds

of the index, with much of that exposure coming from the Baby Bells. Because of their high dividend yields and sluggish growth, the Baby Bells are classic value stocks, and thanks to their hefty market caps they're big components of the Morningstar US Value Index.

The Baby Bells had a horrendous quarter, partly because of an FCC ruling went against them. Among the biggest drags on the index was SBC Communications, which lost 25%. (Morningstar also cut the stock's fair value to \$27 from \$36 in February.) SBC's pain was widely shared: It ranks among the top 10 holdings of value mutual funds. Fellow Baby Bells Verizon Communications and BellSouth lost 8% and 16%, respectively.

MORNINGSTAR CAP INDEXES

Morningstar Large Cap Index: -3.01%

The first quarter's pain was equally shared among Morningstar's three size indexes: Large Cap, Mid Cap, and Small Cap. In the market as a whole, 57% of stocks lost ground during the quarter, and that percentage was pretty consistent across the size indexes.

The loss in the Large Cap Index almost exactly matched the loss in the overall market index. Holding back the Large Cap Index were large declines in the market caps of AIG and SBC Communications. AIG, which lands in the large-core square of the Style Box, shed 14%, partly because of a \$1.8 billion

charge to shore up its loss reserves. Property-casualty insurers overall had a poor quarter.

Morningstar Mid Cap Index: -2.74%

Among the size indexes, the Mid Cap Index posted the smallest loss during the quarter. Only 42% of mid-cap stocks gained ground in the first quarter, but some of the winners won big. Among them: Amazon, Xilinx, and Corning.

Morningstar Small Cap Index: -4.22%

The Small Cap Index suffered from exposure to fallen angels: stocks that used to land in the mid-cap or large-cap areas, but which have fallen so far that they now qualify as small caps. These include CMS Energy (down 53%), Americredit (down 57%), AMR (down 68%), Goodyear (down 24%), and Delta Air Lines (down 26%).

Most of the poor performers—especially the fallen angels—are constituents of the Small Value Index. Not only have fallen angels moved southward across the Style Box, but they've also moved westward as well because of both collapsing growth rates and shrinking price multiples. In contrast to the 6.6% loss for the Small Value Index during the quarter, the Small Growth Index posted just a 2.4% loss for the quarter, helped by a large exposure to Hardware stocks.

Best-Performing Morningstar Style Index:

Large Growth 1.48%

The three best-performing sectors in the first quarter: Hardware, Healthcare, and Consumer Services. The style index with the greatest exposure to each of these three sectors? You guessed it. Large Growth. Hardware makes up 19% of the index, Healthcare 33%, and Consumer Services contributes another 15%. Thanks to rebounds in those three sectors, the Large Growth Index outperformed the overall US Market Index by almost 500 basis points.

Worst-Performing Morningstar Style Index:

Large Value -7.18%

The Large Value Index lost almost 8% during the quarter, more than double the loss of the overall market. In sharp contrast to the Large Growth Index, Large Value has almost no exposure to Hardware, Healthcare, or Consumer Services. Instead, 35% of the Value Index is parked in Financial Services (the third worst-performing sector during the quarter) and 13% in Telecom (the fourth worst-performing sector). In addition to heavy exposure to lackluster sectors, Large Value had large weightings in some of the big dogs of the first quarter, including Tyco International, Altria, and Schering-Plough.

—Haywood Kelly, Director of Securities Analysis

21.61	19.96	32.33
14.43	20.32	32.62
17.52	19.71	29.52

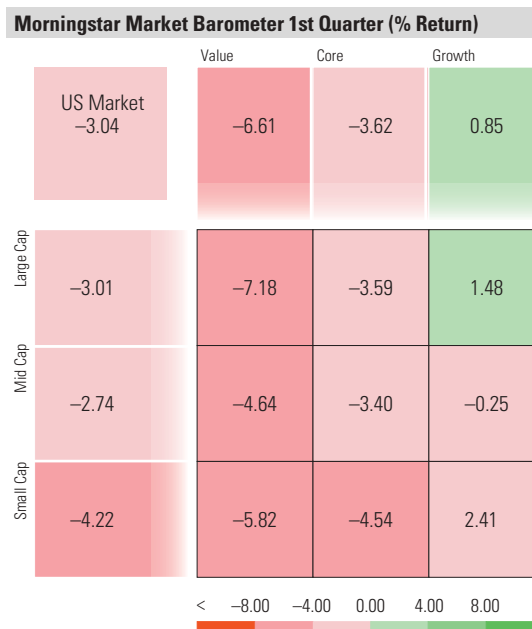
Price-to-Earnings 3-31-03

3.26	1.74	0.68
3.89	1.49	0.18
4.02	1.33	0.11

Dividend Yield % 3-31-03

Morningstar Index Quarterly

Trailing Returns %						
Morningstar Indexes	Qtr	6-Month	1-Year	3-Year	5-Year	10-Year
US Market	-3.04	4.75	-24.84	-15.93	-4.05	7.92
Large Cap	-3.01	4.97	-25.29	-18.56	-4.89	7.98
Mid Cap	-2.74	4.70	-22.84	-8.40	-2.10	7.41
Small Cap	-4.22	2.55	-26.49	-7.21	-2.78	7.02
US Value	-6.61	2.23	-23.70	-3.44	-2.20	NA
US Core	-3.62	3.15	-24.40	-9.21	-2.38	NA
US Growth	0.85	9.00	-28.79	-31.98	-9.01	NA
Large Value	-7.18	2.84	-24.47	-6.56	-3.02	NA
Large Core	-3.59	3.18	-25.56	-12.60	-3.35	NA
Large Growth	1.48	9.02	-28.23	-33.88	-9.92	NA
Mid Value	-4.46	1.52	-20.98	5.81	0.03	NA
Mid Core	-3.40	3.54	-20.25	1.86	-0.54	NA
Mid Growth	-0.25	8.99	-29.23	-27.00	-6.68	NA
Small Value	-5.82	-3.35	-23.35	7.21	0.49	NA
Small Core	-4.54	1.50	-22.85	2.35	2.35	NA
Small Growth	-2.41	9.08	-34.35	-26.63	-10.24	NA



2nd Quarter 2002

-7.18	-16.30	-21.89
-5.44	-7.23	-21.18
-3.56	-6.96	-20.46

3rd Quarter 2002

-20.83	-13.64	-16.40
-17.19	-16.85	-18.12
-16.90	-19.70	-25.24

4th Quarter 2002

10.80	7.02	7.42
6.45	7.18	9.26
2.62	6.33	11.78

1st Quarter 2003

-7.18	-3.59	1.48
-4.64	-3.40	-0.25
-5.82	-4.54	-2.41

Portfolio Analysis

Morningstar Indexes	Median Market Cap (\$Mil)	Price/Earnings	Price/Book	Price/Sales	Price/Cash Flow	Dividend Yield %	1-Yr Revenue Growth %	1-Yr Book Value Growth %	1-Yr Historical Earnings Growth %	1-Yr Projected Earnings Growth %
US Market	1,226	24.29	4.09	2.73	14.08	1.74	3.29	9.06	3.81	14.25
Large Cap	16,442	24.70	4.50	2.93	14.77	1.86	3.29	9.76	3.81	13.14
Mid Cap	2,674	22.68	3.17	2.24	12.25	1.62	6.03	8.77	6.66	14.72
Small Cap	652	21.60	2.61	2.43	11.72	1.59	3.96	7.88	2.70	20.05
US Value	1,202	19.63	2.06	1.26	7.10	3.54	-2.79	4.88	-12.30	8.55
US Core	1,338	20.54	4.20	2.01	12.10	1.65	2.53	9.76	3.81	13.68
US Growth	1,096	32.53	5.66	4.85	19.68	0.53	10.64	12.47	7.35	19.47

Notes and Disclaimer: ©2003 Morningstar, Inc. All Rights Reserved. Unless otherwise noted, all data is as of March 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. Biggest Influence of Index Performance lists are calculated by multiplying stock returns for the week by their respective weights in the index as of the start of the week. 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.

