

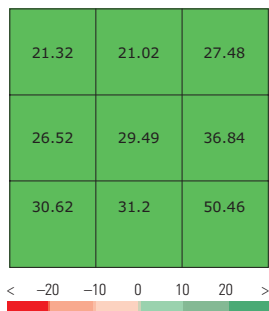
Morningstar Index Quarterly

Third Quarter 2003

Morningstar Market BarometerSM



3rd Quarter (% Return)



1-Year (% Return)

Overview: Growth Leads Again

Notwithstanding a stumble late in the quarter, the stock market produced another quarter of positive returns. The Morningstar US Market Index posted a 3% quarterly gain through September 30, and is now up 16% for the year. All told, 15 of Morningstar's 16 indexes finished the quarter in the black, and all of them are up year to date.

Growth stocks have outpaced value stocks so far this year, but investors have been betting on earnings growth that has yet to materialize. Given the strength of the stock market rally since March, stock prices may have run ahead of expected earnings. Of the stocks covered by Morningstar analysts, more than 25% currently receive a Morningstar Rating of one star (indicating a stock price significantly higher than its fair value estimate), while less than 2% receive five stars.

Another worrisome trend: The gains have been increasingly fueled by margin buying, pushing the Nasdaq margin debt levels to 1999 peaks.

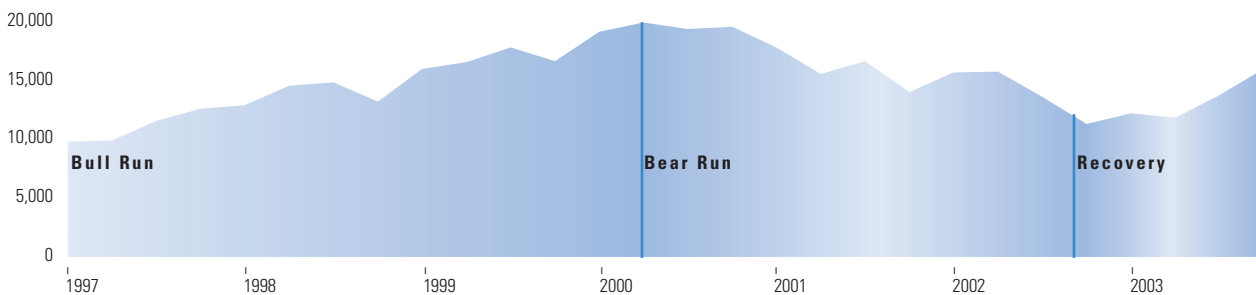
Valuations are still much lower than they were at the market peak in early 2000—at least for large and mid caps. A glance at the graph below shows the P/E ratios for each of Morningstar's nine Style Box squares at the market peak in 2000, the market nadir in October 2002, and current levels. The P/E ratio of large growth stocks stands at 38, versus 55 at the market peak (small growth stocks are approaching peak levels).

And economic news turned brighter during the quarter. The most recent Bloomberg economic survey shows that economists expect GDP growth of 4.5% and 4.0% for the third and fourth quarters, respectively. Economists cited increased business spending on equipment and inventories as a key driver, along with the recent tax cuts and high productivity.

While the economy and the stock market appear to have strong momentum, the risk of overpaying for a good company has grown.

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

	3-00	9-02	9-03	5-Year Average
Price/Earnings	38.78	25.8	25.36	30.74
Price/Book	11.1	4.34	4.26	6.66
Dividend Yield %	1.03	1.73	1.57	1.34



Price/Earnings Ratio for Morningstar Style Indexes
















20.83	38.55	55.49
15.54	22.92	48.60
14.67	22.38	41.12

21.11	22.66	33.73	17.18	21.79	38.28
19.02	22.47	33.18	17.43	22.01	33.82
18.8	21.93	32.63	19.15	22.28	36.03

Surveying the Sectors

Of Morningstar's 12 sectors, eight ended the third quarter in positive territory. The other four sectors lost marginally or were flat. Media, the worst performer, slipped largely because of poor performances from megacaps like Viacom, AOL Time Warner, and Liberty Media.

Consumer services stocks also fared well. Recent tax cuts and the mortgage refinancing boom have put money into consumers' pockets, and same-store sales in August were notably strong across many retail segments. Continued consumer spending, now almost 70% of GDP, benefited discount and specialty retailers. Consumer Services returned 7% for the quarter.

Morningstar US Market Index (% Sector Breakdown)														
		3-00	9-02	9-03			3-00	9-02	9-03			3-00	9-02	9-03
	Information	44.08	20.76	22.8		Service	33.34	50.26	49.48		Manufacturing	22.58	28.97	27.72
	Software	8.37	4.82	4.75		Healthcare	9.12	14.72	13.71		Consumer Goods	6.11	9.89	8.73
	Hardware	23.58	8.50	10.63		Consumer Svcs	7.30	9.56	9.77		Industrial Mtrls	9.55	10.35	10.39
	Media	5.18	3.59	4.38		Business Svcs	3.25	4.39	4.47		Energy	4.66	6.02	5.76
	Telecom	6.95	3.85	3.04		Financial Svcs	13.67	21.59	21.52		Utilities	2.26	2.72	2.85
















The March 2000 data represents the height of the Bull Market, while September 2002 represents the trough of the Bear Market.

The winners of the third-quarter performance derby should sound familiar: They've been tearing up the track all year. Computer-hardware and software stocks, which led the second quarter, continued to post the highest returns in the third quarter. Despite the rich valuations of these stocks, investors continued to bid them up in the hopes of the long-awaited return of business technology spending.

The best-performing of Morningstar's 12 sectors was Hardware, with a 16% return during the third quarter. The sector's nowhere near its peak—when, as the accompanying chart shows, it made up more than 23% of the entire stock market. But it's been on a run all year. These are heavily cyclical stocks, many of which depend on corporate capital spending. Software stocks were up significantly as well, posting an 8% return. Contract manufacturers, wireline equipment, and semiconductor-related industries were among the best performers in the technology arena. Both Intel and Texas Instruments raised their earnings forecasts during the quarter.

Aside from Media, Healthcare was another so-so performer during the quarter, with basically flat returns. The five largest stocks in the Healthcare sector—Pfizer, Johnson & Johnson, Merck, Novartis, and Amgen—all lost ground. If it weren't for another good gain for biotech stocks (and even they cooled down considerably during the quarter), the sector's performance would have been worse.

Utilities and energy stocks also numbered among the worst performers as a group, posting flat performance for the quarter. The massive East Coast blackout, which left 50 million customers in the dark, underscored the problems with electric utility companies: falling wholesale prices, high capital expenditures, low returns, and regulatory uncertainty. Energy stocks saw oil prices fall after spiking briefly during the war in Iraq; however, oil prices remain above their long-term averages.

Morningstar Sectors (% Return)														
		Qtr	1 Yr	3 Yr			Qtr	1 Yr	3 Yr			Qtr	1 Yr	3 Yr
	Information	5.64	48.53	-32.33		Service	4.22	24.45	-5.60		Manufacturing	4.04	18.32	-6.01
	Software	7.70	47.00	-33.47		Healthcare	-0.61	17.61	-9.90		Consumer Goods	4.40	11.00	-2.23
	Hardware	15.54	73.68	-37.57		Consumer Services	7.00	24.45	0.55		Industrial Materials	7.51	24.65	-6.94
	Media	-2.37	28.52	-22.23		Business Services	5.47	26.96	-14.08		Energy	0.98	20.22	-2.88
	Telecom	-1.22	36.69	-27.60		Financial Services	6.03	28.31	-2.64		Utilities	-0.09	21.02	-19.78

Growth Smokes Value

Breaking down returns by style, we see a clear pattern. Small growth stocks (the lower right corner of the Morningstar Style Box) had a great quarter, and large value stocks (the upper left corner of the Style Box), sputtered. Small growth stocks rose 10% during the quarter—the best-performing of Morningstar’s 16 indexes. They’re now up an incredible 50% for one year trailing. Large-value stocks, by contrast, shed 0.2% of their value during the quarter.

Most of the intrinsic value of growth stocks resides into the future, so their market value naturally fluctuates as investors become more or less rosy-eyed about the future. With hopes for an economic turnaround running high in the third quarter, the more growth oriented the stock, the better it tended to do.

Morningstar US Growth Index: 5%

When technology stocks do well—and Hardware and Software stocks had a great third quarter—chances are the Morningstar US Growth Index will rise in tandem.

The Morningstar US Growth Index has a 21% weighting in the Hardware sector, compared with just 7% for the Morningstar US Core Index and 3% for the Morningstar US Value Index. The index’s weighting in the Software sector, at 14%, also dwarfs the weightings of the Core and Value indexes.

The largest contributors to the 5% return of the Morningstar US Growth Index included Intel, which rose about 30% during the quarter, and Microsoft, which rose 10%. Because of their massive market caps, those two stocks make up a 14% weighting of the Morningstar US Growth Index. Whenever those two giants move, chances are they’ll take the index with them.

Morningstar US Core Index: 3%

Helping the performance of the Morningstar US Core Index were financials. Citigroup and Merrill Lynch posted strong gains for the quarter, and were among the top 10 contributors to the index’s showing. Dragging down the performance of both the Morningstar US Growth and the US Core Indexes was the performance of the Health sector. Large-growth stocks like Pfizer and Johnson & Johnson lost significant ground during the quarter, while Core stocks such as Merck and Eli Lilly & Company held back the performance of the US Core index.

Morningstar US Value Index: 1%

Telecom stocks held the Morningstar US Value Index back during the third quarter. Although they had a great second quarter, the Baby Bells fell sharply in the three months through September. Verizon Communications, SBC Communications, and BellSouth fell between 10% and 20% during the quarter. Those losses helped erase gains from the cyclicals that make up a large component of the Morningstar US Value Index. Caterpillar, Tyco International, and Solectron each rose sharply.

Best-Performing Style Index: Small Growth

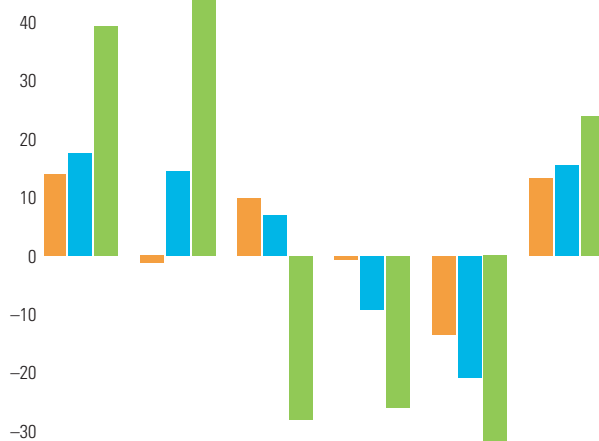
The Morningstar Small Growth Index posted a 10% return during the third quarter. Among the top 10 contributors: ITT Educational Services, Foundry Networks, and International Rectifier. With a 21% weighting in the Hardware sector and an 11% weighting in the Software sector, there was no stopping Small Growth in the third quarter.

Worst-Performing Style Index: Large Value

The Morningstar Large Value Index lost ground during the quarter, dragged down by stocks like Verizon Communications, SBC Communications, and Schering-Plough.

History

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



	1998	1999	2000	2001	2002	9-03
Morningstar US Value						
Price/Earnings	21.35	22.12	20.19	21.85	20.53	17.37
Price/Book	3.74	4.40	4.15	3.00	2.17	2.45
Earnings Growth Projected	9.82	10.59	11.52	10.21	9.08	8.33
Dividend Yield %	2.52	2.79	2.30	2.74	3.41	3.06
Morningstar US Core						
Price/Earnings	30.02	32.05	33.53	28.24	21.46	21.87
Price/Book	6.43	7.22	8.12	6.03	4.24	4.47
Earnings Growth Projected	13.60	14.33	14.94	14.35	12.46	11.95
Dividend Yield %	1.20	1.09	0.86	1.04	1.60	1.47
Morningstar US Growth						
Price/Earnings	46.06	51.50	44.60	47.39	32.87	37.29
Price/Book	12.80	15.98	10.56	6.93	5.63	5.61
Earnings Growth Projected	22.05	26.30	28.12	21.75	17.53	17.22
Dividend Yield %	0.38	0.19	0.13	0.17	0.50	0.39

The Smaller the Better

Breaking down returns by size, the third quarter is simple to explain: the smaller the stock, the better the performance. Morningstar's four small cap indexes—Small Cap, Small Cap Value, Small Cap Core, and Small Cap Growth—were the four best-performing of our 16 indexes, with returns of between 7% and 10%.

Morningstar Small Cap Index: 8%

All kinds of small speculative stocks soared during the third quarter. The Morningstar Small Cap Index, thanks to a heavy dose of the top-performing areas of the market during the current rally—hardware, media, consumer-services, and biotech stocks—was by far the best performing of Morningstar's three size indexes during the quarter.

Among the big contributors to the index's performance was Avaya, the wireline-equipment maker, which gained nearly 69% for the quarter.

Morningstar Mid Cap Index: 6%

The Morningstar Mid Core Index rose 7% during the quarter, about 200 basis points better than the Mid Growth Index and more than 175 basis points better than the Morningstar Mid Value Index. The top contributors to the performance of the broader Mid Cap index include a host of Hardware stocks: National Semiconductor, Corning, Solectron, Advanced Micro Devices, Sandisk, and Sanmina-SCI.

Also helping the performance of the Mid Cap index was its low weighting in Healthcare stocks, one of the worst-performing sectors during the quarter. The index has only a 9% weighting in healthcare stocks, versus 12% for the Small Cap Index and 15% for the Large Cap Index.

Morningstar Large Cap Index: 2%

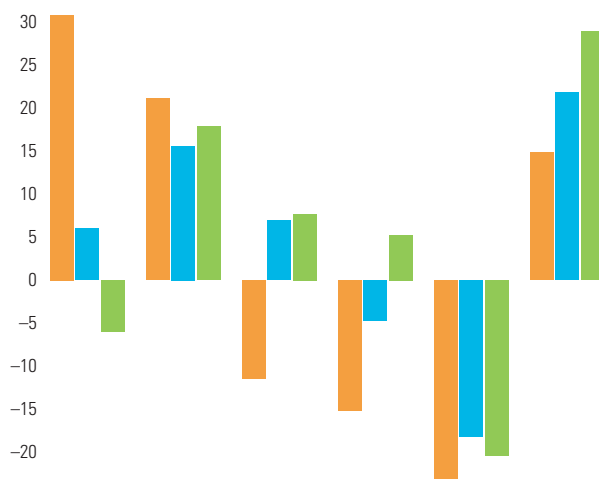
Large cap stocks looked like they'd end the quarter with a decent return, but because of the sharp drops late in the quarter, they ended flat. During the third quarter, Wall Street analysts raised more earnings forecasts than they lowered. The trend was especially pronounced for large caps stocks large growth stocks in particular. Among large-growth stocks, upward earnings revisions outnumbered downward revisions 39 to 12. Across the entire market, upward revisions outnumbered downward revisions by 826 to 712.

The four largest positive contributors to the Morningstar Large Cap Index's return in the third quarter were Intel, Microsoft, Cisco, Citigroup, and General Electric.

By Haywood Kelly, James Callahan, and Dan Culloton

Growth of \$10,000

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



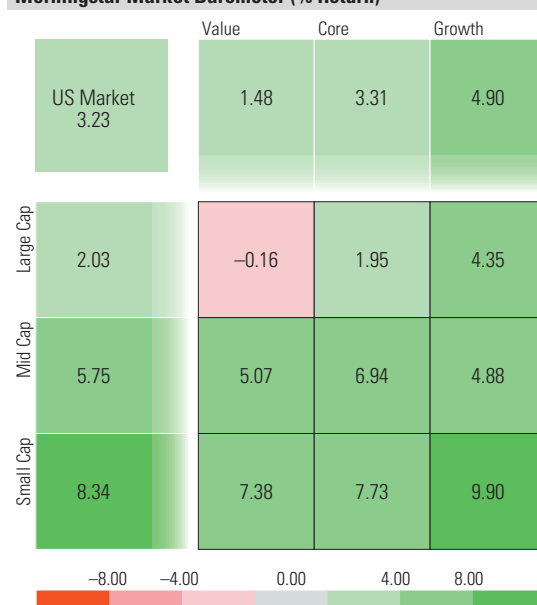
	1998	1999	2000	2001	2002	9-03
Morningstar Large Cap						
Price/Earnings	35.36	40.06	33.75	32.03	25.14	25.66
Price/Book	9.19	11.51	8.49	5.98	4.56	4.59
Earnings Growth Projected	15.58	18.45	18.16	14.78	12.81	12.46
Dividend Yield %	1.20	1.00	1.02	1.29	1.80	1.66
Morningstar Mid Cap						
Price/Earnings	27.33	31.06	27.01	26.84	24.97	24.15
Price/Book	5.15	7.55	5.35	3.96	3.19	3.52
Earnings Growth Projected	16.44	19.81	17.74	16.14	13.93	12.57
Dividend Yield %	1.42	1.38	1.40	1.33	1.60	1.43
Morningstar Small Cap						
Price/Earnings	25.55	28.89	21.28	25.15	22.96	25.63
Price/Book	3.87	5.99	3.68	3.10	2.72	3.33
Earnings Growth Projected	19.42	20.19	19.66	17.56	14.96	14.78
Dividend Yield %	1.07	1.17	1.35	1.18	1.56	1.19

Morningstar Index Quarterly

Trailing Returns %

Morningstar Indexes	Qtr	YTD	1-Yr	3-Yr	5-Yr	10-Yr
US Market	3.23	16.29	25.64	-10.14	1.46	9.48
Large Cap	2.03	13.71	23.08	-12.95	-0.68	9.45
Mid Cap	5.75	21.63	30.92	-3.05	6.71	9.07
Small Cap	8.34	28.15	37.21	1.16	9.85	9.10
US Value	1.48	12.58	23.24	0.70	3.42	NA
US Core	3.31	15.29	23.38	-5.79	4.46	NA
US Growth	4.90	21.13	30.92	-24.36	-4.82	NA
Large Value	-0.16	9.49	21.32	-2.48	1.72	NA
Large Core	1.95	13.08	21.02	-9.84	2.36	NA
Large Growth	4.35	18.66	27.48	-26.25	-7.55	NA
Mid Value	5.07	18.85	26.52	8.55	7.39	NA
Mid Core	6.94	20.81	29.49	7.22	9.27	NA
Mid Growth	4.88	25.24	36.84	-20.67	2.70	NA
Small Value	7.38	27.28	30.62	15.58	11.17	NA
Small Core	7.73	23.39	31.20	8.00	15.54	NA
Small Growth	9.90	34.61	50.46	-16.60	3.89	NA

Morningstar Market Barometer (% Return)



Morningstar Market Barometer Trailing 4 Quarters (% Return)

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	-3.4	-0.25
-5.82	-4.54	-2.41

2nd Quarter 2003

18.16	15.05	12.05
18.61	16.95	19.71
25.85	19.99	25.51

3rd Quarter 2003

-0.16	1.95	4.35
5.07	6.94	4.88
7.38	7.73	9.90

Correlation Matrix: Morningstar Style Indexes

	Large Value	Large Core	Large Growth	Mid Value	Mid Core	Mid Growth	Small Value	Small Core	Small Growth
Large Value	1	0.79	0.48	0.86	0.89	0.44	0.76	0.69	0.34
Large Core	0.79	1	0.68	0.62	0.76	0.63	0.54	0.63	0.51
Large Growth	0.48	0.68	1	0.23	0.50	0.89	0.33	0.65	0.82
Mid Value	0.86	0.62	0.23	1	0.90	0.28	0.88	0.69	0.19
Mid Core	0.89	0.76	0.50	0.90	1	0.53	0.88	0.84	0.46
Mid Growth	0.44	0.63	0.89	0.28	0.53	1	0.42	0.77	0.95
Small Value	0.76	0.54	0.33	0.88	0.88	0.42	1	0.84	0.40
Small Core	0.69	0.63	0.65	0.69	0.84	0.77	0.84	1	0.77
Small Growth	0.34	0.51	0.82	0.19	0.46	0.95	0.40	0.77	1

The matrix above shows the correlation coefficient between Morningstar Style Indexes. High correlation coefficient indicates high linear relationship between two indexes. For each index we highlight in blue and orange, the index with highest and lowest correlation (going vertically downward). All correlations calculated using 5 years monthly return data.

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