C Y P R E S S
ASSET MANAGEMENT, INC.

MARKET OVERVIEW

October, 2003

The U.S. equity markets have risen significantly this year, with the S&P 500 up 26% from the March 12, 2003 low and up 14% year to date through September 30. In hindsight, the historic bear market which began in March 2000 came to an end 3 years later in March 2003 on the eve of the Iraq War. In the final weeks leading up to the war, the market tested but did not reach the bear market low of October 9, 2002, and then began its current advance. The end of the bear market coincided with the onset of the Allied military campaign against Iraq, which commenced on March 19, 2003. While grateful for a strong recovery in both stock prices and the economy, we believe we have now reached a point of relative equilibrium. Valuation is reasonable but not cheap, earnings are recovering but still well below capacity, and the geopolitical picture is more stable but still uncertain. Once again, the central issue for investors is where do equities go from here, and the answer is largely dependant on the economy. Our outlook is for a strengthening U.S. and global economy and corporate profit picture over the next 12 months, leading to higher earnings and stock prices.

A Bull Market Economic Stimulus Package

Since the end of the "major combat" phase of the war in Iraq, two major developments have shaped and will continue to shape the market: the Bush fiscal stimulus package and the reconstruction of Iraq. The tax cut and stimulus package ("Jobs and Growth Tax Relief Act of 2003") enacted in late May is a far reaching measure, positive for both economic growth and for stocks. The act made all previously scheduled income tax cuts effective January 1, 2003, and lowered the top marginal tax rate from 38.6% to 35%. More important, the maximum tax rate on dividends and long-term capital gains was reduced to 15% for the period 2003-2008. As a result, dividend income that was taxed at 38.6% in 2002 will be taxed at only 15% for the next 6 years, and dividends are now treated as favorably as long-term capital gains. The equal treatment of dividends and capital gains is very positive for investors and the capital markets. A level playing field means management is no longer incentivized to withhold cash flow from shareholders. The old preference for capital gains encouraged many companies to take unwise investment risks in order to achieve faster growth, and therefore a higher stock price. We believe the cut in dividend rates is good for the market and sends the right message to corporate management – run the company for the shareholders, focus on your core business, and return cash flow to the shareholder unless you have a demonstrably superior investment opportunity. It should

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do more good for corporate governance and shareholders than the thousands of pages of new SEC regulations implementing Sarbanes-Oxley.

Simply put, the tax cuts make equity investments more attractive and raise after-tax returns. Taken as a whole, the Jobs and Growth Tax Relief Act of 2003 is a powerful economic growth measure. It not only lowers tax rates on income and investments, stimulating both demand and supply, it contains measures that encourage business investment and capital spending. It is highly unlikely that the current economic recovery would have gotten off the ground without this fiscal stimulus. Moreover, it will provide continued and significant economic stimulus over the next 5 years. This represents a major tailwind as the U.S. and global economy recover from the deflationary, post-bubble recession of 2000-2001.

The High Stakes of Reconstruction

The reconstruction of Iraq is proving a challenging and expensive undertaking and serves to underscore the continuing geopolitical risk in the world today. The stakes and the degree of difficulty are both high in postwar Iraq. Reconstruction also has obvious implications for the U.S. budget deficit, which has become a market concern and a hot political issue. The course of postwar Iraq will also continue to effect U.S. relations with its allies and influence the value of the U.S. dollar. In short, it goes to the heart of peace, security, and economic prosperity in the world.

It is hard to imagine a favorable outcome for the U.S. and the world, and obviously for equity markets, should we fail in our efforts to build an independent and democratic Iraq. Despite the generally negative perspective in the press, we believe that we have already made significant progress in both Iraq and the global war on terrorism. Importantly, U.S. history in postwar Europe, Japan and South Korea all provide reason for optimism.

It is also important to note that reconstruction is taking place against the backdrop of a global economic recovery. Economies are strengthening in Europe, Japan and Asia, and Latin America, and stock markets are up significantly around the world. This both aids the rebuilding of Iraq and reflects market confidence as to a favorable outcome.

A Few Notes of Caution: 2004 Election Year, Deficits and the Dollar

A cautionary note, however, is that we have entered an election year that extends through the Fall of 2004. To the extent that the Bush tax cuts are threatened and become a political issue, the market will be negatively impacted. Just as clearly, there is risk in the failure to achieve a bipartisan agreement and commitment in rebuilding Iraq. Election year politics threaten the patience and resolve necessary to stay the course on U.S. tax policy and Iraqi reconstruction, and could negatively impact the market.

The political cycle also means increased commentary about the U.S. budget and trade deficits – potentially frightening the market. While the deficits are a serious issue, and one that we are closely monitoring, there is absolutely no agreement among economists as to either the level at which the deficits become a genuine risk to the economy or the resulting economic consequences. In the mid 1980's we experienced a similar increase in the U.S. trade and budget deficits

accompanied by a broad decline in the U.S. dollar. Subsequently, however, neither the trade nor budget deficits proved to be an insurmountable problem; in fact, both returned to a positive balance in the 1990's and the dollar strengthened. The trade and budget deficits are both estimated to be 4-5% of GDP next year. The budget deficit is below the record 6% level it reached after the 1982 recession. However, the trade deficit is now above the 3% level reached in the mid 1980's. At this time we see no cause for undue concern. We view the budget deficit and the trade deficit as static evidence in a dynamic world economy on the verge of upturn. Renewed economic growth should lead to greater prosperity, higher tax receipts and a cyclical return to shrinking deficits. Likewise, a weaker dollar and improved Japanese and European economies will lead to a more balanced world economy and international trade picture.

Investment Strategy: Dividends and Equity Return Fundamentals

There continues to be a return to fundamentals in the equity markets. Over the next 6 months, the focus should be on the economy and jobs, earnings growth, and the outlook for inflation and interest rates. Significantly, U.S. corporate profits have now recovered to their previous peak set in the year 2000 and are projected to increase by 10-12% in 2004. Thus we have **record corporate profits** while the S&P 500 Index remains some 35% below its March 2000 high of 1550. As a result, the market represents better value today than in most recent years. The S&P trades at roughly 17 times 2004 consensus earnings. We believe this is fairly reasonable, as current earnings represent early to mid cycle earnings in an economic recovery and are of significantly higher quality than those of just a few years ago. An earning yield of 5.75% on 2004 S&P estimated earnings also compares favorably to money market rates of less than 1% and a 10 year treasury yield of 4%.

We continue to look for growth at a reasonable price and strive to build and maintain a high quality, diversified portfolio for the long term. You may have already noticed that we have been adding equity investments that should provide an attractive total return comprised of both earnings and dividend growth. Investments that can achieve a significant portion of their return with a strong and growing dividend, and thus comparatively lower investment risk, represent good value in today's market.

We believe this incremental "growth and income" focus is particularly well suited to the current environment. In a low inflation global economy, investors should not expect long term equity returns to exceed 8-10%, more in line with the historical norm rather than the mid double digit returns characteristic of the roaring 1980's and 1990's. Dividends represent a meaningful portion of that return, and the new lower dividend tax rate means that individuals will take home more of the dividend than in the past. Intuitively, given historically low inflation and low tax rates on equity investments, 8-10% represents a very attractive rate of return.

Your portfolios represent a strong platform for future growth. Most of our companies have emerged from the turbulence of the last three years in a stronger market position. As always, we will continue to work hard to grow your assets and to build and preserve your long term wealth.