



By William W. Priest, CEO

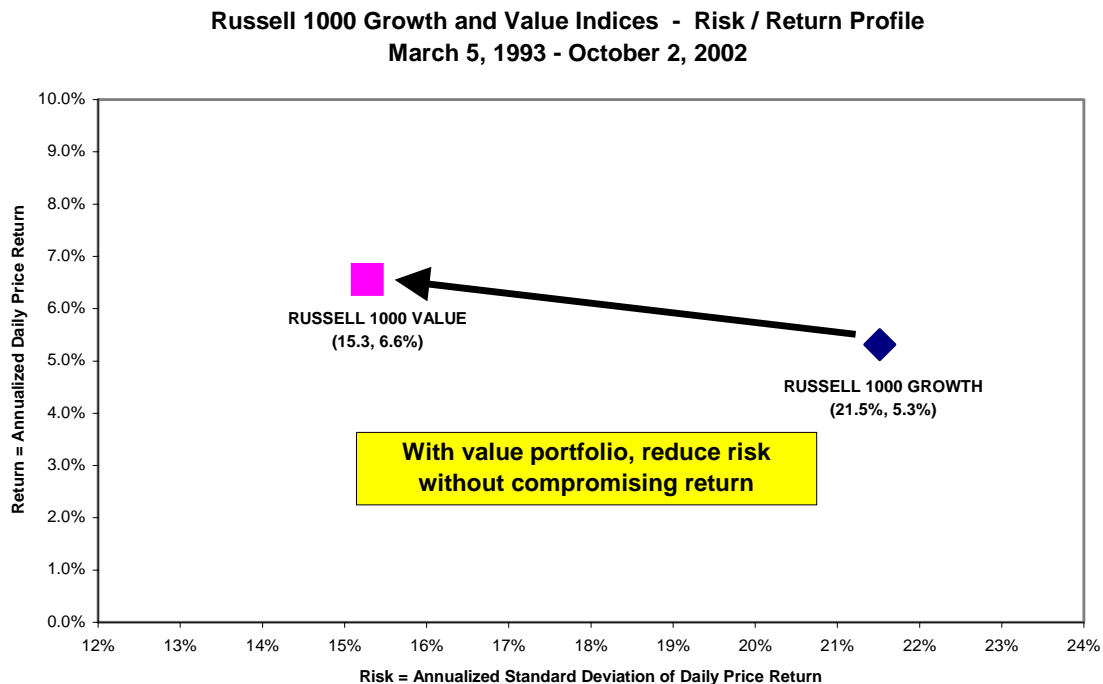
Value vs. Growth – An Update

Near the end of 2002, we authored a thought starter entitled, “Value vs. Growth – Does it really make a difference?” This essay examined the period March 1993 through September, 2002, and appears below.

Recent History – March 5, 1993 to October 2, 2002

Figure 1 contains a risk/return profile of two frequently used benchmark indices – the Russell 1000 Growth and the Russell 1000 Value. The start date, March 5, 1993, is the beginning of these indices. Although a statistician would not be willing to bet his reputation on data of less than ten years, this chart contains some interesting conclusions.

Figure 1

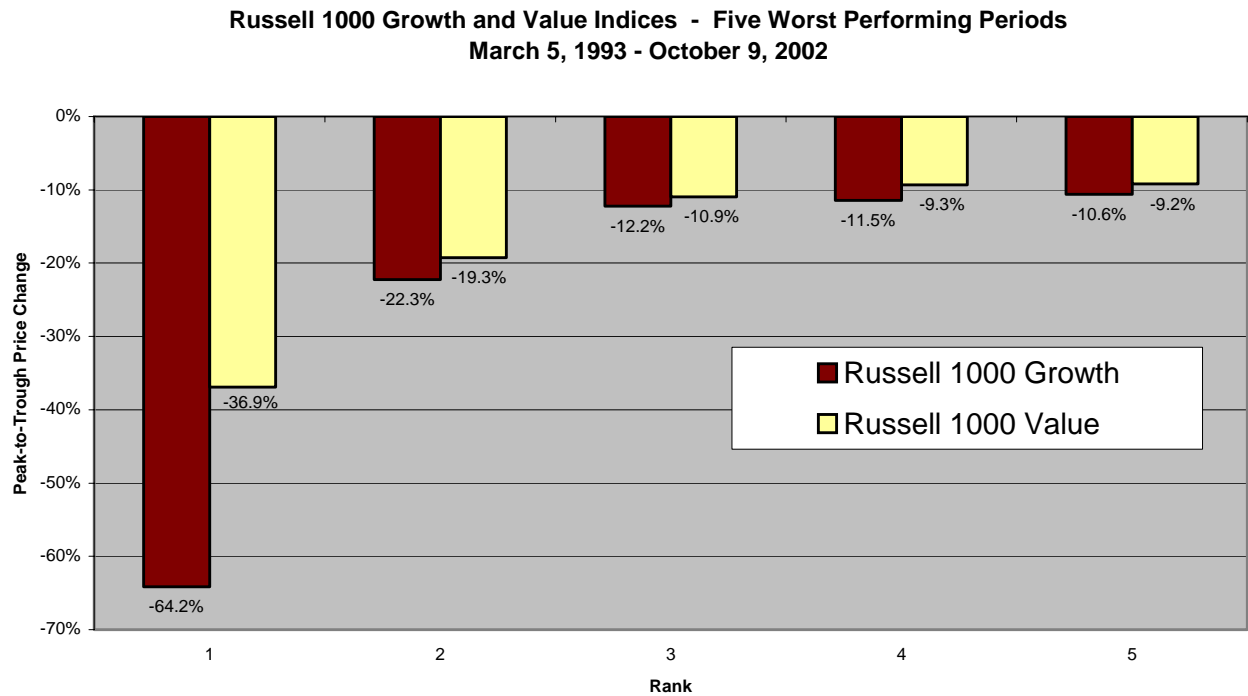


Over this period, just shy of ten years, the Russell 1000 Growth had quite a run in the late nineties and the Russell 1000 Value had a similar run in more recent years. Ultimately, Value was the clear winner in terms of both return and risk. Value returned 6.6% per annum whereas Growth returned only 5.3%. One hundred and thirty basis points a year may seem small, but 6.6% doubles in less than 11 years whereas 5.3% doubles in almost 14 years.

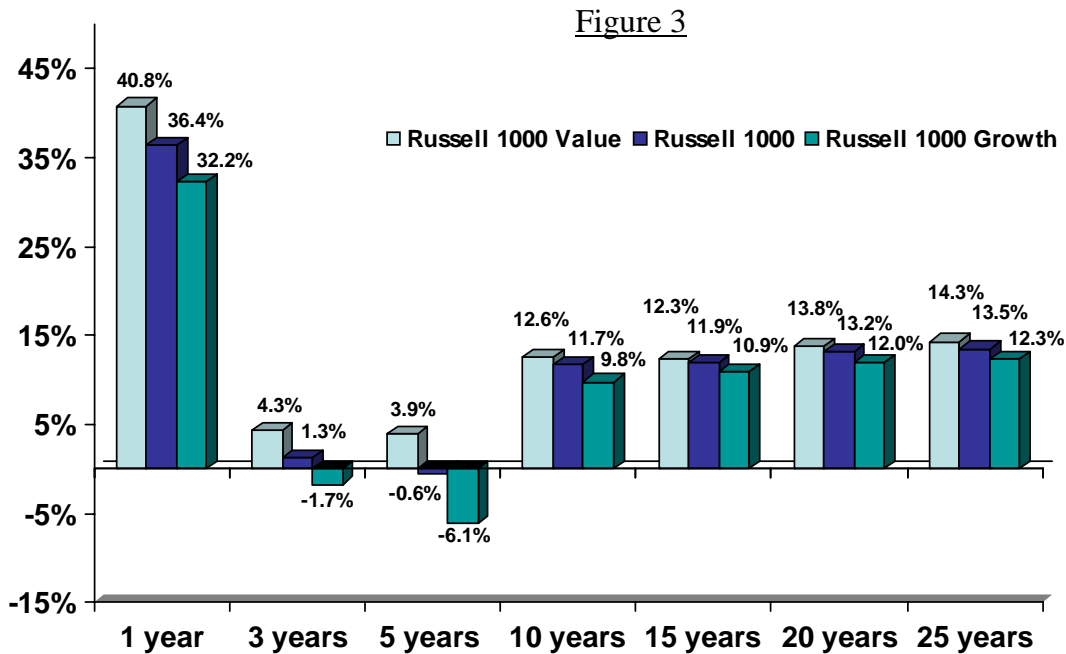
The risk element is even more defining. The annualized standard deviation of daily price returns for Growth is 21.5%, almost 40% greater than the 15.3 % number for Value. At least for this period, Value not only outperformed Growth, but it was also less risky.

Figure 2 may illustrate in part why Value beat Growth. Here, we compare the five worst periods for Growth over this near ten-year period with the five worst periods in Value. Value outperformed Growth in every period. We can speculate on why, but higher book value, higher dividend yields and lower cash flow multiples are no doubt major explanatory variables.

Figure 2



To this earlier discussion, we now add additional perspective through Figures 3, 4 and 5. In Figure 3, we display data for the Russell 1000 as well as the Russell 1000 Value and the Russell 1000 Growth. Value beats growth over all time periods.

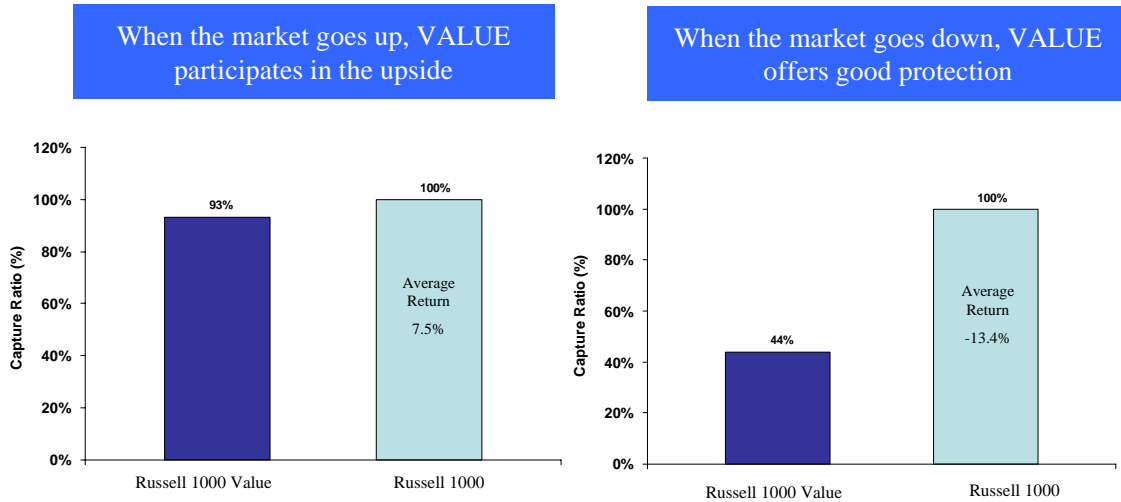


As of March 31, 2004

Source: Ibbotson, Credit Suisse Asset Management, LLC. The data presented is for informational purposes only. This report is not a recommendation to buy or sell or a solicitation of an offer to buy or sell any securities or to adopt any investment strategies. Readers are advised not to assume that any investment in securities, companies, sectors or markets described will be profitable. The information presented has been prepared on the basis of publicly available information, internally developed data, and other third party sources believed to be reliable. No assurances are provided regarding the reliability of such information. All opinions and views constitute judgments at the time of the writing and are subject to change at any time without notice. Investing entails risks, including possible loss of principal.

If one divides the market movements into “upside” and “downside” elements, Figure 4 illustrates that value does a pretty good job in competing with growth in rising markets, generally capturing 93% of the rise experienced by the Russell 1000 growth. In declining markets, value experiences only 44% of the decline experienced by growth.

Figure 4

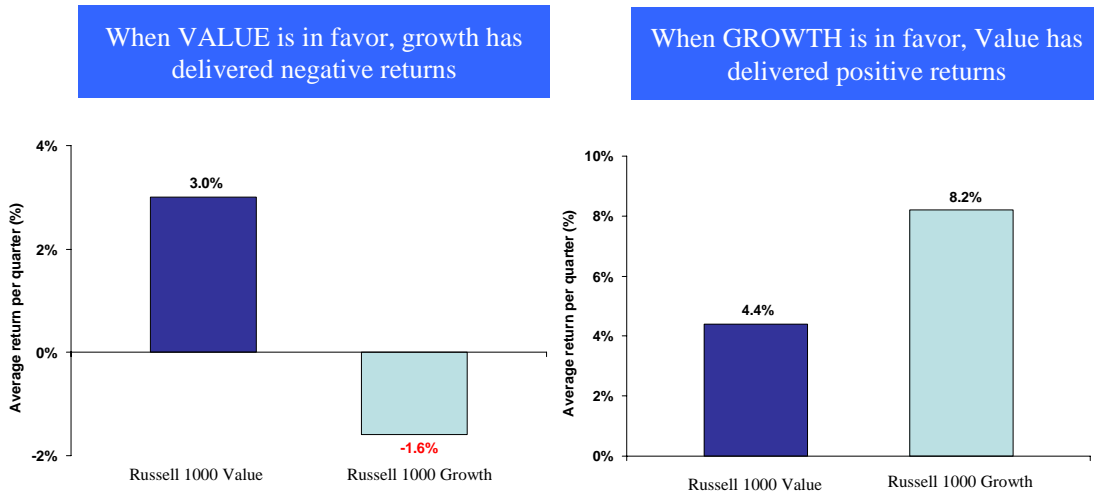


January 1, 1979 to March 31, 2004

Rolling Annual Returns Using Quarterly Data

Figure 5 is even more interesting in that it shows that when “value” is favored by market participants, growth is experiencing negative returns. When growth is in favor, value still delivers positive returns, albeit less than that of growth.

Figure 5



January 1, 1979 – March 31, 2004

Source: Ibbotson Associates. The performance shown in these charts covers 101 quarters of data from January 1, 1979 to March 31, 2004. The Russell 1000 Growth Index outperformed the Russell 1000 Value Index in 52 out of those 101 quarters. The Russell 1000 Value Index outperformed the Russell 1000 Growth Index in 49 of those 101 quarters. The data presented is for informational purposes only. This report is not a recommendation to buy or sell or a solicitation of an offer to buy or sell any securities or to adopt any investment strategy. Readers are advised not to assume that any investment in securities, companies, sectors or markets described will be profitable. The information presented has been prepared on the basis of publicly available information, internally developed data, and other third party sources believed to be reliable. No assurances are provided regarding the reliability of such information. All opinions and views constitute judgments at the time of the writing and are subject to change at any time without notice. Investing entails risks, including possible loss of principal.

The Next Ten Years

Given the inverse correlation of interest rates and P/E ratios (when the former is falling, the latter is rising and vice versa), the drivers of total returns in equities will be yield and earnings (free cash flow for us), which are characteristics more often found with Value than Growth. In order for Growth to beat Value, one needs to believe that capitalization ratios (P/Es or P/CFs) will expand. This appears highly unlikely. Rising inflation will ultimately result in higher interest rates and falling P/Es. On the other hand, raising inflation does help earnings, cash flow, and eventually dividends. Value should win in this case.

Should inflation remain low, why will multiples not eventually expand, enabling Growth to beat Value? It could happen, but it is unlikely in our view. Both in the U.S. and the world as a whole, an “output gap” exists; i.e., theoretical GNP exceeds actual GNP. This gap discourages attempts to raise prices. Moreover, global production costs are falling as manufacturing shifts to the Far East, particularly China placing additional downward pressure on prices. Demand growth from the consumer is stifled in the U.S. in part by substantial debt increases undertaken in the past five years by consumers, businesses, and now government entities. Combined with modest employment increases, a sharp increase in inflation would appear unlikely.

In other words, it is hard to envision an environment in which Value will not beat Growth over the next decade.