LIGHTHOUSE BEACON

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Have stocks hit bottom yet?

When It Happens, Market Rebound May Be Sudden & Fast

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For the first nine months of 2002, the primary sentiment moving the stock market has been simple, stark fear. The contrast couldn't be sharper from the overwhelming optimism -even greed- that marked the final days of the bull market in late 1999 and early 2000.

Both trends bring to mind the words of legendary investor Warren Buffet: "Be fearful when others are greedy and greedy when others are fearful." That pithy advice was appropriate for the first quarter of 2000 and may be equally appropriate as we look ahead to the coming weeks and months.

If you were invested in equities, you had very little to cheer about in the third quarter of 2002, with the major market indices all losing 17% or more, as the accompanying chart indicates. "Have stocks hit bottom yet?" was the question on everyone's mind, as the market averages dove lower and lower. We won't know the answer to the question until weeks after the market hits bottom and starts moving forward again.

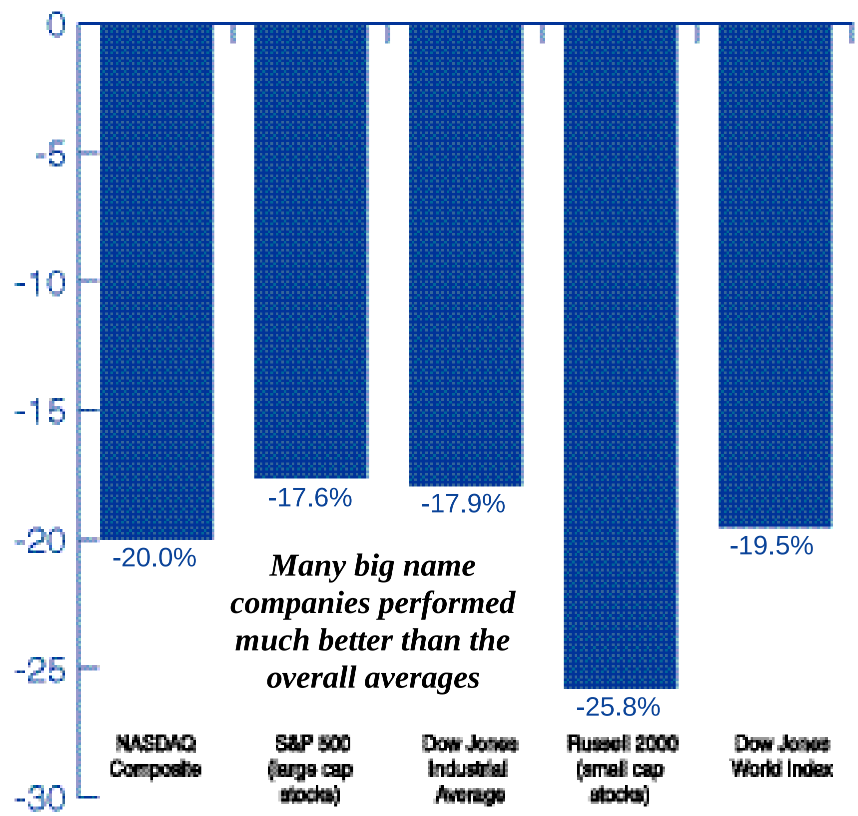
If history is any indication, investors don't want to miss the early stages of a market recovery, which can be very dramatic. Just look at what happened when the market hit an apparent low in late July of this year. The popular stock averages all rose by 25% or more in just a few weeks. Unfortunately, July was not the bottom and the market gave back all the gains later in the dismal third quarter.

During that quarter, record-level liquidations of stock mutual fund investments and the heightened fear of a war with Iraq added to the investor nervousness brought on by worries about corporate profitability, accounting scandals and violence in the Middle East.

Inconclusive economic reports only added to the uncertainty. Time and again, one report indicating an economic slowdown was followed by another study suggesting healthy growth. It seemed like everyone was looking back over their shoulders rather than forward, thinking about the long-term outlook. The financial

Focus on the Markets

Although the economy and corporate profits grew during the third quarter of 2002, stock prices continued to dive, with smaller cap stocks falling the hardest.



Index returns are for price only, and do not include reinvestment of dividends. Past performance is not a guarantee of future results.

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media was no exception, accentuating the negative and eliminating the positives.

Let's look at some of the positives, though. In August, sales of new homes rose to a record high, helped by the lowest mortgage rates seen in three decades. Also, in August, capital goods orders increased while unemployment actually dropped in both August and September. And, the economy -as measured by gross domestic product (GDP)- kept expanding. Total gross domestic product at the end of the second quarter of this year was $10.4 trillion. That's a 25% increase over the $8.3 trillion figure for the end of 1997. So, while the stock market averages were lower than they were five years ago, economic output had gained 25%!

Much of the attention has been focused on the consumer, whose spending accounts for two-thirds of the economy. Rarely in history has consumer spending actually decreased and there is little reason to believe it will now. As home prices continue to rise, total household wealth also is increasing, despite problems in the stock market. Home refinancings not only bring monthly mortgage payments down, they also are used to increase disposable income, which continues to rise.

Lighthouse Highlights

Selected Lighthouse Portfolio Holdings
Third Quarter 2002 Performance

Company	Sector	Price Change*
Johnson & Johnson	Healthcare	+3.5%
Amgen	Healthcare	-0.4%
Harley-Davidson	Consumer	-9.4%
Nokia	Telecom	-8.5%
Dell Computer	Technology	-10.0%
S&P 500		-17.6%
NASDAQ		-20.0%

** Price change only. Neither company nor index returns include any dividends. Performance of individual stock holdings in portfolios managed by Lighthouse Asset Management are not intended to indicate future results.*

Corporate earnings also are rising, even if not at the rates of the late 1990s. The rate of improvement in the third quarter was better than the second quarter. As we enter the fourth quarter, it will become easier for more and more corporations to show that they are growing their earnings faster than they did 12 months earlier. The stocks of many industry-leading companies held up much better than the overall market during the third quarter. The list includes not just blue chips such as Johnson & Johnson, GE, Wal-Mart, American Express, Dell Computer and Nokia, but smaller firms such as Medtronic, Harley-Davidson,Amgen, TJX and Starbucks. Even though many of these stocks have fallen recently, they still show a stability that points to a resilient faith by investors.

While many investors are demoralized, this is hardly the time to throw in the towel and give up on stocks. Many technical factors point to an approaching market bottom. We have, for example, extraordinary volatility in the market. One day's three-percent gain is followed by the following day's three-percent loss. Among other things, this indicates investors are looking for reasons to believe in stocks, but finding it hard to sustain their belief when another problem arises.

Stock prices peaked in March 2000 and have been declining since them. That means that we have gone through the most prolonged bear market in history -longer than either the start of the Great Depression in 1929-32 or the oil crisis of 1973-74. But the economy is growing, corporate profits are increasing and interest rates encourage economic activity.

While the short-term sentiment is negative, the long-term opportunities are positive. This is no time to be out of the market.

Lighthouse Guides

Q: After all the controversies about accounting practices, can we trust the earnings reports now coming out of corporations?

A: The scandals are resulting in some important reforms that should make Wall Street research much more credible.

You should be increasingly confident in these numbers. After all the controversies about Arthur Anderson, Enron, Tyco, WorldCom and others, corporate executives are being extraordinarily careful about the accuracy of the financial statements they release. Moreover, since August, a new Securities and Exchange Commission (SEC) rule requires that CEOs and CFOs personally attest to the accuracy of their statements.

The SEC, the Financial Accounting Standards Board (FASB) and even Congress are finding and fixing problems. And, thanks to aggressive prosecutors in New York and Texas, some former executives are taking "perp walks" and facing the real prospect of prison sentences.

People are going to jail for financial misstatements, and everyone is getting the message.

Lighthouse Guides is a regular column answering typical questions posed by clients discussing their portfolios.