

MJB ASSET MANAGEMENT LLC

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RICHARD BREGMAN, CFA, *Chief Executive Officer*

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Dear Clients and Friends:

You cannot step twice into the same river.

-- Plato, interpreting Greek philosopher Heraclitus

No two markets are the same; no two places in history are the same. All that goes into the markets -- economic conditions, political conditions, investor psychology, global events, etc. -- is constantly changing. The past is not certain to repeat, the future is unpredictable. Change is the only certainty, with its timing and magnitude not known until it occurs. Investors must confront this certainty when making investment decisions. Many continue to use methods that in some way rely on past data to "predict" future outcomes. By and large these efforts are futile, though at time they appear correct purely by coincidence.¹ At MJB Asset Management we do not limit ourselves to the view that the past will repeat itself. Nor do we speculate on the future. Rather, we base investment decisions on the present, i.e., on current observations of the investment environment. We call this "investing in the moment," and it frees us to take every day as it comes with the flexibility to adjust portfolios as current conditions warrant.

At this moment, the good times are ending for bond investors, and changes are in order for bond portfolios. Over the past three years, the bear market in stocks made bonds more attractive to many investors; the economic slowdown temporarily eliminated inflation as a threat to fixed interest rates; and geo-political uncertainty caused investors to seek the perceived safety of bonds. All of this combined to push U.S. Treasury prices to record highs ; interest rates, which move in the opposite direction of prices, dropped to record lows. But conditions are changing. Recent reports, while still mixed, are starting to show glimpses of improvement.² Washington has enacted tax cuts designed to further stimulate the economy. And the Federal Reserve, fearful of deflation, has announced it will keep short term interest rates low until

¹ Akin to the hypochondriac whose tombstone reads, "I told you so."

² Gross domestic product has improved. So have corporate earnings, though not yet across the board. And commodity prices have risen, indicating a pickup in industrial activity.

economic growth improves noticeably.³ Bond investors are now anticipating renewed economic growth, which they fear will lead to higher inflation and higher long term interest rates when the economy fully recovers.⁴ They are selling their low interest rate bonds, thereby pushing prices down and, by definition, interest rates up. As a result, owners of bonds and bond funds are at risk of losing principal; purchasers are at risk of locking into low interest rates.

We are working to minimize these risks for our fixed income clients by shifting portfolios into bonds that are less exposed to the dangers of inflation and rising interest rates,⁵ including (i) bonds with short maturities and (ii) for clients with longer time horizons and higher risk tolerances, high yield bonds that already have high interest rates and will benefit from an improving economy. For clients with individual bonds we are holding onto older bonds with higher interest payments. For new bonds, we are only purchasing corporate or municipal bonds with maturities of less than one year that, when held to maturity, will provide our clients with higher interest payments than they are currently receiving in money market funds. For clients with bond funds, we have moved to shorter maturities by taking profits from longer and intermediate term funds such as PIMCO Total Return and Loomis Sayles Bond, and redirecting the proceeds into shorter term funds such as PIMCO Low Duration Bond, PIMCO Short Term Bond and Vanguard Short Term Corporate Bond. For clients with a higher risk tolerance, we established positions in the PIMCO High Yield Bond and Vanguard High Yield Bond funds; we already have trimmed our positions slightly to take profits made in the first half of this year. We will maintain this posture in the bond market until we see an end to the increases in interest rates, at which time we will consider switching back into longer term bonds and bond funds.

The signs of economic improvement that have hurt the bond market have helped the stock market, as did the relatively quick end to “official” hostilities in Iraq. The three month period ending June 30th saw the Dow Jones Industrial Average climb 13.1%, the S&P 500 Index gain 15.4% and the NASDAQ index rise by 21.0%. While the ride upward has been welcome, it is not without peril, particularly given the mixed economic reports and sluggish economic activity. We are concerned that prices of many stocks have reached levels that do not reflect current economic fundamentals. Much of the improvement in corporate earnings has come through cost cutting as opposed to increased sales. Capital spending has not fully resumed in the face of continued excess capacity. Unemployment remains high. Consumer confidence remains fragile. As this point, we are maintaining our positions in the equity markets, but will wait to see evidence of sustained economic improvement before committing substantial amounts of new money to stocks.

For clients with individual equities we did not add any new positions during the past quarter. As stock prices rose, we took profits by selling portions of our holdings in McDonalds (up 52% in the quarter as investors rewarded management’s initiatives to cut costs and diversify the fast food giant’s menu away from burgers and fries), Xerox (+21% as the company continued its drive toward sustained profitability) and Walt Disney (+16% on improved advertising sales

³ The Fed controls short term rates; investors in the bond markets determine intermediate and long term rates.

⁴ We do not speculate on whether the bond market is right or wrong. We simply observe what bond investors are doing, determine the potential consequences of those acts and position ourselves accordingly.

⁵ As always, perspective is important. For investors living on a fixed income, higher rates can be a welcome development.

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and strong box office results for *Finding Nemo* and *Pirates of the Caribbean*). Client portfolios also benefited from strong gains in Ford (+46%), Bristol-Myers (+28%), Intel (+27%) and Clear Channel Communications (+25%). For clients with equity mutual funds, we continued to shift out of “growth” strategies into more conservative “value” strategies, in effect taking profits from the growth-oriented funds that rallied during the first half of the year and placing the proceeds in more conservative value funds that better protect principal. We also continued to increase positions in funds using alternative strategies with comparatively low correlations to the movements of the stock market. And given our concerns about the market, we reduced our positions in index funds that track the markets and re-positioned the proceeds into actively managed funds that focus on research and individual stock-picking.

We invest side by side with all of our clients at MJB Asset Management and are making the same adjustments to our portfolios. We will continue to stay focused in the present, making appropriate adjustments when we observe changes in the investment environment. In the meantime, we wish you an enjoyable remainder of the summer.

Thank you for investing with MJB Asset Management.

Sincerely,

Richard Bregman