

June 30, 2002

To our Clients:

As evidenced by the media hysterics over Martha Stewart's alleged insider trading activities, the financial markets remain focused on bad news and willfully ignorant of data signaling an economic upturn. With this in mind, we reiterate a key component of our investment philosophy that has been affirmed over the years: **stock prices follow earnings**.

Truly, earnings growth has been the missing cog in the economic machine, which for now is firing on only three of four cylinders: manufacturing activity has accelerated following excess inventory reduction, the service sector has gained upward momentum after paring back expenses, and the consumer remains ebullient thanks to a strong housing market. Earnings, meantime, have fallen for five consecutive quarters.

So when will corporate earnings pick up? As Federal Reserve Chairman Alan Greenspan said recently, **the economy is following a "classic" recovery path**, where increases in economic activity precede margin expansion and profit growth by several months.¹ If Mr. Greenspan is correct, earnings should begin growing again soon. Indeed, Standard & Poor's Corporation, the keeper of many widely-referenced stock market indices, expects operating profits for S&P 500 companies to rise nearly 18% in 2003, with earnings in the beaten-down technology segment projected up 70%.² Underscoring the upbeat tech forecast is the recognition that computer equipment bought in 1999 to stave off the "Y2K" bug is now obsolete and will eventually be replaced.

Though we think the above projections may prove too optimistic, we believe the general direction for earnings (up!) is correct. Our experience suggests that what we are now seeing -- improving economy, declining stock market, overreaction to marginally bad news -- is the final purge of the late, great bubble years. **The resumption of earnings growth, when it comes, should be the cure for the market's ills.**

We encourage investors to maintain their patience with these turbulent markets, as we believe a diversified portfolio of top-quality companies should benefit greatly from the modest but ongoing economic recovery. However, **many risks remain**: inflation in some industries, deflation in others; political and religious crises abroad; corporate accounting and ethics fiascos here at home. We have been increasing portfolio diversification to reduce industry-specific risk, moving toward less-volatile businesses for which there is higher confidence in the earnings outlook, and emphasizing dividends and interest income as a means to enhance total investment return.

On a separate note, we are pleased to announce our recent selection to the Schwab Advisor Network, an exclusive group of independent, fee-based investment managers that Charles Schwab & Co. recommends to its clients. Program members are screened to meet a broad set of criteria, with emphasis placed on the participating firms' objectivity. In this time of corporate chicanery and biased Wall Street research, we are quite proud that independence and objectivity have been Fulton Breakefield Broenniman hallmarks throughout our fifteen years as an investment advisory firm. We look forward to continuing this tradition in the better markets to come.

Sincerely yours,
Fulton Breakefield Broenniman, LLC

1. Reuters, May 9, 2002

2. Standard & Poor's, "Evaluating Corporate Earnings," May 31, 2002.