L M CAPITAL GROUP, LLC

Investment process:
Global macroeconomic / Fundamental

Total firm assets:
$1.92 billion

1ST QUARTER, 2004

US HIGH YIELD SECTOR OFFERS OPPORTUNITY IN LIGHT OF POSSIBLE INTEREST RATE HIKES

BY MICKEY CHRISTIAN, SENIOR VICE PRESIDENT

In a recovering economy, fixed income strategies attempt to avoid interest rate sensitive securities while increasing the exposure to high yielding securities and investment grade securities with intermediate maturities. High yield bonds tend to perform well during economic rebounds and historically are less sensitive to interest rate moves than US Treasuries and investment grade corporates of similar maturity. This makes US high yield an attractive sector to utilize in a Core Plus portfolio as part of a defensive strategy.

When considering an exposure to high yield bonds in a portion of the client's portfolio, LM Capital uses a strong fundamental approach focused on sector analysis and issuer cash flow analysis. High yield bond investments rely on a credit analysis very similar to that used in equity analysis because it is focused on the fundamentals of the company and the industry. The analysis takes into consideration such factors as liquidity, profitability, debt/equity rations and debt servicing capabilities; and such qualitative factors as an assessment of management, the industry environment, and accounting methodology. A well researched high yield security gives the client the following advantages:

Over the last 15 years, high yield bonds have yielded approximately 250 basis points over the same maturity US Treasuries.

Positive events in the economy, industry or issuing company can reward the investor with significant price appreciation. Rating upgrades, improved earning reports, mergers and acquisitions, positive product development or other market related events are likely to contribute to increased bond prices.

With such a high percentage of their return generated from current income, the high yield portion of the portfolio will be less affected by changes in interest rates.

As with any credit risk, LM Capital spreads the exposure among several issuers and industries. This reduces the risk of price declines or defaults caused by events unrelated to risk.

Well researched and diversified high yield bond positions fit perfectly in a client's portfolio while adding additional income to the portfolio. LM Capital uses them on an opportunistic basis as appropriate for each client’s investment policy.

Emerging Markets Economic Commentary

Luis Maizel, Senior Managing Director

The fourth quarter was extremely strong for the emerging market debt sector as the EMBI+ index toyed with a historically low 400 bp spread before settling just a tad above it.

There were no major crises except for the continuing battle between the Russian administration and the chairman of Yukos, Russia's largest oil company. The chairman was jailed for alleged tax evasion and this event put pressure on both the equity and the bond markets in Russia.

The flow of funds into emerging market debt slowed as money was attracted to global equities. As the markets perceive that US interest rates may begin an uptrend, the flow into traditional bond funds fell only to a trickle. The attractiveness of the Emerging Market Debt asset class has diminished slightly as the quest for higher yields continues and investors feel that the risk in emerging debt is smaller than in US high yield bonds.

More institutional investors are allocating funds into the asset class as their actuarial needs force them to seek higher returns within the established asset allocation framework determined by their consultants. The risk-reward ratio is favorable as the markets have stabilized and their performance, particularly in US dollar denominated issues, has become more predictable.

Argentina is still the ugly duckling. Two years have passed since they stopped paying their debt and there is no clear indication of a solution on the horizon. The fact that their economy is much improved stops creditors from making the huge concessions demanded by the government as their ability to service their extended debt improves every month.

Brazil is still a major surprise as its bonds are very strong in spite of some major conditions that could derail their economy. These factors include a large amount of debt maturing in 2004, inflation that has kept domestic interest rates at unacceptable levels, and a potential social crisis as the income differential between classes has become even more than before.

The big surprises in the sector have been Turkey and Ecuador, the prices of their issues now fully reflect the poor current conditions that both countries face.

The US economy posted a strong GDP growth rate of 4.1% for the 4th quarter, 2003 based upon preliminary data. This is a continuation of the very strong growth recorded in the 3rd quarter, 2003. As in the previous quarter, growth occurred without inflationary pressures or a significant strengthening of the employment picture; in other words, strong growth without inflation or job creation. The Federal Reserve continued to signal its determination to maintain low interest rates and the fixed income markets responded by maintaining a wide and volatile trading range that calmed down as we approached year-end. The clear signal from the Fed, despite the uproar over the change in the FOMC announcement language in January, is that interest rates will remain low until inflation pressures rise and excess capacity utilization is reduced well below current levels. However, many investors are focused on the employment picture as an indicator of consumer confidence and a source of inflationary pressure. Currently, market consensus does not expect any rate moves by the Fed until June at the earliest, and our Trend Identification Score remains in the neutral range.

The core portfolios were positioned at year-end with above average cash positions and maintained average duration and maturity characteristics relative to their respective benchmark. We continue to overweight the corporate sector, based upon relative value, and to underweight both US Treasuries and MBS securities. The adjustments have produced better results thus far in 2004. We now regard the economic recovery as sustainable through 2004 although the positive impact on the employment picture is uncertain. At some point, we fear the negative impact on the bond market of $500 million federal deficits and the resurgence of corporate issuance once capacity utilization limits create a need for increased capital investment. We are positioned for a continued trading range market, albeit with a downward bias. Market sentiment remains extremely volatile, switching almost weekly between the expectation of higher interest rates due to inflationary fears fueled by the economic recovery versus no rate hike through year-end 2004 because of lowered consumer confidence related to the poor employment picture.

LM Capital group receives over $600 million in new assets

LM Capital Group is pleased to announce the addition of two new client relationships and the award of additional assets from an existing client. Most recently, LM Capital was selected by the Teachers Retirement System of Illinois to manage $180 million in a Core Portfolio; additionally, the Plaza de Cultura y Arte Foundation chose LM Capital to manage a $7 million Short Term portfolio. Finally, Los Angeles County Employees Retirement Association (LACERA) awarded LM Capital Group an additional $450 million in the Opportunistic Core Portfolio bringing their total allocation to $510 million.

"We are very excited to have the opportunity to work with the Teachers Retirement System of Illinois and their talented staff, and we couldn't be happier," stated John Chalker, Managing Director. "The award from the Plaza de Cultura y Arte Foundation marks our desire to work with Foundation and Endowment clients and to manage money for a non-profit organization as part of our community relations efforts.

Regarding the new assets from LACERA, "We are extremely pleased that LACERA has elected to increase their investment in our Opportunistic Core strategy" said Luis Maizel, Senior Managing Director. "Initially, our firm was selected in 2001 under their Emerging Manager Program, and due to the success of our investment process and overall performance, we are very proud to have earned the distinction of becoming a mainstream investment manager for LACERA."

"Led by Luis Maizel and John Chalker, LM Capital has one of the most knowledgeable and insightful groups of investment professionals who have generated an impressive performance and track record for LACERA" said Juan Almaguer, principal investment officer with LACERA. "Our board of investments has been very impressed with the LM Capital team, which led to our decision to select their firm to manage this investment".

The firm is well positioned with the necessary people and systems to offer institutional investors successful, long-term fixed income investment strategies and portfolio management services. Although 2003 has been a tumultuous year in the fixed income marketplace, LM Capital has continued to provide strong results for our clients. We are pleased to announce the addition of new assets from three existing clients: the San Diego Metropolitan Transit Development Board, Coca-Cola Enterprises and Shell Oil Company.

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