



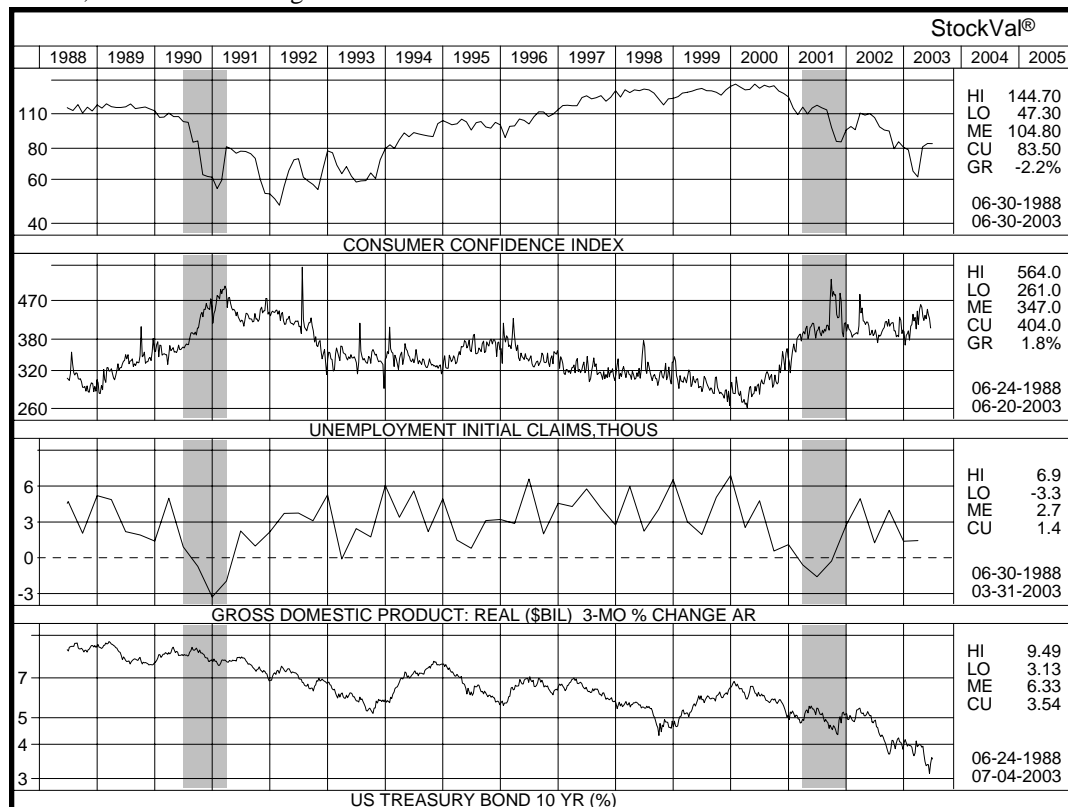
The economy continued to improve in the second quarter, albeit at a fairly slow pace. Many of the statistics reported during the quarter were better than expected, which was a

welcome relief.

Consumers became more positive about economic conditions, as seen by the Consumer Confidence Index and the Michigan Consumer Sentiment Index. From the graph below, notice the upward move from approximately 60.0 to a current value of 83.5. The expectations part of this survey, which is much more of a leading indicator, was also advancing.

by leaps and bounds, growth is evident in the Gross Domestic Product (GDP) number. This is a very volatile series, but one can see the advances from the recent recession lows of 2001. Annualized growth for the first quarter of 2003 was 1.4%.

Interest rates continued to decline in the second quarter, following the 13th rate cut by the Fed. On June 25th, the Fed lowered the Fed Funds rate 25 basis point to 1.00%. They left the door open for another cut next quarter by not dropping the Fed Funds rate by 50 basis points. Lower rates help consumers to refinance their homes, but hurt investors living off fixed incomes.



Additionally, employment figures showed improvement by the end of the second quarter. Initial jobless claims declined to 404,000, which is an enhancement from the previous release. A reduction significantly below the 400,000 mark would be a welcome move.

Although the economy is not growing

Although the economy looked better at the end of the second quarter, we are not yet out of the woods. In the beginning of July, jobless claims increased to 430,000 and the unemployment rate rose to 6.4%. Also, 1st quarter GDP was revised downward from 1.9% to 1.4% in June.

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## Second Quarter Results

After a disappointing first quarter, second quarter performance exceeded most expectations. The S&P 500 Index increased 15.4%, which was the largest advance since the fourth quarter of 1998. The Dow Jones

Industrial Average increased 13.1%, while the NASDAQ lead the charge with a gain of 21%.

It was evident that many investors became too risk averse during the first part of the year. What held the market back in the first quarter helped spur it on in the second quarter. With an end in sight to the conflict in Iraq, the equity market began advancing. The roadmap that the stock market tracked in 1991 was followed almost to a “T” this time around. The gains in stocks began as the war progressed, and picked up steam after a victory was declared.

Additionally, The Jobs and Growth Tax Relief and Reconciliation Act of 2003 helped to boost stock prices. The Bush administration believes that this plan will continue to fuel consumer spending and create much-needed jobs. The market seemed to agree and bid up stock prices accordingly. Also, the recurring “second half recovery” theme was played again, which got investors eager to take part in a rally.

Other factors moving equity prices higher in the second quarter was anticipation of lower energy prices and improved quarterly results. The oil supply was expected to increase after Iraq came back on-line, which would lead to lower prices at the pump. However, this did not come to fruition during the second quarter. Companies continued to report better results, but revenue growth continued to lag earnings growth. Bottom line improvements came mainly from cost cutting.

Leading the way to higher index values were the biotech and technology sectors. The smaller companies in these groups performed the best. Some beaten-down technology shares more than doubled during the second quarter rally. This led some to question the significant move in stock prices.

S&P Economic Sector	2nd Qtr Returns	Index	2nd Qtr Returns
Cons.Discretionary	18.8%	Dow Jones	13.1%
Consumer Staples	8.5%	S&P 500	15.4%
Energy	6.4%	NASDAQ	21.0%
Financial	17.8%	Russell 2000	23.4%
Health Care	9.6%	<b>Calendar</b>	
Industrial	15.3%	<b>2002 Returns</b>	
InfoTechnologies	18.0%	Dow Jones	-16.8%
Materials	13.0%	S&P 500	-23.4%
Telecomm	20.4%	NASDAQ	-31.5%
Utilities	20.1%	Russell 2000	-21.0%

## Investment Style Performance

It was a strong quarter across the board as investors drove nearly all styles and market caps higher. Many of the beaten down areas of the market experienced a welcome boost that led to solid gains. Small-cap stocks were the best performers, as investors increased their appetite for risk and short covering took place in companies with weaker fundamentals. Small-cap growth stocks turned in a handsome gain of 22.2%, outpacing large-cap growth stock gains of 13.3%. Investors craving higher dividend paying stocks, due to the new tax laws, sent large-cap value stocks higher by more than 16%. Overall, it was very welcome relief from that past few years as stocks in all areas of the market appeared to be on more solid footing.

Moving forward, investors will need to become more selective and sort out which companies can actually sustain their current valuations. The strong movement upward exhibited over the past few months will probably taper down and only those companies that can truly prove that their fundamentals are improving will be able to perform for the remainder of the year. Value stocks with high dividend payouts should continue to hold their value and achieve solid performance in the coming years. These also tend to be companies that have solid balance sheets and plenty of cash flow, so their dividend payout is not in jeopardy. The companies actually have the potential to increase their dividends as the economy expands. We continue to participate in all areas of the market and use a variety of mutual funds and I-Shares to gain exposure to small-cap, while achieving large-cap and mid-cap exposure through individual stock selection.

	2nd Qtr 2003 Returns			YTD Returns		
	Growth	Core	Value	Growth	Core	Value
Lipper						
Largecap	13.3%	14.1%	16.8%	12.3%	10.4%	10.8%
Multicap	17.0%	15.9%	17.9%	16.3%	12.0%	12.3%
Midcap	17.7%	18.0%	20.1%	15.8%	13.7%	14.3%
Smallcap	22.2%	21.4%	21.5%	17.5%	15.6%	14.2%

## Expectations for 3<sup>rd</sup> Quarter

As you are probably aware, the stock market is a discounting mechanism. Stocks anticipate changes in the economy and company earnings approximately 12 months out, and move accordingly. The equity market is forecasting increases in corporate profits later in 2003, so buyers began putting excess cash to work. The \$100K question at this point is did we move too far, too fast? Many feel that there needs to be a marked improvement in fundamentals to support current stock prices. If this doesn't occur, we could experience a pullback in equities.

Some arguments supporting the continued move upward in stock prices are sideline cash and relative valuation. In an attempt to shield themselves from further erosion of principal over

the last several years, many investors moved capital out of equities and into money market funds. Some estimate that there are many trillions of dollars in cash right now, waiting to be invested. If individual investors feel they are missing a rally, money will continue to move into stocks.

Moreover, stocks are certainly cheaper than other asset classes. For example, using a derivation of the Fed Model, the S&P 500 has a forward price to earnings multiple of 18X. If the 10-year Treasury bond is put on a “PE” basis, it’s multiple is 30X. Although stocks may not necessarily be cheap on an absolute basis, they are better values than most bonds. Also, Real Estate has also done very well, but may not be the best investment at current levels.

In general, PacWest believes in investing on a stock-by-stock basis. Although stocks as a whole are a bit overextended, some are selling for compelling valuations. We will continue to put cash to work in these stocks, and wait for a pullback in others. We have some excess cash in portfolios and will continue to until stocks get more reasonably priced. During periods of emotion and momentum, disciplined investing is always the best approach.

The following table compares PacWest’s current weightings with those of the S&P 500 Index:

Sector	PacWest %	S&P 500%
	06/30/03	06/30/03
Cons. Discretionary	15.0%	11.1%
Consumer Staples	12.0%	11.7%
Energy	5.0%	5.8%
Financial	15.0%	20.5%
Healthcare	13.0%	14.8%
Industrials	15.0%	10.4%
Information Technology	8.0%	16.2%
Materials	6.0%	2.7%
Telecom Services	2.0%	3.9%
Utilities	5.0%	3.0%
REITs	4.0%	—

**Dividend Debate- A Bird in the Hand...**

There has long been a dividend debate that seems fitting to discuss right now. Prior to the 1960’s, dividend policy was thought to play an important role in determining firm

value. The thinking was that it is better to get dividends now than to wait for capital gains that might never come. Those companies that paid a dividend were more highly regarded than those that did not. In 1961, Miller and Modigliani published a paper on dividend theory. From this work came the MM dividend irrelevance theory. It states that a company’s dividend policy shouldn’t have an effect on firm value.

Although dividends shouldn’t impact company value, they certainly are highly regarded right now. With the recent tax relief package, more and more companies are deciding to pay a dividend or boost their current payout percentage. Because of the lower dividend tax rates, investors are flocking to high yielding common stocks. In turn, companies are paying out excess cash on their balance sheets to shareholders.

PacWest has always managed accounts on a total return basis. We look for stocks that have growth potential, but income is also very important to many of our clients. Therefore, dividend-paying stocks comprise a high percentage of our clients’ equity allocation.

**Financial Planning Corner- Stretch IRA**

A Stretch IRA is a traditional IRA or Roth IRA that has language giving the beneficiary the option to take distributions from an inherited IRA over the beneficiary’s life expectancy. Although it sounds like a new type of IRA, it is not. It is simply a method of increasing the period of time that the funds can stay in the IRA after the owner dies. Hence, the IRA is “stretched out.” Since earnings grow tax deferred, this is a terrific way for the beneficiary to accumulate wealth. It is possible to stretch out the IRA over multiple generations. Other names for similar products are legacy IRA, multigenerational IRA, extended IRA, and super IRA.

How long funds can stay in a tax-deferred IRA is limited by the required minimum distribution (RMD) rules. The federal government requires you to withdraw annually from a traditional IRA after you reach 70 1/2. The purpose of these rules is to ensure that people do not use retirement accounts simply as a vehicle to transfer wealth. All IRAs are subject to RMD rules, even after the death of the owner. If the beneficiary of the IRA is someone other than the spouse, the beneficiary can normally take distributions based on their own life expectancy.

It is important that the terminology in the IRA documents allows for a stretch-out. The agreement should provide for post-death distributions based on life expectancy of your beneficiary and determine whether your beneficiary is able to name his or her own beneficiary. Make sure that your IRA allows the beneficiary to stretch out the required minimum distributions. If they do not, the beneficiary can still accomplish this by transferring the inherited IRA to a new account at another institution. It would be in the name of the deceased owner, “for the benefit of” the beneficiary, clearly stating that the account is an IRA. Also, make sure your beneficiary names a successor beneficiary. This is needed in case the beneficiary dies a few years after they inherit your IRA.

For questions on this, please call your portfolio manager or financial institution.

## Fixed Income Markets

There is a tug of war in the fixed income market. Will interest rates stay at their 45-year lows or will they start an upward trend? Interest rates have been rising since the 13<sup>th</sup> rate cut by the Fed at the end of June, which dropped the fed funds rate to 1%. The ten-year Treasury note's yield increased from 3.07% in the middle of June to over 3.7% on July 7.

The arguments for higher rates include optimism of the American public, as 45% of people polled in the middle of June felt the economy was improving. This compares with 23% in March. Also, The Fed seems more upbeat on growth, meaning that it is still concerned with inflation. Lastly, money has been flowing from bonds to stocks, reducing demand for bonds. Lower bond prices means higher yields.

A case can also be made for low interest rates. With the decline in household wealth because of the bear market in stocks, the aging baby boomers have to save more for retirement. The excess capital needs to be invested. It is important to have low interest rates to entice investments by businesses. Otherwise, this will further slow down our economy and increase the probability of deflation. Finally, there is excess capacity on a global basis that can absorb any pickup in economic activity. This will reduce the pressure to increase the cost of money.

At Pacwest, we do not see interest rates rising significantly in the near future. In addition to the reasons mentioned previously, the following factors will also dampen the rise in interest rates. Two hundred billion dollars of refinancing took place since 2001. Most of those dollars were spent by the consumers and they leveraged their balance sheets further. Many corporate balance sheets are debt-laden also. A rising rate environment will create additional risk in the economy. Moreover, manufacturing jobs have also been shrinking for 33

consecutive months. The economy is too fragile to accommodate significantly higher interest rate. The Fed is willing to ease further (not much room left) to prevent the economy from hitting another recession.

Where do we find value in the bond market? In previous quarters the high yield bonds and the emerging market bonds were very cheap in relationship to US treasuries. The default risk has been reduced and downgrades of bond ratings have declined. But we consider those credits too speculative. In the investment grade arena, we are purchasing preferred stocks, callable government agencies with longer call protection and tax free bonds. We find municipals particularly attractive because they yield almost as much as US treasuries and are tax-free. The reduction in taxes on dividend and income as well as concerns over the financial health on municipalities have created value in municipal bonds.

US Treasury Yield Table

Source : Bloomberg

	3 mo	6 mo	2 yr	5 yr	10 yr	30 yr
12/31/01	1.72	1.81	3.14	4.41	5.09	5.54
12/31/02	1.19	1.22	1.56	2.7	3.78	4.74
3/31/03	1.11	1.10	1.49	2.73	3.83	4.86
7/7/03	0.85	0.93	1.12	2.58	3.74	4.74



## International Markets

With the appetite for risk increasing in the second quarter, international stocks and emerging markets turned in some spectacular gains. Some of the countries that have been hit the hardest by political and economic turmoil were the ones to produce the highest returns. Argentina, with some signs that their economy is now growing for the first time in over four years, tacked on gains of 35%. U.S.-based returns were once again aided by the weak dollar. The Dow Jones index for the U.K. was up 13% in local currency, but in U.S.-based currency rose over 18%. Venezuela, which has seen their share of political and economic problems, soared nearly 95% in the quarter. As the U.S. market rewarded the companies that have been beaten down the most, the international markets awarded stellar gains to the countries with the most problems.

With SARS being on the minds of everyone living or visiting Asia, some of the weaker worldwide returns came from those markets. While still positive, Hong Kong's return of approximately 10% was one of the lower returns in the international arena. Later in the quarter, as SARS appeared to be under control, the markets regained some of their ground. No new cases have been reported since June 15 and it appears that the economic fallout will be somewhat muted going forward.

We continue to add to international mutual funds to gain diversification and provide currency based enhanced returns. While some international markets may not experience an upturn in their economy before the U.S., the valuations are somewhat more attractive than the U.S. stock market.