Sanwa Bank California

WEALTH MANAGEMENT Investment *UPDATE*

Summer 2000 **First Edition**

MARKET REVIEW

By the end of June, U.S. stocks had recovered some, but not all, of the losses they registered earlier in the second quarter. For the first six months of the year, mid-cap equity issues turned in the best performance, rising 8.8%. Smaller capitalization stocks followed with 4.7%. Both the large-cap and mega-cap segments of the market remained negative at mid-year, with returns of -0.4% and -2.3% respectively. All of these segments outperformed the volatile NASDAQ Composite, which finished the first half of the year with a return of -2.5%.

Investment grade bonds, as measured by the Lehman Aggregate, returned 3.99% over the same time period. Spreads between agencies and Treasuries widened sharply early in the second quarter, but returned to previous levels by quarter-end. As for the municipal market, yields on five-year AAA general obligation issues dropped to 4.80% at the end of June from 5.11% a month earlier.

Global markets rebounded in June. Japan, for example, registered an impressive gain of 6.9% for the month. Nevertheless, through mid-year, every major international index remained negative. Leading among mid-year decliners was Great Britain, which lost 11.7% over the period.

A Profile of Wealth Management's Chief Investment Officer

As senior vice president and chief investment officer, Bob Bannon oversees the investment strategy and portfolio management of Sanwa Investment Management's $3 billion in managed assets. As head of Sanwa's Investment Management Department, Mr. Bannon supervises a team of more than a dozen investment professionals, and oversees all of Sanwa's external investment management relationships. Under his direction, the Sanwa Investment Management team implements a unique style of quantitative investing for its clients.

Mr. Bannon has 13 years experience in the investment management field. Before joining Sanwa, he was managing director of Analytic Investors, Inc., where he was responsible for a broad array of functions, including research, product management, and client servicing. Prior to joining Analytic, he also worked for I.D.E.A. in New York, developing fixed income trading strategies, and for Security Pacific National Bank, as a financial economist.

Mr. Bannon is a Chartered Financial Analyst, and has a graduate degree in econometrics and financial economics from UCLA, as well as an undergraduate degree in economics from Villanova University. He has taught on the faculties of the University of California and Pepperdine University.

Strategy Outlook

Equities

We continue to find the outlook for U.S. equities favorable compared to that for cash equivalents, though we were less bullish on stocks entering July than we had been previously. The main factor for this moderation in our positive appraisal of stocks was the increase in short-term interest rates.

In the current environment, according to our quantitative analytical framework, equity markets are especially sensitive to short-term rate hikes. Higher interest rates typically dampen prospects for stocks since it is more expensive for companies to finance their activities. Additionally, as short-term rates rise, cash equivalents grow more attractive relative to a riskier asset like stocks. Therefore, at the beginning of July, our forecast continued to favor stocks over bonds and cash, though our outlook was less bullish than it was a month earlier.

Even though the increase in short-term rates has been a major determinant in our equity market outlook, our approach employs a variety of quantitative measures. Some of these are value-oriented factors designed to search the universe of available securities for underpriced issues. Others assess prospects for growth, while still others evaluate price momentum and other technical aspects of the markets.

Early in July our outlook was largely influenced by these technical factors, specifically a combination of long-term price momentum and short-term price reversals among the issues in our stock universe. Simply stated, at the beginning of July we expected stocks that (a) had performed well over the preceding twelve months and (b) had done relatively poorly over the most recent three months to reverse this short-term price decline and begin outperforming the benchmark market index.

These same factors also led us to expect weaker relative performance from stocks that had experienced sharp price increases in recent months and yet lacked a favorable longer term performance record. Consequently, early in the month our list of highly rated stocks included well-known technology issues that had turned in lackluster returns in recent months, but now were expected to resume their longer term outperformance of the benchmark index.

A favorable outlook for some technology stocks does not mean that we will significantly overweight the technology industry in our portfolios. In fact, a key risk management characteristic of our approach is to keep portfolio industry exposures extremely close to industry weightings in the benchmark index. For example, we strive to select only the best technology stocks in the technology sector, but we do not significantly overweight the portfolio's exposure to the technology industry in general.

Bonds

Our outlook for bonds did change significantly in early July. In contrast to our forecasts earlier in the second quarter, we reversed our bearish stance on bonds relative to cash. Our most recent analysis, updated early this month, called for bonds to outperform cash equivalents by some 46 basis points during the month of July.

The factor mainly responsible for this reversal in our bond outlook was the recent softening in commodity prices. In the context of our quantitative framework, a drop in commodity prices is usually favorable to bonds because it indicates an easing of inflationary pressures. Inflation drives down the value of fixed income securities.

As with several other factors in our framework, the impact of commodity price changes on our bond outlook depends on whether we are in a high-growth or low-growth environment. In the recent and continuing high-growth economic environment, our analysis shows bonds to be particularly sensitive to changes in commodity prices.

Domestic Asset Allocation

As the illustration on the final page of this update indicates, we continue to overweight equities modestly in client portfolios, relative to the normal, or neutral, benchmark allocation. However, as the previous summary suggests, the degree of equity exposure has not increased from last month. Across all five investment objectives — capital preservation, income, balanced, growth, and aggressive growth — recommended equity exposure in July remained only two to three percent above the normal allocation.

The most significant shift in our active asset allocation recommendations for July was from cash equivalents to bonds. July's more favorable assessment of bonds relative to cash equivalents translated into changes in recommended asset mix. For example, a portfolio with an investment objective of "Growth" has a neutral asset allocation of 70% stocks/30% bonds. In June, the recommended mix was 72% stocks/20% bonds/8% cash. In July, cash exposure was cut to 0% across the board. For clients with a "Growth" objective, the July analysis resulted in a recommended allocation of 72% stocks/28% bonds.

Global Asset Allocation

Our global asset allocation analysis was bullish on both U.S. and British equities as well as bonds. As a result, previous allocations to cash were shifted to equity and fixed income positions in these two markets. Since Germany and Japan, the two other major markets included in our global asset allocation discipline, were expected to underperform cash equivalents in July, recommended allocations to these countries were reduced or held constant. We continued our bullish stance on the U.S. dollar in July, and therefore recommended that all foreign currency positions be hedged back to the dollar.

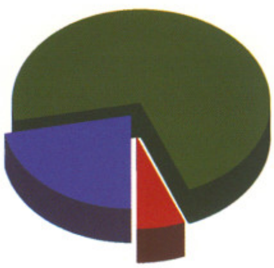
Asset Allocation by Investment Objective

as of June 30, 2000

The figures below illustrate the difference, if any, between the established neutral asset mix and the current recommended mix for five portfolios, each of which has a different long-term risk/return objective. If our quantitative analysis shows that one asset class — stocks, for example — is more attractive than others, the mix is shifted to reflect that finding. If no asset class is significantly more attractive than the others, we hold the portfolio mix at its neutral, or benchmark, allocation. Our most aggressive portfolio has maximized its cash position at 10%.

Objective:
Capital Preservation

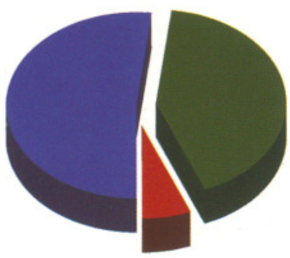
CURRENT:
22% Stocks
72% Bonds
6% Cash

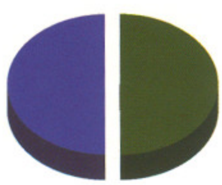


20% Stocks
80% Bonds
0% Cash

Objective:
Income

CURRENT:
52% Stocks
42% Bonds
6% Cash

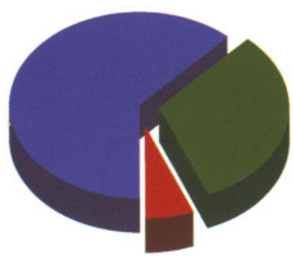


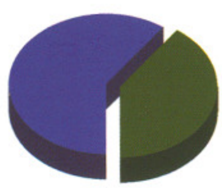


50% Stocks
50% Bonds
0% Cash

Objective:
Balanced

CURRENT:
62% Stocks
32% Bonds
6% Cash

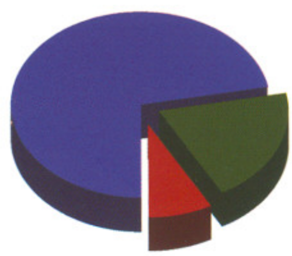


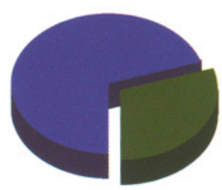


60% Stocks
40% Bonds
0% Cash

Objective:
Growth

CURRENT:
72% Stocks
20% Bonds
8% Cash

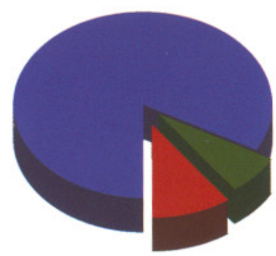




70% Stocks
30% Bonds
0% Cash

Objective:
Aggressive Growth

CURRENT:
83% Stocks
7% Bonds
10% Cash



80% Stocks
20% Bonds
0% Cash

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California

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