



YANNI
PARTNERS

MEASURING UP

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DELIVERING
THE PROMISE

IN THIS
ISSUE

A recap of domestic and international stocks and bonds.

Lessons Learned: Troubled Markets in the Year 2001

Investors in the capital markets endured a turbulent ride throughout 2001. A deepening recession, eleven Fed rate cuts, and the most deadly one-day attack on U.S. soil, leading to a war on terrorism,

created a market environment in which only the most defensive of investors avoided losses. The lessons of event-driven risk, diversification, and the inherent limitations of economic forecasting all became apparent.

The terrorist attacks on September 11 took their toll physically, emotionally, and financially.

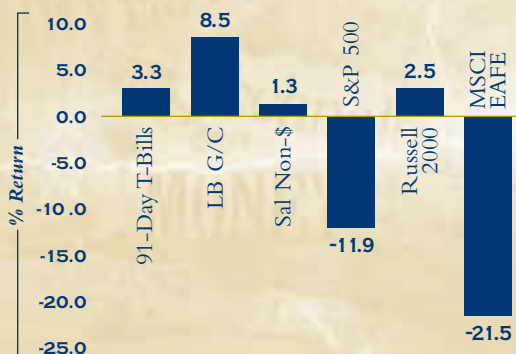
Americans as a people will no longer be able to

enjoy the sense of security and relative safety that they once did. Similarly, because of the shock to the markets subsequent to the attacks, investors will no longer be able to ignore event-driven risk in the markets. Analysts will be sorting out for some

time to come the increased risk premium demanded by investors due to our heightened awareness of catastrophic possibilities.

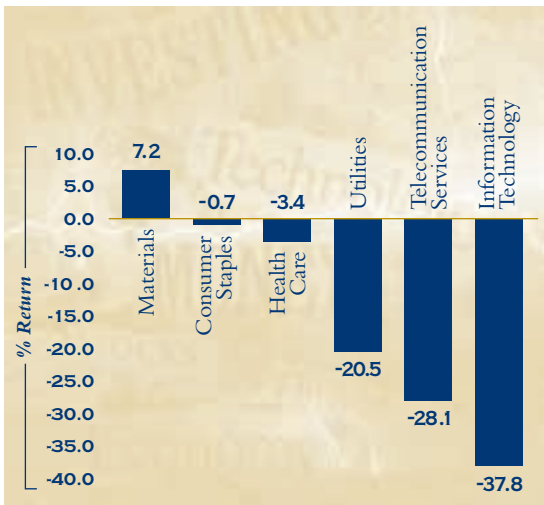
Whereas many investors in the late 1990s reaped the benefits of the strong performance of the domestic equity growth sector, the past year exposed the risks of investing too heavily in any one market segment. In 2001, the investor whose holdings included all asset classes – equity, including large-cap and small-cap, domestic and international, and fixed-income – was well positioned to avoid the severe losses found in certain individual asset classes. For example, while the large-cap segment of domestic equities lost 11.9%, the investor who diversified just to domestic bonds by allocating 60% to large-cap stocks and 40% to intermediate-term fixed-income would have lost 3.4% of portfolio value. Because it is virtually impossible to predict what asset class will outperform, and when, investors have learned that the best course of action is to optimally diversify their portfolios.

FIGURE ONE
2001 Performance:
Major Market Indices



Throughout the year, economists endeavored to answer the questions that all investors wanted to have answered. The short-term future state of the

FIGURE TWO
Best and Worst of 2001: Domestic Equity Sectors



economy was up for debate. After the numbers were crunched, the data was analyzed, and the forecasts were published, the experts could not agree on whether the economy was headed for recession, how long a recession might last, or what shape the recovery might take. It became clear to

observers once again, that despite the accuracy of the inputs and the soundness of the process, the usefulness of economic models was limited.

Major Market Returns

Returns for the broad-market indices are displayed in *Figure One*. Three-month T-Bills returned 3.3% for the 2001 calendar year. Bonds, as measured by the Lehman Brothers Government/Credit (LB G/C) Bond Index, were up 8.5%. Foreign bonds

returned 1.3%, as measured by the Salomon Non-Dollar Government (Sal Non-\$) Index. Large-cap U.S. stocks, as reflected by the Standard & Poor's 500 (S&P 500) Index, declined 11.9%. Small-cap stocks, represented by the

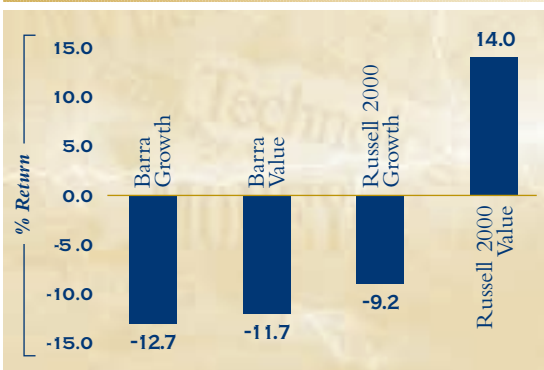
Russell 2000 Index, were up 2.5%. International equities, as measured by the Morgan Stanley Capital International Europe Australia and Far East (MSCI EAFE) Index, returned -21.5%.

Domestic Stocks

The 11.9% drop in the S&P 500 was the index's worst calendar year market decline since 1974. Combined with the 9.1% loss in value for 2000, the large-capitalization sector of domestic equities is now off 19.9% over the past twenty-four month period. The best performing S&P sectors for 2001 were Materials, Consumer Staples, and Health Care (see *Figure Two*). Materials, the only positively performing sector, was up 7.2%, while Consumer Staples and Health Care lost 0.7% and 3.4%, respectively. The worst performing sectors were Information Technology, Telecommunication Services, and Utilities, declining in value 37.8%, 28.1%, and 20.5%, respectively. The NASDAQ Composite Index, whose performance is highly correlated with the technology sector, declined in value 21.1%, this coming after a dismal 39.3% drop in 2000. Small companies, perhaps because they were able to act in a more nimble manner than larger companies in a slowing economy, provided the bright spot for domestic stocks. The Russell 2000 Index, a proxy for small-cap stocks, returned a positive 2.5% on the year.

The value style of domestic equity investing outpaced the growth style in 2001 (see *Figure Three*). However, the difference in the styles was far less dramatic in the large-cap sector than it was for small-cap stocks. Across large-cap stocks, the S&P/Barra Value Index declined 11.7%, while the S&P/Barra Growth Index lost 12.7%. The divergence among small-cap style returns turned out to be a 23.2% spread, as the Russell 2000 Value Index gained 14.0% and the Russell 2000 Growth Index lost 9.2%.

FIGURE THREE
2001 Performance: Domestic Equity Market Indices



Domestic Bonds

Fixed-income securities outperformed equities for the second straight year. Analysts cite several interrelated reasons for this phenomenon: eleven Federal Reserve Board interest rate cuts; capital flow away from struggling equity markets; a weakened economy; and political unease. The yield curve began 2001 in the inverted position (see Figure Four), reflecting investors' bearish mood on the economy. The inverted nature of the curve indicates that shorter-term fixed-income maturities were at a higher yield than longer-term maturities. While the yield on 30-year Treasuries remained nearly fixed throughout the year, the Fed's rate-cutting program lowered shorter-term Treasuries dramatically by year end. The year concluded with the more common upward-sloping yield curve, but steeper than usual.

Investors in domestic fixed-income securities came away from 2001 with positive returns across the board. The Lehman Brothers Government Credit Index (LB G/C) and the Lehman Brothers Government Credit Intermediate Index (LB G/C I) returned 8.5% and 9.0%, respectively. Longer-term bonds lagged the shorter issues as the Lehman Brothers Long Government Credit Index (LB G/C Long) rose 7.3%. The First Boston High Yield Index (FB HighYield), representing the lower quality, high-yield issues, returned 5.8%. The Merrill Lynch One-Three Year Government (ML 1-3) Index, a proxy for short maturity, high quality issues, increased in value 8.3% for the year, and T-Bills returned 3.3% (see Figure Five).

International Stocks and Bonds

The international markets struggled greatly in 2001 as witnessed by the 21.5% decline of the MSCI EAFE Index. The economies of the United States, Europe, and Japan all exhibited contraction at the same time, something that has not happened in

more than two decades. The under-performance of the European economy, in particular, was the most surprising to many analysts. The size and strength of the economically unified Europe were not enough to keep the continent immune

from the troubles of the U.S. The continuing problems in Japan were many and great. Unemployment rose, loan defaults mounted, and bankruptcies hit a near record pace as Japan continued to suffer through its worse recession in over fifty years. Argentina, experiencing financial crisis and political upheaval for much of 2001, was the big story in Latin America. Mexico, benefitting from its increased trade with the U.S., was the lone country in the Americas whose markets saw positive performance for the year.

International bonds, as measured by the Salomon Non-Dollar Government Index, posted a 1.3% gain. Emerging Markets bonds, as measured by the J.P. Morgan Emerging Market Bond Index, lost 0.8% of its value. Argentina, however, was a large, negative outlier in this sector. All other country components in the index saw strong performance, ranging from a positive 5.5% in Venezuela to 55.8% in Russia.

FIGURE FOUR
Year-End Comparison
Yield Curve Structures

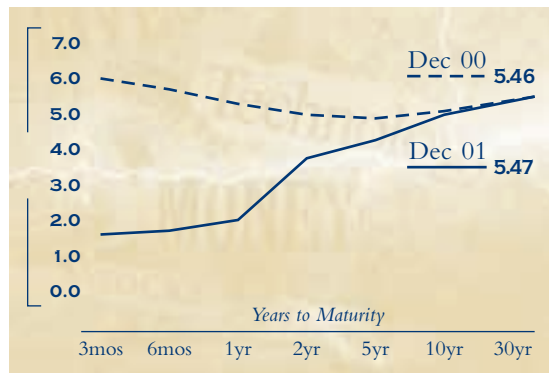
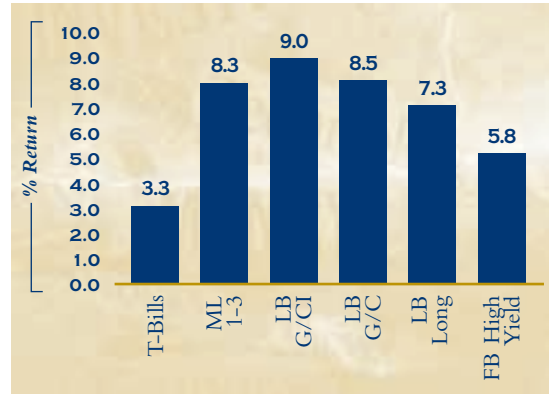


FIGURE FIVE
2001 Performance: Domestic
Fixed-Income Markets Indices



MEASURING UP

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On the Move

Yanni Partners and Yanni & Company Investment Advisors recently moved their office locations due to the growth and spatial needs of each firm. For those of you who may be unfamiliar with the difference between the two organizations, Yanni Partners is an institutional investment consultant with health care clients, corporations, endowments, foundations, Taft-Hartley, and public funds. Yanni Partners provides a full array of investment consulting services, such as analyzing past performance, establishing goals and objectives, assisting in the selection of investment managers, and monitoring ongoing performance. The firm also maintains a proprietary database known as

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GRID® (Graphical Ranking of Investment Descriptors). Yanni Partners has a staff of thirty-two individuals.

Yanni & Company Investment Advisors is a separate entity from Yanni Partners. This firm is dedicated to providing investment advisory services to high net worth individuals and smaller retirement plans. Typically, they use no-load mutual funds for their client portfolios. Yanni & Company Investment Advisors employs a staff of seven individuals. The new addresses for each firm are listed below. Please adjust your address records accordingly.

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Calendar of Events



Yanni Partners provides a full range of consulting services vital to the management of various portfolios. Our ultimate goal is to offer a basis for improved investment monitoring and performance.

Yanni Partners is registered as an investment advisor and as an NASD registered broker/dealer. Yanni Partners is also a member of the Securities Investors Protections Corporation (SIPC).