



MANCHESTER CAPITAL MANAGEMENT LLC

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Summer trading sessions have seen a sustained rally in equities.

Market Outlook

Driven by evidence of renewed economic growth, the stock market advanced through the summer. The S&P 500 index was up 15.9% year-to-date (as of the end of August), out-performing the bond market, which was up 1.1% as measured by Lehman Bros U.S. Aggregate Index. Market timing investors who ran to bonds during the stock market weakness were left on the sidelines. Part of the sustained summer rally in stock prices was caused by their efforts to catch up by re-balancing their portfolios back to equities.

On the traditional measures of price to earnings (P/E), price to book (P/B), and price to sales (P/S), the stock market is currently richly priced with each indicator above its historic trend line. While we watch these numbers carefully and recognize they create constraints on long-term rates of return, we expect stocks to hold on to their gains into next year as politicians stoke the economic fires in an election year.

The third and fourth quarter earnings periods are expected to show increasingly strong EPS growth. Bonds may retreat a bit, particularly if the jobs situation starts to improve. For an early signal of the direction of both bond and stock markets, all eyes will be watching the Non-farm Payrolls report. More than ever, job growth is the focus of investors, consumers, and politicians.

August numbers were discouraging as the U.S. economy lost 3,000 jobs, following an upwardly revised 49,000 lost jobs in July. U.S. factories have now shed 16% of their workers since July 2000, when the record string of consecutive monthly declines began. There was a modest decline in unemployment of 6.1% in August, down from 6.2% in July.

How can the economy continue to recover and consumers continue to spend when there are an increasing number of unemployed workers? In part, unemployment is normally a lagging indicator of a recovery as businesses wait for profits to recover before they are willing to rehire (employees are the costliest of all expenses). Consumers and the markets are anticipating something that might not happen. In our judgment, corporations are unlikely to rehire workers for some time. Corporations are enjoying unprecedented increases in productivity

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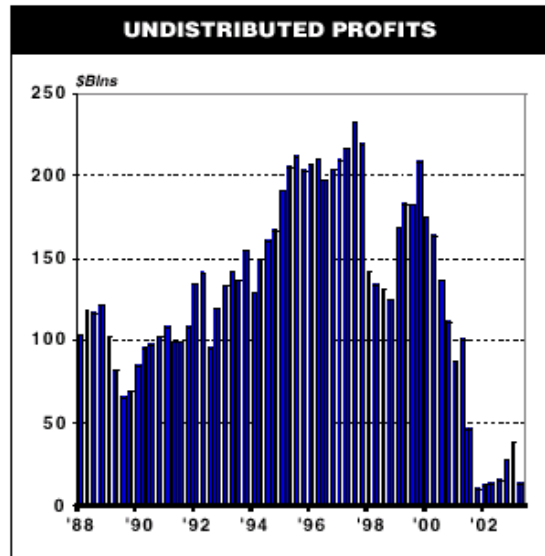
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created by technological advances and new practices that will allow them to avoid rehiring. More importantly, corporate profitability is still a restraint on employment.

Retained earnings or undistributed profits (corporate profits that remain after businesses pay taxes and distribute dividends) fell 63.9% in the second quarter and are now the lowest since the second quarter of 2002. The National Federation of Independent Business, a trade group for small business, reported that only 26% of small businesses plan on purchasing capital equipment in the near future. Small businesses provide the greatest job creation in the country. According to the small Business Association, 22.9 million small businesses provide 75% of the net new jobs added to the economy, and represent 99.7% of all employers.

While we admire the miracle of productivity, we also recognize that it is another factor that can constrain fundamental growth. We anticipate strong GDP numbers for the last two quarters of this year, but 2004 economic growth is likely to be less robust than investors hope. Our portfolio designs have done remarkably well and do not merit change at this time.



Source: Argus Viewpoint, September 2003

Another Scandal

Consider this hypothetical: After the market's close, Intel announces that they'll beat revenue expectations and the stock rises ten percent higher in *after market* trading. It appears likely that the news will have a positive effect on other technology stocks in tomorrow's market. You also know what mutual funds held large positions of Intel and technology in general because some mutual fund companies allowed you to view account holdings. And best yet, they will allow you to purchase their mutual funds after the close of trading but at that day's 4PM EDT price.

This is a practice called "late trading" and it's not allowed for obvious reasons. Any fund order placed after the market's close will be executed at the following day's closing price. It's pretty close to a risk free trade. It's also fairly under the radar screen – you're only stealing a little from a lot of investors. On the hypothetical trade, the day trader probably netted about 4/10th of one percent. The average fund investor wouldn't even notice the loss as it's spread out over 99% of the other fund investors.

The only negative is that it's illegal. As with all investment scandals, that's enough to prevent the great majority of firms and individuals from conspiring to break investment laws but not all. Call it human nature but understand that, such a practice, if it transpired as New York State Attorney General Elliot Spitzer has alleged, represents a clear breach of securities law. Amazingly, this was permitted by Bank of America's Nations Funds unit. Other names being formally investigated so far are: Bank One Corp., Janus Capital Corp., and Strong Capital Management Inc. It's the equivalent of allowing someone in the lottery pool after the winning ticket number has been picked.

What does it mean to us and to our clients? The following points should be noted:

1) Disclosure will be the investment community's method of cleansing itself. We are still in the early

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stages of uncovering possible abuses. Mutual funds and hedge funds are still receiving subpoenas. Brace yourself for further tawdry revelations. This should be viewed as a strength of the system.

2) Truly great firms will exit with their reputations intact or heightened. The great majority have nothing to hide or fear. The Vanguard Group, when asked to supply information, said "these practices are not and have never been allowed at Vanguard." We'll hear many similar statements. Intuitively, our feeling is that the overwhelming majority of firms, when presented this "opportunity" to cater to large hedge fund investors, understood it for the illegal, debilitating scam that it was and discreetly said "no thanks."

3) At this time, it appears that the illegal aspect of this scandal only reaches back about 2 years at best. This should be viewed positively. There will always be someone trying to "game the system" and the market timing scandal is a distant cousin to the insider-trading gambit. Hopefully, the investigation will prove that industry and government officials have been timely about uprooting and punishing illegal behavior.

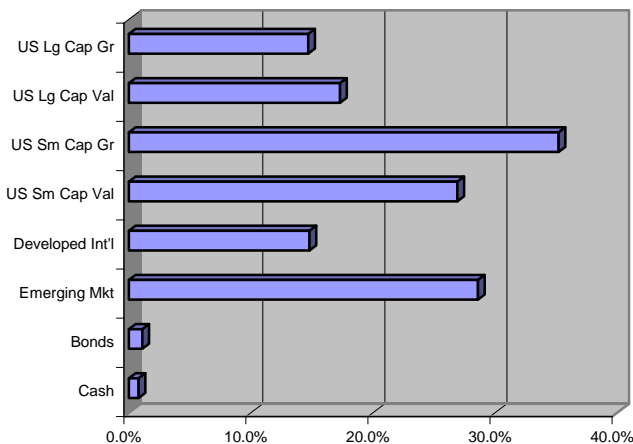
4) Lastly, an aggressive and thorough investigation is a boon to the market. Our hunch is that the next few months will be an important psychological indicator. If investors feel the government is dealing forthrightly with these crimes, then investor confidence will increase and this will show up in stock prices.

Aggressive and thorough investigations are a boon to markets

It is the responsibility of investment managers such as ourselves to demand that the laws are being followed, to avoid those individuals and companies that engage in errant behavior and make sense of the broader implications. Against this backdrop, we naturally find much to be disgusted about but also silver linings. Let's keep both sides in perspective.

Year to Date Market Activity

YTD Returns



Driven by better than expected earnings (net income, *not* retained earnings) and improved economic conditions, the US and global markets have continued advancing through the summer. Year-to-date, small capitalization and emerging market stocks have led by posting better than 25% returns. These asset classes traditionally outperform during recovery phases. Theoretically, smaller companies have more flexible business designs enabling them to adapt more efficiently to changes in the economy.

Because of MCM's approach to investment management, our portfolios have benefited from the gains in small capitalization securities. Currently, our portfolios have as good a balance between upside potential and downside protection as they have ever had.

Inside MCM

MCM Welcomes New Managing Director in Burlington



Rick Johnston recently joined Manchester Capital as Managing Director of the Burlington, Vermont office. His responsibilities include managing individual and institutional portfolios, and overseeing the Burlington office. He served as Managing Director of Offitbank, a New York trust bank, whose primary business was ultra-high net worth wealth management and whose assets under management were over \$10 billion. During his tenure at Offitbank, which began in 1992, Mr. Johnston served as a member of the management team, and was an active member of several key committees, including the Management Committee, the Investment Strategy Committee, and the Risk Management Committee. At OFFITBANK, Mr. Johnston was also a portfolio manager, managing over a billion dollars of funds with international securities, and was responsible for advising clients with more than a billion in assets. His earlier experience includes an association with Salomon Brothers building the firm's international corporate finance business. His tenure also includes working with Manufacturers Hanover Trust Company in the International Corporate Banking Division. Mr. Johnston received a BA in Economics from Middlebury College, and has lived in more than six countries overseas. He currently serves as a member of the Board of Directors of GlobalSource, a privately-owned economic and political consulting firm.

MCM's Website Gets a Face Lift

Obviously, this section still needs some content