Kensington Times

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2000 Review and A Look At 2001

Without question, 2000 was a very difficult year for the economy and for equity investors. A disproportionate amount of the damage occurred in the fourth quarter of the year (see table on page 6).

Recipe for Volatility

A unique confluence of factors was responsible for much of the damage as the record economic expansion in the U.S. economy showed signs of weakness late in the year. The culprits of the slowdown were numerous and very identifiable. For example, rising energy prices and the onset of an unusually cold winter created a drag on consumer and industrial activity. Retail sales were weak during the critical holiday selling season, due in no small part to the "reverse wealth effect" of the falling market. Corporate layoffs were increasing at an alarming rate, adding a further chilling effect to consumer confidence and spending. And certainly we can't forget the problems with energy shortages in California that were starting to make headlines.

The markets turned to the Federal Reserve Board for interest rate relief, but that assistance would not materialize until after the beginning of the New Year. Another blow to the market came from the political uncertainties wrought by the presidential election. Corporate earnings were softening, especially relative to market expectations, resulting in an inordinately large number of corporate preannouncements of disappointing earnings. Analyst recommendation downgrades inevitably followed. Late-year tax loss selling only served to steepen the sell-off, as did a pickup in margin call activity. Last, but certainly not least, the "dot.com" companies

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Nasdaq's Big Lesson

By Ruth Simon and Jeff D. Opdyke
01/02/01-The Wall Street Journal

It's time to get back to basics. Little more than a year ago, making money in the market seemed as simple as throwing a dart at a list of technology stocks or, better yet, getting in on the ground floor of a hot IPO. Who needed to think about having a well-balanced portfolio when the Nasdaq was up a remarkable 795% during the 1990s? Nor did a 2% dividend seem worth much when investors could double their money in a few years by buying growth stocks.

"Tech stocks went up so much in '98 and '99 that people presumed that they should keep on going up!" says Roger Ibbottson. "But with the Nasdaq down more than 39% over the course of 2000, it is time for investors to rethink their habits." **The big lesson of 2000, is that diversification and other often ignored fundamentals still matter.**

The year "2000 was a textbook case of investor lessons that have been learned before and which had to be learned again," says Jim O'Shaughnessy. "Investors who abandoned conventional strategies to invest in hype and stories were spanked very, very badly." Here is a look at some of the pivotal lessons from 2000 and you have probably heard ALL of these before:

Spread the Risk

Don't put all your eggs in one basket. Even the most ardent advocates of diversification had a hard time winning over an audience in recent years. When you see friends and fellow investors making big money diversification seems downright old-fashioned. But utilities and other income producing stocks can be a safe haven when markets turn choppy. The boring Dow Jones Utilities Index, for instance, climbed a sweltering 50.5% last year. "Diversification and steady,

(Continued in "The Big Lesson" on page 8)

Year of Living Dangerously

By Greg Ip
01/02/01 — The Wall Street Journal

Investors have just lived through one of the most extraordinary years in stock-market history. Last year's massacre of technology and Internet stocks marked the end of what many consider the U.S.'s biggest financial mania of the last 100 years. Yet it left much of the market unscathed.

The Nasdaq Composite Index plunged 39.3% to 2470.52, the worst year since it was created in 1971, giving back almost all of 1999's record 86% rocket ride. Its peak-to-trough 54% plunge represented a loss of $3.3 trillion in paper wealth, equivalent (in dollars if not in effect) to one-third of the houses in America sliding into the ocean.

But the Dow Jones Industrial Average fell only 6.2% to 10786.85 for the year. Though that broke a nine-year winning streak and represented its worst calendar year since 1981, the Dow's peak-to-trough decline of just 16% was less than that of 1990, failing to meet the 20% bear market rule of thumb. The S&P 500 stock index lost 10.1% to 1320.28 last year. But excluding its technology components, the index was down just 4%. Indeed, the Dow and the S&P 500 have given up less than a sixth of what they made when they tripled between 1995 and 1999.

By contrast, the 1973-74 bear market clawed everything. The Nasdaq's 60% slide then was the only time it has fallen further than last year. The Dow lost 45% and the S&P 500 48%, ending 1974 at their lowest levels since 1963.

The new year begins with investors wondering if Nasdaq's bloodletting is the vanguard of a broad-based bear market. The answer depends mostly on whether the economy's downshift in recent

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months is a pause in the longest expansion in a century or the first stage of a recession. So far, much of Wall Street opts for the former view. Just as Allan Greenspan's raising interest rates through last May eventually sank stocks and braked the speeding economy, economists expect it to lower rates soon and (the hope is that it will) propel stocks and the economy forward again.

Strategist Edward Kerschner thinks we are at one of the five most attractive opportunities to own stocks in 20 years. Indeed, strategists as a group are the most bullish they have been in 16 years.

There are some gloomier forecasters who think last year set the stage not for a big rally but for several years of miserable stock performance. That is because the eight-year boom in technology investments that boosted productivity, kept inflation low, and drove-up stocks — especially technology stocks — also created enormous production capacity and has drawn in new competitors that could weigh heavily on profits for years to come.

Most of last year, it looked less like a bear market and more like a bubble deflating. From a low of 1419.12 in October 1998 after the debt markets crisis to its closing high of 5048.62 last March 10, the Nasdaq climbed an astounding 256%. Based on the magnitude of the rise, the disconnect between valuation and economic reality, the number of ordinary investors drawn in and the sheer money involved, many market historians rank the technology/Internet bubble ahead of earlier U.S. manias such as radio and investment trusts in the 1920s conglomerate stocks in the late 1960s and early 1970s and oil stocks and gold in the late 1970s and early 1980s. **Yahoo!** rose from below $30 in fall 1998 to $250 last January when it was valued at $133 billion — more than **Ford** and **General Motors** combined. At year end, it was back to $30.06. Web-page technology provider **Akamai Technologies** lost $56 million on sales of $4 million in 1999, went public in October that year, and was valued at $32 billion by January-more than **Texaco**. It since has fallen 94%.

"The first half of the year was the blowing off of speculative excess in the Net sector," says Henry Blodget Internet analyst, adding, "From 1995 to 1998, most investors actually underestimated the power of the Internet. In 1999, people began to overestimate it. But what was interesting in mid-2000, was the excesses moved into other sectors: business-to-business, then infrastructure, then jumped into optics."

As the stock market turned off the spigot to money-losing Internet companies and the junk-bond market did the same to capital-hungry telecommunications companies, the likes of Yahoo and **Lucent Technologies** began to feel the pinch. Investors began questioning not just the price being paid for technology companies' earnings (the P/E ratio), but the earnings themselves. But outside technology, most stocks were unscathed, and some even boomed. Old Economy stalwarts like **3M** and **Exxon/Mobil** were up 23% and 8%. Utility and healthcare stocks were even more buoyant, with the Dow Utility Average rising 45% and **Merck** up 39%.

To be sure, wealth has been lost, but more important, it has been shuffled. At the end of March, **Microsoft**, **Cisco,** and **Intel** were the first, second and fourth most valuable companies in the U.S. At the end of the year, Cisco was fourth, behind **GE**, **Exxon/Mobil** and **Pfizer**; **Microsoft** sixth, behind **Wal-Mart**; and **Intel** 10th, behind **Citigroup**, **American International**, and **Merck**.

It was a humbling year for bulls. Chief investment strategist Jeff Applegate, whose bullishness on stocks, and technology in particular, had served his clients well through the late 90's, titled a report in November, "**Mea culpa**." In March, he considered pulling back on technology recommendations, but "I just decided I'm a rotten sector rotator, so why bother." But since March, excess greed has turned to excess fear, and Mr. Applegate thinks technology will come back.

Valuations have been corrected, and the high-priced stocks still standing, can remain high-priced for years just as **IBM**, **Xerox** and **Polaroid** did for most of the 1960's.

He believes that the long-term bull market that began when inflation was tamed in the early 1980s is still intact. (The bear market in 1990 was one of the shortest on record.) Between 1980 and 1999, the Dow had only three down years-1981, 1984, and 1990-as did the S&P 500-1981, 1990 and 1994. The year following each witnessed double-digit returns.

But there is a school of thought that last year might mark the beginning of a long stretch of dismal stock returns. The market's P/E ratio rose from 14 in 1990 to 28 in 1999, which means the profit investors demanded for every $100 in stocks fell to $3.50 from $7 over the same period.

At the same time, corporate-bond yields fell. Combined, this meant the cost of capital plummeted. That, argues Ben Inker, meant rational companies made investments that posted ever-lower returns. "If P/Es remain high, it means companies have a permanently low cost of capital (which) is only consistent with a permanently low return on capital. It's how capitalism is supposed to work."

In fact, returns on investments-whether in specialty retailers, sport utility vehicles, semiconductor-fabrication plants or broadband networks-were quite high because demand has been so strong. But late last year, overcapacity began popping up throughout the economy and demand slowed sharply, and sector-by-sector, profit margins are being squeezed. "Certainly **AT&T** and **Lucent** are the casualties today," says Mr. Inker. For the current decade, Mr. Inker is bullish on the economy, but thinks stocks overall, will return next to nothing in the next 10 years, after inflation.

And what if the economy does stumble? The falling stock market has pinched household wealth and raised the cost of capital, endangering consumer spending and investment.

(Continued in "Dangerously" on page 4)

Fund Priorities for 2001

By Clint Willis

While you're making a list of priorities for 2001, don't neglect your investments. The bumps and bruises of the past 12 months have shown that many investors can benefit from making a change or two in their approach to mutual funds. With that in mind, here are a few resolutions that seem especially timely:

Resolution No 1: **Invest with your head, not your gut or your heart.** Many investors during 2000 got carried away by the sharp run-up in technology stocks, which carried more than 40 tech funds to 100 percent or better returns during 1999. It's hard to resist the lure of such profits — especially when it seems that everyone but you is sharing in them.

Experienced investors recognized that the risks in the technology sector were extremely high. Some chose to take those risks as part of a long-term strategy that included a broadly diversified portfolio — and those investors will be fine.

Other investors ignored the risk and invested too heavily in technology stocks and funds because they simply could not resist the chance to gamble on big gains. If you were among them, resolve to think twice — make that three times — when you're tempted to invest in a hot sector of the market

PRIORITIES

- Think twice before investing in a hot market.
- Don't forget out-of-style investments.
- Get back to basics.

Resolution No. 2: **Leave some room for "out-of-style" investments.** Investors had very little interest in small-company funds or value oriented funds at the start of 2000. Both fund categories had performed poorly in recent years. But value funds and small-company funds both came back in 2000, proving once again that sooner or later, the last shall be first.

Currently, overseas funds are unpopular because they have delivered poor results in recent months. The average international fund has lost 18.6 percent so far this year. And international funds have been dismal performers during the past five years, gaining just 8.8 percent while diversified domestic stock funds have climbed 16.92 percent. This could be the time to investigate the sector.

Resolution No. 3: **Get back to basics.** Many fund investors got carried away with the big gains of the past decade. This is a good time to remember that **investing is a long-term process that involves both bull and bear markets**. A wing and a prayer may be all you need to make money in a raging bull market, but over time you'll need to draw upon more traditional tools to meet your investment goals.

The most important tools include the least glamorous one. For example, every investor should sign up for an automatic investment program. You can arrange for an employer or a bank or other financial institution to shift a fixed sum into mutual funds at preset intervals—typically once or twice a month. That way, your savings grows over time regardless of swings in the market or your mood.

Ideally, have the money shifted to a retirement savings plan such as an IRA, SIMPLE IRA, SEP IRA, or 401(k). The tax breaks that come with such plans can make it much easier to accumulate money for your long term goals.

Looking Back at Last Year's Stock Market

By Tim Ferguson

Last year's markets were extremely volatile. Depending on which funds you own, your year-end statement could have shown a decline in value from a year ago. The fact that these losses are on paper, until you decide to sell, doesn't make them any easier, but it may give you some control over your situation. If you are a long term investor, it may help to put these events in perspective. At the heart of the market's decline is a slowdown in the U.S. economy. We have probably seen the end of the longest economic expansion in the history of the U.S. Experts predicted it would end many years ago, but instead it set records by growing faster and for a much longer period than most thought possible. In 1999, worried that all this economic growth was going to spark an increase in inflation, the Federal Reserve started raising interest rates. Today's slower economy is exactly what it sought to achieve. The slowdown feels like the economy has ground to a halt, and it has been a difficult adjustment for investors.

In the long run, the market always reflects its underlying health or what we in the business of managing money call its fundamentals. The good news for long-term investors is that, in our estimation, the market's fundamentals are still strong. The economy is still growing, only slower, and with only the shadow of a threat of inflation, which is generally more dangerous to economic health than a slowdown in growth. Although many high-flying companies have come back to earth, corporate profits on the whole are healthy. Going forward, however, they are more likely to grow at rates typical of the last decade than the past two extraordinary years. And after raising interest rates **6 times**, the Fed's inflation-fighting program is over. It will continue to try to cushion the slowdown with lower interest rates.

Types of Investment Risk

Whatever you choose to do with your money involves some element of risk. What's important to keep in mind is that risk and reward go hand-in-hand. Low risk investments tend to provide lower returns. Conversely, to achieve higher rates of return, you must also normally accept a greater level of risk.

To help you become clearer on the concept of risk we've listed the main types of investment risk below. Risk can be different things to different people, and what you perceive to be the riskiest choice may not be to someone else.

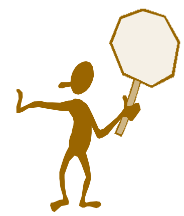
Market Risk

Why do so many people shy away from investing in stocks and bonds? The answer has to do with market risk. It's the danger that you'll lose money as a result of a steep market decline. The thought of an investment that moves up and down in value can be unnerving, but market fluctuations are ***an expected*** but unpleasant part of stock market behavior. Stock market volatility can be unsettling, but in the long run, stocks have tended to outperform more conservative investments. Of course, past performance cannot guarantee future results.

Inflation Risk

To avoid the risks of losing money in the stock market, many people simply put their savings in a local bank. However, what's safe for the short-term can be ***extremely*** risky over time. That brings up another type of risk — purchasing power or *inflation* risk.

Inflation or purchasing power risk is the chance that the value of your money won't keep pace with inflation. Inflation is a constant, steady erosion of your money's value. The amount of erosion varies — in some years the rate of inflation is higher than in others. ***But the effect of inflation is the same: as the cost of living keeps going up, we all need more money just to stay even***.



Interest Rate Risk

Interest rate risk is concerned with the danger that your investment will lose value because it has a fixed rate of return that will not change as interest rates rise. Many investors fail to consider this type of risk as a factor when putting savings into fixed rate investments such as bank CDs or a fixed annuity.

For example, let's say you want to invest $10,000 into a one-year certificate of deposit or a fixed annuity that pays 5% interest annually. A week later, interest rates rise a whole percentage point. That may not seem like a lot to you, but over time a single percentage point can have a major impact on the amount of money you can save. Left to compound for 10 years, $10,000 invested at 5% will grow to $16,289. The same amount, invested at 6% will reach $17,908 over the same time period. That's $1,619 more.

Your problem is this: your investment will continue to pay 5%, but because you've committed to hold the investment until it matures, you can't take advantage of the higher interest rate without facing penalties or surrender charges.

Interest rate risk is the reason you want to make sure that you balance investments that lock you into a fixed rate of return with investments whose return can keep up with economic or market changes.

Liquidity Risk

Another often overlooked, but equally dangerous threat to all investors is liquidity risk. This refers to the possibility that you may need your money before your investment's maturity date. Many so-called "risk free" investments—such as certificates of deposit and annuities with surrender charges —- must be held for a specified period of time in order for you to receive the stated return. If you need your money for an emergency, you'll probably be subject to penalties, and the interest you actually earn is calculated using a much lower rate.

Making sure that you understand these risks and do all that you can to keep them at a minimum, is essential for a wise investor. Diversifying your portfolio with stocks, bonds, cash, and mutual funds, is one step towards managing these risks.

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Mr. Bernstein thinks profits could actually fall this year, although declining interest rates could offset that impact.

In fact, rate cuts are historically one of the most bullish signals. According to Ed Keon, stocks have returned 20% annualized, on average, during 12 easing periods since 1953, and **in only two were stocks lower six months after the first rate cut**.

Furthermore, the bear market in "value" stocks — those with low prices relative to earnings or book value — began back in 1998. They hit bottom early last year, just as the technology bear market got going.

Knowing the market's tendency to return to the mean, value investors will be the ones who (probably) make the most money in the next few years. But technology stocks won't recover until their current owners give up on them. At the peak, some 75% of the money in Fidelity Investments' sector funds was in technology, and that had only dropped to 58% by mid-December.

A very clear sign of capitulation will (should) be when Wall Street tells people to avoid technology stocks (altogether); and concentrate their investment dollars anywhere else.

How To Survive The Stock Market's Ups AND Downs

"Since 1900, the Market's 69 up years have outweighed the 32 down years."

Worried about the ups and downs of the stock market? Try taking a long-term view instead. Since 1900, the stock market has posted positive annual returns in 69 years and has registered more than twice as many up years as down years. Plus, investors have enjoyed double-digit returns in 55 out of 69 years and returns **higher than 20%** in 38 years of the 20th Century. Of course, past performance cannot guarantee comparable future results.

The Stock Market: The Good Years

When the market's been good, it's been very good. Since 1900, the market has advanced more than two out of every three years—with an average annual gain of 22.39% in up years.

MORE THAN 32% GAIN		21—32% GAIN		10—21% GAIN		0—10% GAIN	
1933	54.20%	1985	31.64%	1942	20.15%	1992	7.61%
1954	52.27	1989	31.59	1944	19.53	1912	7.60
1935	47.59	1950	31.46	1972	18.96	1900	6.55
1908	46.60	1955	31.41	1986	18.62	1978	6.52
1928	43.60	1938	30.76	1949	18.60	1956	6.48
1958	43.15	1919	30.50	1979	18.45	1984	6.22
1904	41.70	1991	30.34	1952	18.16	1947	5.63
1905	38.20	1925	30.00	1988	16.50	1948	5.37
1927	37.49	1998	28.52	1964	16.43	1987	5.18
1995	37.44	1961	26.88	1909	15.00	1970	3.89
1975	37.14	1924	26.20	1971	14.22	1994	1.36
1945	36.31	1943	25.63	1921	12.70	1960	0.45
1936	33.74	1951	23.97	1965	12.46	1902	0.40
1997	33.32	1967	23.89	1959	11.95	1911	0.40
1980	32.45	1976	23.81	1926	11.62		
1915	32.36	1996	22.90	1968	11.04		
		1963	22.76	1918	10.50		
		1983	22.46	1993	10.03		
		1922	21.70				
		1982	21.50				
		1999	21.01				

Sources: Dow Jones, Inc.; © 2001TowersData

The above table represents the annual return of the Dow Jones Industrial Average (the Dow) from 1900 – 1927 and the S&P 500 from 1928–1999, including reinvestment of dividends and price changes. The Dow is a price-weighted average of 30 actively traded, blue chip stocks. The S&P 500 is an unmanaged group of securities widely regarded to be representative of large-company stocks.

Patience May Help Investors Survive Market Swings

Sure, the market was up roughly two out of three years since 1900. But what about the down years?

As you can see from the tables, above, and on page 8, the market's 32 down years averaged a -13.19% return — but the 69 up years averaged 22.39%. And it has had back-to-back down years **only once** since World War II. The moral of this story? Over time, the positives have out gained the negatives. So don't look at the bumps in the road, keep an eye on your long-term goals and keep looking towards the future!

(Continued in "The Stock Market's Ups and Down's" on page 8)

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were going through a major melt-down as this speculative bubble was unwinding.

Data as of 12/29/2000

	FULL YEAR CHANGE	4TH QTR CHANGE
S&P 500	-9.10%	-7.82%
NASDAQ*	-39.30%	-32.70%
Russell 2000	-3.02%	-6.91%
S&P Tech Sect*	-40.00%	-32.50%
S&P Comm Sect*	-39.70%	-19.40%

Changing of the Guard

It was a year of reversals, and the leadership changes within the market were very pronounced. Small & mid-capitalization stocks greatly outperformed larger cap issues. Value also outperformed growth for the first time in years. Bonds did better than stocks, as well.

Lessons Learned

Equity investors were forced to relearn some critical stock-market lessons:

- The "New Economy" has not repealed the business cycle, as many had thought.
- Portfolio diversification matters.
- Earnings matter.
- There are no "one decision" stocks, and
- DISCIPLINE STILL MATTERS.

Indeed, most investors in equity mutual funds learned the hardest lesson in 2000 — stock funds don't always yield robust or even positive returns. Industry statistics indicate many investors made their initial foray into equity mutual funds during the last few years when returns on so many funds soared well above the historical norm of 10-12% for the Standard & Poor's 500 Index. With that in mind, the events of 2000 clearly led to disappointment for many investors when reviewing their year-end statements. However, we firmly believe disciplined investing can create performance over time. Therefore, those who have placed long-term money in investment companies like **The AIM Family of Funds** and **American Funds**, can be reassured that the management teams at these companies maintained the same investment discipline during the market volatility of 2000 as they did during the more favorable periods, so many benefited from in the previous years. In fact, their disciplined approach to investing has served investors well — weathering all the markets' up and down times.

Looking to 2001

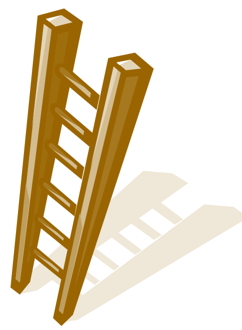
Where do we go from here? Fortunately 2001 has started with better footing. The Fed has become an activist in reducing the level of interest rates. Tax-loss selling is over for now. Speculation has taken a back seat to more sound investment principles. Record levels of cash are on the sidelines and valuations are certainly more attractive. Additionally, record mortgage refinancing activity can potentially help re-liquefy the consumer. While no one can know for sure what will happen in the stock market from year to year, much less day to day, we are cautiously optimistic 2001 could provide a better environment for equity investors. **As always, we encourage you to work with us to map out a prudent & long term investment strategy. The door is always open and the phones are always on!**

Visit us at 2866 Leechburg Road in Lower Burrell. OR call us at 724.334.1950 or send us an e-mail at k-admin@kensingtonfinancial.com.

Ten Steps to a Great 401(k)

By Marine Costello

There was a time when you didn't have to worry about things like asset allocation, pretax dollars, or early withdrawal fees. But this is the **ME** Generation of retirement investing, when nobody at your job cares much about how you're going to support yourself when you stop working. Your 401 (k), for better or for worse, is yours to cultivate or destroy.



A Recipe for Success

To make matters more confusing, there's no right way to build a 401 (k), but countless wrong ways to do it that can obliterate any chance for a comfortable retirement.

Scared Yet? Then you might want to start by doing your homework. Study after study shows most people are ignorant when it comes to their 401 (k), even though it will likely be their largest asset and primary income source in retirement.

One survey by Wiese Research Associates found most 401 (k) investors are "woefully uninformed" about what they are investing in and how to maximize their savings. Nearly half of the people surveyed could not name any of the investments in their plans.

So, what to do? Well, we have put together a **Ten Point 401(k) Checklist**. While it certainly is a start — there is NO substitute for professional advice. **Get your investment advisor at Kensington Financial involved in the decision making process.**

Ten Point 401(k) Checklist

1. *DO YOUR HOMEWORK! There is NO substitute for knowing what you are getting yourself in to.*
2. *If possible, MAX out your contributions.*
3. *Know your risk tolerance AND do not exceed it.*
4. *Don't forget to diversify.*
5. *Make the best out of your choices, remember, they are for the long-term.*
6. *Don't try to time the market.*
7. *BEWARE of investing too much in your company's stock.*
8. *If possible, avoid borrowing from your **retirement** plan.*
9. *Understand when you should — and **shouldn't** roll over your plan to another*
10. *Have a good, SOLID distribution strategy, put in place, for when you retire.*

Market Corrections: A History Lesson

"Insights for today's Investor"

If you invested your first dollar in the stock market after October 1990, you may respond differently to a market decline than an investor who started in the 1970s. That's because the bull market continued to charge upward throughout the 1990s. From Jan. 1, 1990, to Dec. 31, 1999, the unmanaged Dow Jones Industrial Average jumped from 2,810 to 11,497. Recent investors may have unrealistically expected the market to keep going up because in the 1990s, the annual average returns of the Dow — 17.88% for a 10-year period and 18.21% for five years—were well above historical averages. Investors rewarded the decade of performance by increasing equity fund assets from $249 billion to $4.04 trillion, as of Dec. 31, 1999, according to the Investment Company Institute. The stock market is represented by the Dow Jones Industrial Average (the Dow). The Dow is a price-weighted average of 30 actively traded, blue chip stocks. Results assume reinvestment of dividends. An investment cannot be made directly in an index.

Are Your Expectations of the Stock Market Realistic?

Familiarizing yourself with the stock market's record may help you keep a long-term outlook.

Time Period (Years)	Start Date Through 12/31/00	Dow Jones Industrial Average Annual Return
70	12/31/30	10.88%
50	12/31/50	12.36
25	12/31/75	15.03
10	12/31/90	17.88
5	12/31/95	18.21
1	12/31/99	-4.66

Sources: ©2001 TowersData

So what's the reality of the stock market over the long term? On average, the market has experienced a down year one out of every four years. While unavoidable, such market corrections don't mean the end of the world. In fact, the up markets have more than compensated for the down years. While past performance does not guarantee comparable future results, it's important to understand the history of the stock market. Realizing this may allow you to stay the course and reap the potential long-term benefits of an investment in equities.

> Understanding that market corrections eventually happen and staying focused on long term goals can potentially help you through unpredictable times.

Responsible Investing Begins with Education

During the most recent bull run, which began in October 1990, many investors did not experience a 20% correction. While this has benefited investors, it may also have given inexperienced investors false expectations of future market performance. Here's some history on the stock market that may strengthen investor awareness:

Ride Out Corrections by Focusing on Long-Term Goals

History shows that ten 20% market corrections in the Dow have occurred over the last several decades. History also shows that new market highs were reached after these lows.

Highs	Lows	Loss	Days in Between	Days to Reach New Market High
05/29/46	06/13/49	-23.95%	1,111	299
12/13/61	06/26/62	-27.10	195	436
02/09/66	10/07/66	-25.21	240	2,226
12/03/68	05/26/70	-35.94	539	899
01/11/73	12/05/73	-25.04	328	3,255
03/13/74	12/06/74	-35.22	268	2,889
09/21/76	02/28/78	-26.87	525	1,709
04/27/81	08/12/82	-24.13	472	83
08/25/87	10/19/87	-36.13	55	675
07/16/90	10/11/90	-21.16	87	231

Source: ©2001 Dow Jones

- On average, one 20% correction occurs every 5 years.
- The last 20% correction in the Dow took place the 3'rd quarter of 1990, 10 years ago.
- Ten 20% corrections happened over the decades from 1946–2000.

Talk to Your Financial Advisor

You can learn more about the stock market and how to take advantage of market corrections by seeking the expertise of your financial advisor at Kensington Financial. Regardless of the market, Kensington Financial's disciplined investment strategy remains the same: We believe earnings drive stock prices and stock prices drive portfolio performance. **AND, remember that past performance is no guarantee of future results!**

The Sky Is Falling ... or Is It?

"An Example of How ONE PARTICULAR Mutual Fund's Investment Style Has Weathered Short Term Volatility"

Worried about today's stock market? Let's look back at the stock market crash of 1987. The Dow Jones Industrial Average fell from its high of 2,722 on Aug. 25 to its low of 1,739 on Oct. 19—a drop of 36%.

Suppose you had placed $10,000 in the AIM Constellation Fund during the market high on Aug. 25. By Oct. 19, your investment would have dropped in value to $5,928—a decrease of **40.72%.** What would you have done with your shares and how would you have fared?

- **Sell Now**—Take the loss and put the remaining money in a CD.
- **Wait**—When the fund breaks even, sell it, and put the money in a CD.
- **Hold On**—Initially, it was a long term investment so choose to let time work for you.
- **Invest**—Take advantage of the opportunity to buy more shares at a lower price.

What Choice Did You Make?

- If you sold your AIM Constellation Fund shares on Oct. 19, 1987, in reaction to the declining market, and placed the remaining $5,928 in a CD, your investment as of Dec. 31, 2000, would be worth

(Continued in "The Sky is Falling" on page 9)

(Continued from "The Big Lesson" on page 1)
slower gains seem boring," notes Jeremy Siegel, a professor at the Wharton School of Business.

But last year's markets provided a fresh reminder that it pays to spread your bets around. The once red-hot Dow Jones Internet Index fell 66% in 2000. The real-estate sector, on the other hand, was among the year's best performers, with the Dow Jones REIT Index providing a total return of 29%.

Single sectors, such as stocks of large U.S. companies, can outperform the market for long stretches at a time. But a diversified portfolio can provide better returns over the long run, with less risk. The S&P 500 provided a compound annual return of 13.2% between Jan. 1, 1972, and Nov. 30, 2000, outpacing foreign stocks, real estate and commodities. But an investor would have done better with a portfolio that was divided equally between those four asset classes and rebalanced each year. That mix returned 13.96% annually!

Even a simple mix of stocks and bonds can help ease the pain of a downturn. An investor who put $10,000 in an S&P 500 Index Fund at the start of the year would have been left with just $9,049.00 on November 30th. But the same investor would actually be $20 ahead with a $10,000 portfolio that was split equally between the S&P 500 Index Fund and an Intermediate Term Bond Index Fund. This diversified portfolio was also a lot less volatile.

Dividends Pay Off

Don't overlook dividends. During the roaring 1990s, many investors dismissed dividends as foolish.

A 2% or 3% dividend is like a "bird in the hand" when markets turn sour, says Chuck Carlson, a contributing editor to the Dow Theory Forecast. "When you have lots of stocks that are down 40% or 50%, it's nice not to rely only on appreciation."

Investors can give their portfolios a hefty long-term boost if they simply reinvest dividends instead of spending them. Including reinvested dividends, the S&P 500 provided an average annual return of 16% between December 31, 1985 and December 29, 2000. Don't reinvest the dividends and the total return drops to just 13% a year. "This compounding can be a powerful force, but people forgot that in their quest to find stocks that were going up 80%, 90%, or even 100%.

Feast and Famine

Even professional money managers can lose when a hot sector cools. Investors poured almost $72.5 billion into technology mutual funds between November 1998, and March 2000. But even the pros couldn't escape the carnage when the Internet bubble burst. Both ***Kinetics Internet Fund*** and ***Munder NetNet Fund*** tumbled more than 50% last year after gaining 216% and 176%, respectively in '99.

"There's nowhere to hide… when sectors get really overheated," says Scott Cooley, at Morningstar. "When they cool off, they do so with a vengeance." "I don't think there's necessarily anything wrong with putting a small percentage of your money in a sector play," Mr. Cooley says. **"But the overwhelming majority of your assets should be invested in pretty boring, steady funds, not chasing a fad."**

The IPO Lottery

IPOs are risky. Just two years ago, landing a stake in a hot IPO seemed like the next best thing to winning the lottery! The average new issue climbed 194% in 1999, according to Thomson Financial. Some Internet companies, such as **Commerce One** climbed even higher, soaring 1,000% during their first year.

But few investors who try to invest in IPOs hit the jackpot. Individuals typically get few, if any, shares of red-hot new issues at the low initial public offering price AND many brokerage firms typically prohibit customers who do get in on the ground floor from quickly selling their shares. In the long run, few IPOs live up to their advance billing. Just 33 of the 317 Internet companies that came public between January 1999 and November 2000 were still trading above their offer price on November 30. In general, IPOs are a pretty lousy investment..

Conclusion

"People were beginning to question… whether any yardsticks of valuation should apply in the new economy," Professor James Siegel says. (Your answer should be,) "The answer is yes, they do. … Show me the money. If you don't have it, I'm not interested."

(Continued from "The Stock Market's Ups and Downs" on page 5)

The Stock Market: The Bad Years

When the market's down, consider it a prime opportunity to buy. During the market's 32 down years since 1900, the average loss was 13.19%.

UP TO 5% LOSS		5—10% LOSS		10—25% LOSS		MORE THAN 25% LOSS	
1939	-0.38%	1914	-5.10%	1966	-10.02%	1974	-26.31%
1953	-0.94	1977	-7.19	1913	-10.30	1920	-32.90
1934	-1.52	1946	-8.02	1957	-10.72	1937	-34.73
1906	-1.90	1932	-8.25	1941	-11.59	1907	-37.70
1990	-3.11	1969	-8.40	1973	-14.67	1931	-43.13
1923	-3.30	1929	-8.55	1910	-17.90		
1916	-4.20	1962	-8.66	1917	-21.70		
1981	-4.88	1901	-8.70	1903	-23.60		
		2000	-9.10	1930	-24.78		
		1940	-9.77				

Sources: Dow Jones, Inc.; © 2001TowersData

Past performance cannot guarantee comparable future results. The tables represent the annual return of the Dow Jones Industrial Average (the Dow) from 1900–1927 and the S&P 500 from 1928–1999. The Dow is a price-weighted average of 30 actively traded, blue chip stocks. The S&P 500 is an unmanaged group of securities widely regarded to be representative of large-company stocks.

(Continued from "The Sky is Falling" on page 7)

(depending on the interest rate): **$13,101** at **6%**, **$14,947** at **7%**, **$17,051** at **8%**.

- If you waited for the fund's value to return to $10,000, sold the shares on Aug. 10, 1989, and then placed the money in a bank CD, your investment as of Dec. 31, 2000, would be worth **$19,803** at **6%**, **$22,185** at **7%**, **$24,850** at **8%**.
- If you sat tight and left your money in Constellation on Oct. 19, 1987, your $10,000 would be worth **$62,577** as of Dec. 31, 2000.
- If you invested an additional $10,000 in AIM Constellation on Oct. 19, 1987, your $20,000 total investment would be worth **$162,313** as of Dec. 31, 2000.
- Assuming you did not have an additional $10,000 lump sum to place in AIM Constellation but started investing $100 each month beginning Oct. 19, 1987, your total investment of **$25,900** would be worth **$117,536** as of 12/31/2000.

Source: ©2001 TowersData

Of course, past performance cannot guarantee comparable future results. Fund performance figures are for Class A shares only. Performance for Class B and C shares will differ due to differences in sales charge structure and class expenses. Performance figures are historical and reflect reinvestment of all distributions, changes in net asset value, and the maximum 5.50% sales charge. Investment return and principal value will vary so that you may have a gain or a loss when you sell shares. The Dow Jones Industrial Average ("the Dow") is a price-weighted average of 30 actively traded, blue chip stocks. An investment cannot be made directly in an index.

Bank certificates of deposit (CDs), which are insured by the FDIC for up to $100,000, are short-term investments that pay fixed principal and interest, but are subject to fluctuating rates and early withdrawal penalties. CD income is calculated using the six-month annualized average monthly CD rate reported by the Federal Reserve. Fund shares are not insured and their value will vary with market conditions.

Weathering Short Term Volatility

Did the sky fall after all? Not for those AIM Constellation Fund investors who survived the stock market crash of 1987. Their patience was vital to helping their investment grow.

Disciplined investors focus on their long-term financial goals rather than seeking what appear to be short-term solutions. And as patient investors know, it's time, not timing, that counts when it comes to potentially maximizing investment returns.

Effective Dec. 1, 1999, AIM Constellation Fund's investment strategy broadened from small- and mid-cap stocks to allow investments across all market capitalizations. Results shown were primarily achieved when the fund focused on small- and mid-cap stocks. There is no guarantee that historical results will continue now that the fund invests across all market capitalizations. Investing in small and mid sized companies may involve greater risks not associated with investing in more established companies. Additionally, small companies may have business risk, significant stock price fluctuations, and illiquidity. Past performance cannot guarantee comparable future results. Market volatility can significantly impact short-term performance. Results of an investment made today may differ substantially from the historical performance shown.

Fund performance figures are for Class A shares only. Performance for Class B and C shares will differ due to differences in sales charge structure and class expenses. Performance figures are historical and reflect investment of all distributions, changes in net asset value and the effect of the fund's maximum sales charge. Investment return and principal value will vary so that you may have a gain or a loss when you sell shares.

Average Annual Total Returns
As of Dec. 31, 2000
AIM Constellation Fund

Years	Including Maximum 5.50% Sales Charge	Excluding Sales Charge
20	14.78%	15.11%
15	18.19%	18.63%
10	19.67%	20.35%
5	13.80%	15.10%
1	-15.30%	-10.37%

The Kensington Financial — Fifth Annual Golf Classic

The Fifth Annual Kensington Financial Golf Classic will be held at the — ***Indiana Holiday Inn / Holidome*** and **Meadow Lane Golf Club** both in Indiana, Pennsylvania from — Friday, June 8'th through Sunday, June 10'th 2001. This year's outing promises to be a weekend full of golf and fun for golfers and non-golfers alike, as well as those gathering with friends. All proceeds benefit the ***Lora Lee Phillips Memorial Award*** at Penn State New Kensington. More information on the golf outing and the weekend's itinerary will be sent out in mid April after all arrangements have been finalized. Please mark your calendar for this fun-for-all event and we hope to see you there!

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If you have any questions about this year's Golf Outing or about the Lora Lee Phillips Memorial Award at Penn State New Kensington, please call Ralph H. Phillips of Kensington Financial at (724) 334-1950.

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- The Fifth Annual Kensington Financial Golf Classic
- Kensington Financial Privacy Notice
- Year 2000 Market Review AND Outlook for 2001
- Investment Risk (and how to minimize it!)
- Your Retirement Plan, Do’s AND Don’ts

Kensington Financial Services, Inc. • First Quarter 2001 Newsletter

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