ANNUAL REPORT

MAGNIFYING OUR INVESTMENT OUTLOOK

Southern Methodist University
Edwin L. Cox School of Business
The Ann Rife Cox Endowment Fund

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LETTER TO OUR CLIENTS

To the Investments Committee of the University Board of Trustees:

The Spring 2004 undergraduate Portfolio Practicum class would like to thank the Investments Committee for the privilege of managing the Ann Rife Cox Endowment Fund ("ARC Fund"). We seek to maximize the educational opportunity that this class offers, and we will dedicate ourselves to the integrity and the fiduciary responsibility with which we have been entrusted. Within the educational framework, we have acted as if the interests of the ARC Fund supersede those of the class. First, the class has sought to understand the investment goals of the University Endowment Fund ("The Fund"), of which the primary objective is to pursue a long-term capital appreciation strategy via assuming more market risk. Specifically, the goals of the University are to:

- Preserve the purchasing power of The Fund while providing a predictable, stable and inflation-adjusted stream of earnings consistent with the University's spending requirements
- Earn an average total return of 9% per year, comprised of a spending rate of 5% of a 12-quarter rolling average of The Fund balances, with the remaining 4% consisting of an inflation-adjusted growth goal and actual growth of the principle of The Fund
- Outperform a blended benchmark of 75% Russell 3000, 15% Lehman Government Credit Index, and 10% treasury bills + Consumer Price Index (CPI)
- Rank in the top half of the Cambridge Associates universe of college and university endowment returns for rolling five year periods

Understanding the goals of The Fund, we believe our portfolio can achieve a return of 7.14%, sufficient to preserve the real value of the portfolio and achieve the desired university spending rate. The class will meet this return objective through diligent, responsible, and ethical research. As explained below, a 9% expected return is not a realistic goal for 2004. Based on the current market environment, the class has decided on an asset mix of 80% equity and 20% fixed income to attain the return objective. In order to ensure proper and successful management of the ARC fund, we pledge to conduct ourselves accordingly to the following considerations:

- All investment decisions will be made based on thorough research, taking care to decipher fact from opinion
- Effective communication with the client on a regular basis
- Members with conflicts of interest, defined as those with immediate familial affiliation, current investment holdings, and/or current or future employment obligations, will abstain from voting in order to ensure ethical, unbiased recommendations. Additionally, members will not engage in front-running or purchase further holdings in the endowment fund while participating in the management of The ARC Fund
- Members will abide by the rules and regulations of all government and other regulatory agencies, both foreign and domestic. In compliance with this, members are prohibited against the use of material non-public information as outlined in the AIMR Code of Ethics and Standards of Professional Conduct. Dishonesty, fraud, and deceit will not be tolerated. The SMU Honor Code will be followed and any violations will be punishable

The 2004 Portfolio Practicum class will always act with integrity in its role as manager of The ARC Fund. The class will conduct itself with a level of competence and the independent judgment expected of any reputable advisor. The class understands that the investment time horizon for The Fund is long-term, consistent with its perpetual life. We will strive to preserve the wellbeing of the fund, so that this valuable educational tool will be available to our successors.

Respectfully,

The ARC Fund Management Team

I. 2003 YEAR IN REVIEW

2003 marked the return of the bull with it being the first up-year since 1999 in the equity markets. It was a broad-based recovery for the markets with the S&P up 28%, Russell 2000 47%, and the EAFE 39%.

The capital markets got off to a slow start with continued uncertainty with the possibility and reality of war with Iraq keeping investors on the sidelines. Once the war was over investors started to gain confidence in taking on more risk. Low interest rates served as the fuel for the equity markets. Issuers could float debt at near historic low levels, serving as a cheap source of capital. The low interest rates lead to up-beat corporate earnings and extraordinary third quarter GDP growth. This spurred the markets onward and the many investors that had exited the markets over the past three years began to enter again. With cheap sources of capital and new growth estimates valuation methods suggested that companies were grossly undervalued.

Index	Performance
Dow Jones Industrial Average	25.3%
NASDAQ	50.01%
Wilshire 5000	31.65%
S&P 500	28.69%
Russell 3000 Value	31.13%
Russell 3000 Growth	30.95%
EAFE	39.16%
LB Aggregate Bond	4.11%
LB Long Treasuries	2.59%
High Yield Corporate	28.96%
Gold	19.6%

(Exhibit I)

Domestic Economy

GDP	4.4%
Inflation	2.2%
Unemployment	6.1%

(Exhibit II)

Every sector saw positive returns in 2003, but among the strongest were the mining, consumer electronics, and Internet services. Treasury prices fell sharply as investors moved into the equity markets. The ten year treasury yield shot up from a June low of 3.1 to 4.5. The equity outperformed the fixed income market greatly except for the high yield corporate bonds, which returned a robust 29%.

Themes in 2003

War in Iraq:

The War in Iraq was major contributing factor in keeping the equity markets depressed in the first quarter. It was a source of uncertainty for investors, which kept investor confidence low. Thus investors were strongly adverse to risk and remained in the fixed income market which continued to beat down the equity markets. Once the official war was over uncertainty diminished and investors began exiting the sidelines.

Interest Rates:

During the June meeting the Federal Reserve cut interest rates by 25 basis points to lower the fed funds rate to 1.00, a level not seen since 1954. The near three year process of lowering low interest rates finally sparked economic growth in 2003.

GDP Growth:

The rally was further fueled by a growth of 8.2% in GDP. An 8.2% growth in GDP has not been seen in the US economy in over two decades. This record growth gave investors something to cheer about as the markets trended up swiftly.

II. DOMESTIC ECONOMIC OUTLOOK FOR 2004

2003 saw an incredible recovery in the equity markets, but the street is asking whether that can continue. Economists are predicting GDP to grow by 4.5%, suggesting the US will continue its recovery. Yet this economic recovery is happening without necessary job growth, which will have some very interesting affects. The government reported in early March that a mere 21,000 jobs were created in February, well below the 125,000 or more consistent with a normally growing economy. Because of the consistent and slightly less optimistic comments from the Fed in February and March than in December and the weak job creation numbers, investors, who had expected the first rate hike in August, shifted that date back to

GDP	4.25
Investment	13.3
Spending	4.0
CPI	1.5
Long-term Interest Rates	4.97
Corporate risk premium	2.0
Short-term Interest Rate	1.25
Unemployment	5.7

(Exhibit III)

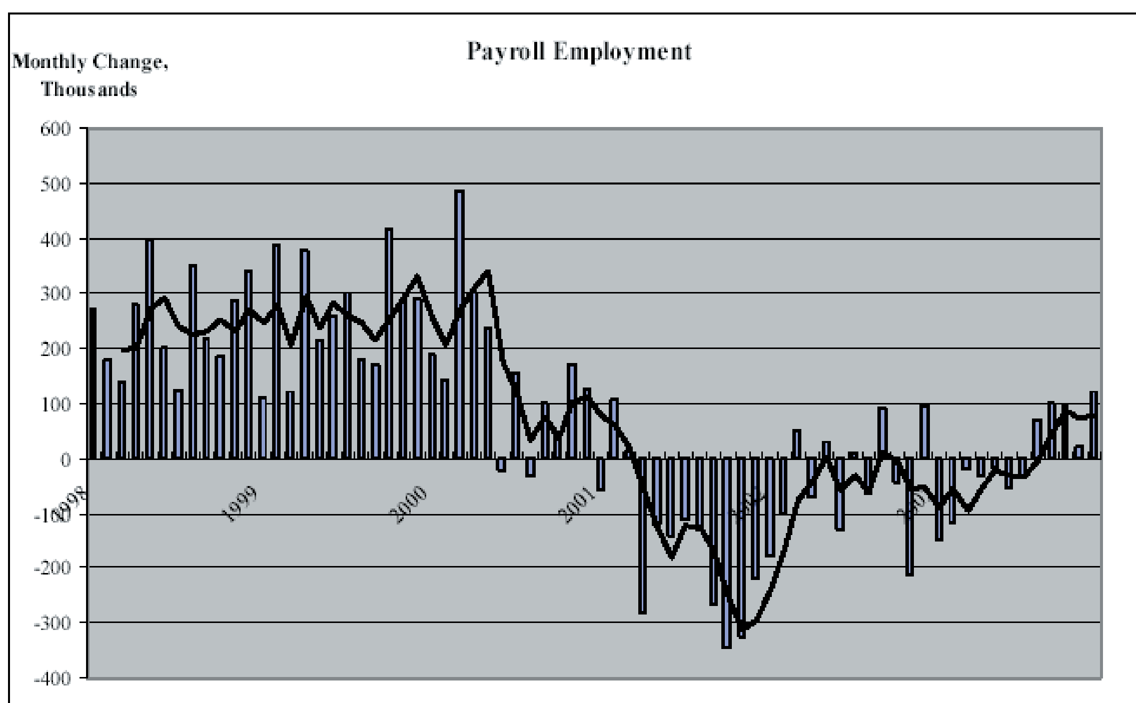
November. Thus making almost certain that if we are to see an interest rate hike it will be in the latter half of the year. Weak job growth suggests that firms are producing so much with existing workers that there is little upward pressure on labor costs. It also endangers consumers' confidence and thus their spending, which accounts for two-thirds of gross domestic product. The administration is combating this by enforcing tax cuts, but many economists feel this will only keep consumer spending up for the first two quarters of 2004. A weak dollar will help exporters and should play a part in generating higher than normal profits for U.S. companies. This coupled with historically low financing rates will cause business growth and potentially job creation. Job creation will be the key economic indicator to watch toward the end of 2004. There has been a lag due to the excess capacity and overall productivity in the economy but at some point businesses must begin hiring to sustain the levels of growth experienced in the last year. The Street is looking for the job creation numbers necessary to signify a full on economic recovery until then equity markets will stagnate and the earliest point at which necessary job creation will occur is in late 2004.

Interest Rates

On January 28, 2004, Fed Chairman Alan Greenspan and his colleagues left the federal funds rate unchanged at 1.0%. The Federal Reserve changed their wording at the meeting, stating that it could be "patient in removing its policy accommodation." On March 16, 2004 the Federal Reserve again voted unanimously to keep rates unchanged, and Mr. Greenspan repeated January's assessment that risks to economic growth were still "roughly equal" while the risk of an "unwelcome fall in inflation" remained "almost equal" to that of a rise in inflation. The Fed also said, as it did in January, that it can be "patient" in raising interest rates. The January and March comments from the Federal Reserve are slightly more pessimistic than December when it stated the economy was growing at a "brisk" pace, this coupled with the lag in job growth indicates that while an interest rate increase is not out of the picture for 2004 it most certainly indicates that an interest rate hike would take place in the latter half of 2004.

Employment

The key factor behind a sustained economic upturn throughout 2004 will be job creation. Simply put, more jobs will lead to more income and thus higher consumer spending necessary for the economy to become self-sustaining. If the increases in payroll employment do not pick up in Q2 and Q3 2004, we believe economic growth will stagnate second half of 2004. However, if job creation does pick up steam, 2004 is likely to be a year of strong growth and sustained momentum. To keep up with the average 1% growth in the labor market, monthly gains in payroll have to be roughly 125000; hence one would like to see monthly gains above this number to drive unemployment down.

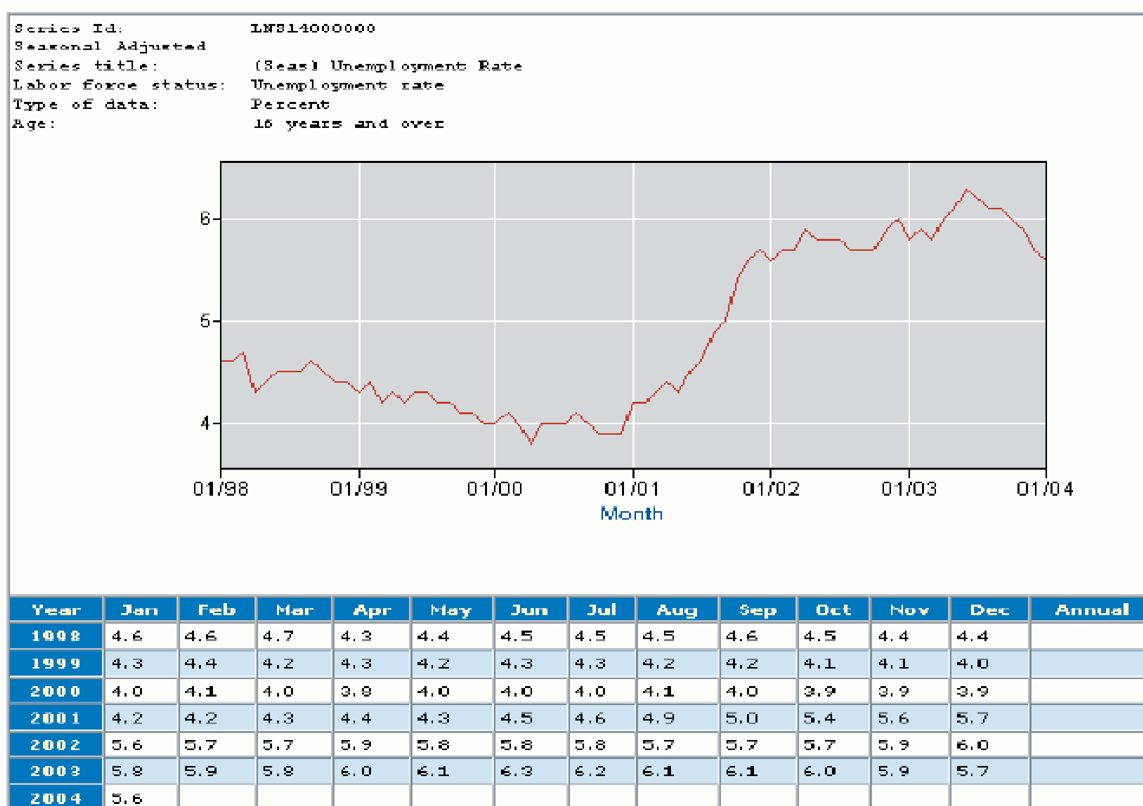


(Exhibit IV)

On the 5th of February the Labor department released the latest unemployment numbers, dropping from 5.7% to 5.6%, the lowest level since late 2001. However, the street was not impressed, expecting lower rates and claiming that much of the drop was due to the fact that many young professionals had stopped to actively look for a job. Also, the increase in payroll was barely sufficient to cover the new entrants into

the job market. The data quelled discussions of the Fed tightening money supply, which could have made US bond yields more attractive to foreign investors

The analyst consensus seems to be that US unemployment rates will decrease slightly during 2004; the congressional budget office predicting 5.8%, the conference board 5.6% and the major I-banks somewhat lower. In terms of predicting future unemployment rates, unemployment and inflation seems to be two sides of the same coin. This concept is in macro-economics captured in the Phillips curve, conveying a historical negative relationship between inflation and unemployment. The basic notion behind the Phillips curve is that a burst of inflation, and more monetary growth underlying this inflation, brings about an economic boom that results in lower unemployment and higher real GDP. Although historical data implies an interchangeable dynamic within this relationship (especially in the UK), our inflation team has in line with market consensus, concluded that US inflation rates are likely to increase in 2004 thus implying lower unemployment.

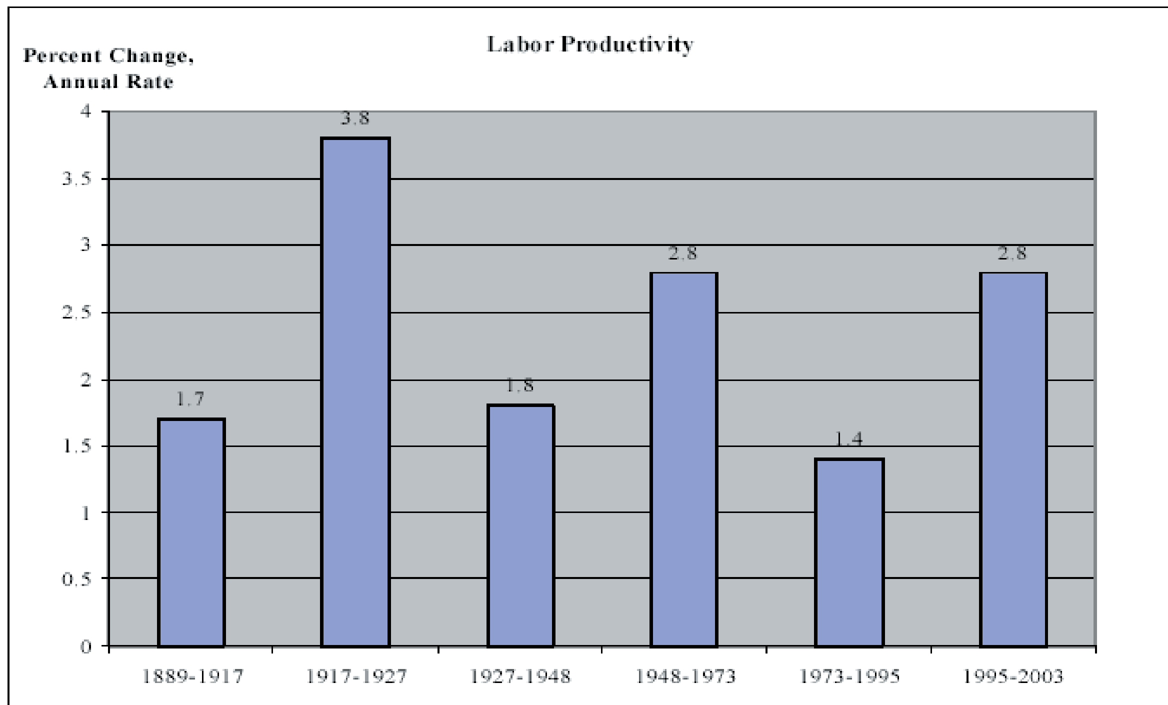


Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Annual
1998	4.6	4.6	4.7	4.3	4.4	4.5	4.5	4.5	4.6	4.5	4.4	4.4	
1999	4.3	4.4	4.2	4.3	4.2	4.3	4.3	4.2	4.2	4.1	4.1	4.0	
2000	4.0	4.1	4.0	3.8	4.0	4.0	4.0	4.1	4.0	3.9	3.9	3.9	
2001	4.2	4.2	4.3	4.4	4.3	4.5	4.6	4.9	5.0	5.4	5.6	5.7	
2002	5.6	5.7	5.7	5.9	5.8	5.8	5.8	5.7	5.7	5.7	5.9	6.0	
2003	5.8	5.9	5.8	6.0	6.1	6.3	6.2	6.1	6.1	6.0	5.9	5.7	
2004	5.6												

(Exhibit V)

Labor Production

The future health of the labor market will in large scale be dependent upon the sustainability of the high productivity rates. It seems to be a likely explanation that companies in 2003 in the aggregate were reluctant to compete aggressively in the labor market due to impressive productivity gains from their existing stock of labor and capital. However, the lack of job creation seems not to be a result of abnormally high productivity; the issue is that GDP growth is not strong enough to generate new jobs given the current productivity growth. Although this might be concerning, it's seems unlikely that labor productivity growth can continue to outstrip real GDP growth in the long term, hence job growth in 2004 would be seen as a very plausible scenario.



(Exhibit VI)

Furthermore, a common myth in economics is; periods of high productivity are accompanied by high unemployment rates. However, empirical data seems to prove the opposite, high productivity goes hand in hand with somewhat lagged job creation.

(Exhibit VII)

U.S. workers slowed their pace of productivity gains during the fourth quarter of 2003, a sign that employers will finally have to begin expanding payrolls to meet the nation's resurgent economic demand. Non-farm business productivity grew at a seasonally adjusted annual rate of 2.7% from October through December, down from a sizzling 9.5% rate in the third quarter. The 2.7% in Q4 was slightly below street expectations of 2.8%. The annual rate for 2003 was 5.3%, the fastest rate since 1965.

Weak Dollar

During 2003, the dollar depreciated almost 22% compared to the Euro and 12% compared to the yen. It declined most sharply against the currencies of many industrialized trading partners. The IMF predicts a further decline in the value of the dollar due to the large trade deficit, budget deficit, and consumer debt. The Congressional Budget Office expects the U.S. dollar to continue to gradually depreciate in 2004.

Although "a strong dollar is in US interest", according to Treasury Secretary John Snow, there is no indication yet the falling dollar is causing any serious problems. The stock market has risen nearly 23% over the past year and has started 2004 on an up-trend. In addition, bond-market analysts don't see any signs that foreign investors are abandoning US bonds. Mickey Levy of Bank of America Securities says the falling dollar "won't materially affect the rate of economic growth, but it will affect the composition—it will help exporters, but hurt consumers" and importers. Over the long term, however, depreciation could lead to rising interest rates and falling stock prices. Although a gradual decline may avoid the type of financial difficulties associated with a steep decline, it could actually put more pressure on interest rates than a steep drop, as investors demand a premium for holding dollar-denominated assets.

III. INTERNATIONAL ECONOMIC OUTLOOK

Euro-land (including UK)

If there is one factor that will differentiate Europe, it is the enlargement of the European Union (EU) when ten new countries will join. Between them, they will add 20% to the EU's existing population, but contribute only 5% to the EU's GDP. While this is a landmark event, unless European companies are able to take advantage of the cheaper cost base these countries offer, or find new sources of end-user demand, this expansion may only have a limited impact on the long-term growth prospects for corporate earnings.

The good news is that European economic growth is expected to accelerate. Economists are looking for UK GDP growth to pick up from 2.2% in 2003 to 3.0% in 2004, and a stronger acceleration out of the Euro-zone, from 0.5% this year to 2.0% next.

It appears that stronger world market growth is offsetting any possible losses of market shares of Euro-land exporters due to Euro appreciation. At the same time, Euro strength exerts downward pressure on inflation and increases the likelihood that it will ease below 2% in the course of this year. With the recovery likely to remain moderate, strong money growth poses no immediate threat to price stability.

While food price inflation accelerated in 2003, core inflation continued to ease towards the end of 2003. A sizeable output gap combined with a stronger Euro and cheaper oil should exert downward pressures on inflation in 2004. However, hikes in administered prices will prevent a more pronounced decline.

No stimulus for domestic demand can be expected from fiscal policy on an aggregate basis. Despite the recent suspension of the excessive deficit procedure against France and Germany, fiscal policy is likely to remain slightly restrictive in 2004 as the two countries promised further cuts in their structural deficits and political pressure for deficit reduction is likely to remain high.

Asia

The main focal point of the Asian region for 2004 is without doubt China. It seems likely that Chinese exports and imports continue to expand at breathtaking rates of 30-40% per annum. The Chinese economy has contributed 40% of global growth in the past five years. China is likely to see increasing inflation in the year to come due to a long period of high growth and supply-side bottlenecks emerging in certain sectors (electricity, shipping, raw materials, transport). China's growth is expected to slow down some to a GDP around 8 percent in 2004, due to the above mentioned bottle necks and an anticipated tightening of the macro policy (fiscal or monetary), already seen in the actions of PBoC (People's Bank of China).

As for the rest of Asia, the sentiment seems to be fairly bullish, expecting an Asian (not including Japan) growth rate in GDP between 6 and 7 per cent. The growth here is mainly believed to come from the industrial countries. With respect to Japan, most analysts believe that the country will come out of the deflationary cycle at the end of 2004, hence providing support for further GDP growth. A weak point of the Asian market in 2004 is believed to be the Philippines due to election uncertainty.

The biggest drag on the Asian economy during 2003 was the lack of domestic spending, SARS being on of the reasons. The return to normal spending patterns in recent months will help the Asian region to reach the optimistic growth projections by the consensus.

In 2004, major economic trends emerging in Asia will likely have a significant impact on global growth, inflation, and asset markets. Asia, led by rising inflation in China and easing deflation in Japan, could redirect the path of global inflation. As Asia's extremely supportive economic policies gain traction, Asia will continue to serve as a pillar of global growth. These trends represent a major shift in the deflationary paradigm that has dominated the region since the financial crisis. In addition, they have significant implications for the global economy at large. Over the past 12 months, Asia (including Japan) gained a US$256 billion trade surplus with America. That surplus was largely self-financed by Asia's US$250 billion of net purchases of US Treasury and Agency securities. As growth and inflation return to the region, central banks – most importantly, the People's Bank of China – are likely to choose stronger currencies instead of higher foreign exchange reserves. Over time, a declining rate of reserve accumulation could place upward pressure on US bonds.

IV. CONCLUSIONS

The primary takeaway from the economic outlook is a continued steady economic growth with an increase in interest rates on the horizon in 2004. It is essential that the asset allocation, fixed income, and sector teams pay careful consideration to the likely hood of a short-term increase and the ramifications an increase would cause. The financials sector in particular will be greatly affected by a hike in the interest rate. Variable loan portfolios of banks would hedge out a substantial portion of interest rate risk. Yet a heavy reliance upon borrowing at the short-term rates and lending at long-term rates for sources of revenue will not be sustainable. The other industries must evaluate the debt structure of their holdings and potential acquisitions so the margins won't be squeezed due to excessive variable debt.

ASSET ALLOCATION

Arriving at an asset allocation involves the consideration of broad asset classes, their expected risk and return characteristics, and how those characteristics impact the goals of the portfolio. In order to analyze broad asset classes, we have selected 3 indexes we believe accurately represent their proxy markets. We selected the Wilshire 5000 to represent the equity markets as it is the most diversified equity index with ample data available, the Lehman Brothers Aggregate Bond Index to represent the investment grade, government, and agency credit classes, and the MSCI EAFE index to represent international equities. Since historical data for all these indexes begins at different periods, we chose to represent a common period for consistency. Initially, we calculated returns, correlations, and standard deviations for the broad asset classes discussed above beginning in January 1976 and ending in September 2003. The results are shown below.

(Exhibit I)

Asset Class	Mean Return	Correlations in blue (std.dev. in green) Wilshire	LB AB	EAFE
Risk Free	6.22%			
Wilshire 5000	13.48%	15.7%		
LB Aggregate Bond	9.03%	0.247	6.1%	
MSCI EAFE	12.06%	0.540	0.164	16.8%

Since the historical risk free rate of 6.22% exceeds the current risk free rate of 1.20%, historical returns do not seem a valid proxy for future returns. To reflect the current reality of a low interest rate environment, we have calculated the historical risk premiums (shown below) and added those risk premiums to today's risk free rate of 1.20% to arrive at future anticipated returns. Furthermore, it is important to note that there is little correlation between historical interest rate levels and risk premiums.

(Exhibit II)

Asset Class	Risk Premium
Wilshire 5000	7.27%
LB Aggregate Bond	2.82%
MSCI EAFE	5.85%

(Exhibit III)

Asset Class	Mean Return	Correlations in blue (std.dev. in green) Wilshire	LB AB	EAFE
Risk Free	1.20%			
Wilshire 5000	8.47%	15.7%		
LB Aggregate Bond	4.02%	0.247	6.1%	
MSCI EAFE	7.05%	0.540	0.164	16.8%

We then adjusted the correlation between the Wilshire 5000 and the MSCI EAFE to reflect increased globalization. The EAFE has become much more correlated to the Wilshire 5000 over the past 5 years, rising from the 1976 – 2003 correlation of .586 to .840. We believe that the recent correlation between the Wilshire and the EAFE will continue into the future as a result of an increase in free trade and the spread of global capital markets. Therefore, we assumed the correlation between the Wilshire and EAFE is 0.840.

Since interest rates are at historically low levels, we worry that a strict interpretation of the above data may call for us over-weighting fixed income relative to equities due to the phenomenal returns experienced during a period of declining interest rates. Bearing that in mind, we have sought to reduce our fixed income exposure. The LB Aggregate Bond Index has a duration of 4.50. Therefore, a 50 basis point increase in

interest rates would cause bond prices to decrease by approximately 2.25% and a 100 basis point increase in interest rates would cause bond prices to decrease by approximately 4.50%. A 50 basis point increase in interest rates would cause enough of a drop in prices to offset the coupon on recently issued short term corporate and agency bonds, while a 100 basis point increase in interest rates would offset most of the coupon on recently issued long term corporate and agency bonds. The effect on recently issued high yield bonds would be of a lesser magnitude. (Bonds Online) We reflected the anticipated higher interest rates by decreasing the mean returns for LB AB Index by 2.25% reflecting a 50 basis point increase in interest rates.

Asset Class	Mean Return	Correlations in blue (std.dev. in green) Wilshire	LB AB	EAFE
Risk Free	1.20%			
Wilshire 5000	8.47%	15.7%		
LB Aggregate Bond	1.77%	0.247	6.1%	
MSCI EAFE	7.05%	0.840	0.164	16.8%

(Exhibit IV)

Finally, due to increased leverage in corporate America, we believe an interest rate increase may cause a decline in equities as well this year. However, we believe the SMU Balanced Pool should maintain its long-term exposure to equities, but use options to provide a cushion against downside moves in the market, increase income, and reduce volatility in the portfolio. Therefore, although the ARC is a long only portfolio, we have built an additional optimal portfolio that considers a buy write (or covered call) strategy for the Balanced Pool's consideration. As with the other broad asset classes, we have reduced the average return of this strategy to reflect lower current interest rates by adding the historical risk premium to the current risk free rate. Due to the fact that historically the buy write index has provided a greater annual return to investors with less risk than an un-hedged index, we investigated the cause of such abnormal returns. Historically, implied volatility in option prices is higher than the volatility realized (Whaley). However, we caution that skewed payoffs and risk parameters are measured with more error. As a writer of options, you capture the implied volatility and pay out the actual volatility, and therefore have realized the spread between the two in the past. We anticipate this spread will continue to be captured due to "excess buying pressure on S&P 500 puts by portfolio insurers. Since there are no natural counter-parties to these trades, market makers must step in to absorb the balance. As the market maker's inventory grows, implied volatility will rise relative to actual return volatility;" (Bollen and Whaley). Below are the returns, correlations, and standard deviations from June 1988 to September 2003 common data period adjusted as discussed above. Since the Buy Write Index represents a more optimal portfolio for equity exposure than the Wilshire 5000, the Wilshire has been excluding from our optimization that includes the Buy Write Index.

Asset Class	Mean Return	Correlations in blue (std.dev. in green) Wilshire	LB AB	EAFE	Buy Write
Risk Free	1.20%				
Wilshire 5000 TR	8.48%	14.92%			
LB Aggregate Bond TR	2.40%	0.171	4.02%		
MSCI EAFE TR	6.05%	0.840	0.069	17.10%	
Buy Write Index	8.51%	0.868	0.142	0.522	9.92%

(Exhibit V)

Furthermore, the endowment could buy protective puts instead of writing calls (or in addition to writing calls, thereby creating a collar) to protect against downside risk. Buying a protective put offers the equivalent of insurance against market risk. As of the close on March 15, the S&P 500 traded at a price of $1,110.70. A put with a strike price of $1,100.00 that expires in June of 2005 costs $69.80. Therefore the cost of protecting against market risk is $69.80 (6.28%) for every $1,110.70 with a $10.70 "deductible" per $1,100.00 exposure to market risk for 1 ¼ years. If the endowment wishes to maintain its exposure to equities, but lower their risk and increase the likelihood of capital preservation it should employ this strategy. However, we would caution the endowment against this approach due to the inefficient pricing of puts discussed in the above paragraph.

When deriving the optimal portfolio for the broad asset classes less the Buy Write Index, we draw several interesting conclusions. First, due to the low anticipated bond returns relative to their risk over the next year, the optimal portfolio would not allocate capital to the fixed income markets. However, we would like to carry some fixed income as a cash substitute and to minimize transaction costs. Therefore, we looked to Wall Street strategists for guidance. The average recommendation for fixed income exposure was 26% at the beginning of the year. However, these recommendations are dated prior to the fed signaling that it might increase rates sooner. Thus, we recommend a 20% allocation to fixed income. However, we should avoid securities with large durations, while focusing on short-term high credit quality bonds. Secondly, due to the increasing correlation between foreign markets and domestic markets coupled with our expertise in the domestic market, we have choose to eliminate foreign equity exposure as the benefits of diversification are minimal. Therefore, we aim to allocate 80% to equities and 20% to fixed income. We expect the following return and risk measures on this portfolio.

We do not believe that the endowment's target 9.00% return can be met without incurring excess risk in the portfolio. However, we believe that the above rate of return should allow the university to continue with its 5.05% spending objective.

(Exhibit VI)

Mean	7.14%
Std. Deviation	12.93%
Sharpe Ratio	0.46

However, the Balanced Pool could reduce risk by substituting a hedged portfolio (i.e. buy-write) for un-hedged equity exposure as discussed above. While we have maintained our fixed income exposure at 20%, the buy-write strategy would receive 80% of capital in an optimal portfolio instead of the Wilshire. We expect the following return and risk measures for such a portfolio.

(Exhibit VII)

Mean	7.29%
Std. Deviation	8.20%
Sharpe Ratio	0.74

While the returns under this strategy would not meet the endowments desire for a 9% return, it would provide a greater return than the strategy using un-hedged equity exposure, reduce volatility dramatically, and provide a better return per unit of risk. Therefore, we suggest an 80% equity exposure preferably through a buy-write strategy with 20% fixed income exposure primarily in short duration bonds for the Balanced Pool, but due to our long-only limitations we will not write options.

COMPREHENSIVE LIST OF HOLDINGS

Sector	Company Name	Ticker	Market Capitalization (Mkt Value of Equity)	Common Shares Outstanding (Mil)	Stock Price (as of 4/21/04)	Shares Owned	Market Value of Holding (as of 4/21/04)	Pct of Total Equity Portfolio & Market Value of Sector
Consumer	Altria Group	MO	$113,740	2037	$55.83	1200	$66,996	
	Brinker Intl	EAT	$3,601	96	$37.60	850	$31,960	
	Catalina Marketing	POS	$927	53	$17.38	850	$14,773	
	Harley Davidson	HDI	$17,206	298	$57.77	1250	$72,213	
	AutoZone	AZO	$7,133	84	$84.67	1200	$101,604	
	Oakley	OO	$1,099	68	$16.18	1000	$16,180	
	Walgreen	WAG	$33,451	1025	$32.65	1000	$32,650	19.4%
								$336,375.50
Energy	Florida Power & Light	FPL	$11,684	184	$63.41	500	$31,705	
	Anadarko	APC	$13,813	255	$54.17	1800	$97,506	
	EOG Resources	EOG	$5,591	116	$48.24	650	$31,356	
	Stat Oil	STO	$28,355	2166	$13.09	3500	$45,815	11.9%
								$206,382.00
Financials	American Intl Group	AIG	$190,939	2608	$73.20	760	$55,632	
	Citigroup	C	$253,413	5157	$49.14	1200	$58,968	
	Wells Fargo	WFC	$95,451	1698	$56.21	900	$50,589	
	Developers Diversified Realty	DDR	$2,792	86	$32.30	2200	$71,060	
	Bear Sterns	BSC	$8,560	105	$81.84	1000	$81,840	
	MNBA Corp	KRB	$32,132	1278	$25.15	1125	$28,294	
	Synovus Financial Group	SNV	$7,160	302	$23.70	900	$21,330	21.2%
								$367,713
Health Care	Amgen Inc.	AMGN	$73,184	1284	57.01	600	$34,206	
	Stericycle	SRCL	$2,060	42	$49.20	950	$46,740	
	Medtronic	MDT	$62,222	1212	$51.33	2000	$102,660	
	Quest Diagnostic	DGX	$8,466	103	$82.35	600	$49,410	13.4%
								$233,016.00
Industrials	Alcoa	AA	$27,593	869	$31.74	1700	$53,958	
	Stericycle	SRCL	$2,060	42	$49.20	950	$46,740	
	World Airways	WLDA	$44	11	$3.85	14000	$53,900	
	United Technologies Corp	UTX	$43,705	514	85.02	850	$72,267	13.1%
								$226,865.00
Technology/ Telecom	Cisco Systems	CSCO	$153,950	6882	$22.37	1760	$39,371	
	Cymer	CYMI	$1,272	36	$35.00	1100	$38,500	
	Dell Computers	DELL	$89,025	2556	$34.83	900	$31,347	
	Microsoft	MSFT	$274,580	10789	$25.45	2400	$61,080	
	Qualcom	QCOM	$52,839	803	$65.84	520	$34,237	
	Wipro Limited	WIT	$11,144	231	$48.15	2200	$105,930	
	Symantec	SYMC	$14,676	310	$47.29	1100	$52,019	20.9%
								$362,484.00

Portfolio Totals:

Equity	$	1,732,835.25
Fixed Income	$	429,644.27
Rebalancing and Mark-to-Market	$	25,889.48
Total Portfolio Value at Close of Apr 26	$	2,188,369.00

EQUITY PROFILE

In an effort to boost returns but reduce risk during the economic recovery, the Undergraduate Practicum class has chosen a value-driven approach to growth. All of the characteristics given are representative of stock prices at the close of trading on April 21, 2004. All holdings, both existing and new, were evaluated by class members using ratio analysis as well as discounted cash flow analysis. The resulting portfolio contains what the class feels are strong companies whose values will appreciate as the US economy and markets recover.

Financial Characteristics

Valuation	ARC Fund	Market
TTM P/E of Portfolio	16.89	21.03
CFY P/E of Portfolio	16.42	18.62
NFY P/E of Portfolio	13.98	17.06
PEG 04-05	1.31	2.04
PEG 5 yr	1.10	2.28
Price/Book	3.04	3.58 *
Growth		
5-Year EPS Growth Rate(wtd)	14.97%	8.17%
EPS Growth Rate 2003 - 2004	2.87%	12.90%
EPS Growth Rate 2004 - 2005	12.57%	9.15%
Risk Characteristics		
Beta	0.95	1
Lt Debt to Equity (BV)	0.61	0.75 *

Note: All figures from S&P 500 unless noted
* - Taken from Valueline Composite

On a price to earnings (P/E) basis, the class has demonstrated the desire to pay significantly less for every dollar of earnings than the S&P 500. Not only has the class paid less for earnings in the past, but should consistently take a value-oriented approach going into the near future. We are also paying significantly less per unit of growth, as shown by lower PEG ratios relative to the market.

The Fund's price to book ratio, an indication of the market's willingness to pay premiums above a firm's hard assets, is lower than the Valueline Composite. We feel that the stocks picked by this year's Class have developed a strong asset base to drive future growth.

Growth

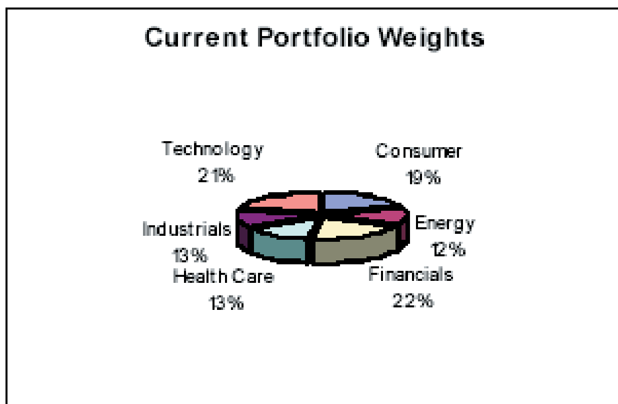
The significant difference in EPS growth rate for 2003 – 2004 can be attributed to the recent acquisition, World Airways. While we feel that World Airways represents an attractive equity investment on a discounted cash flow and comparable companies basis, the Company is during a period of transition, which

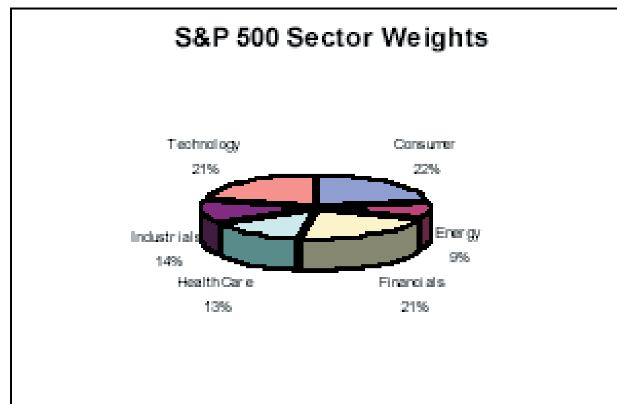
will cause a significant drop in earnings per share next year. When World Airways' earnings are omitted from the Portfolio as a whole, the 2003 – 2004 growth rate rises dramatically to 14.42%.

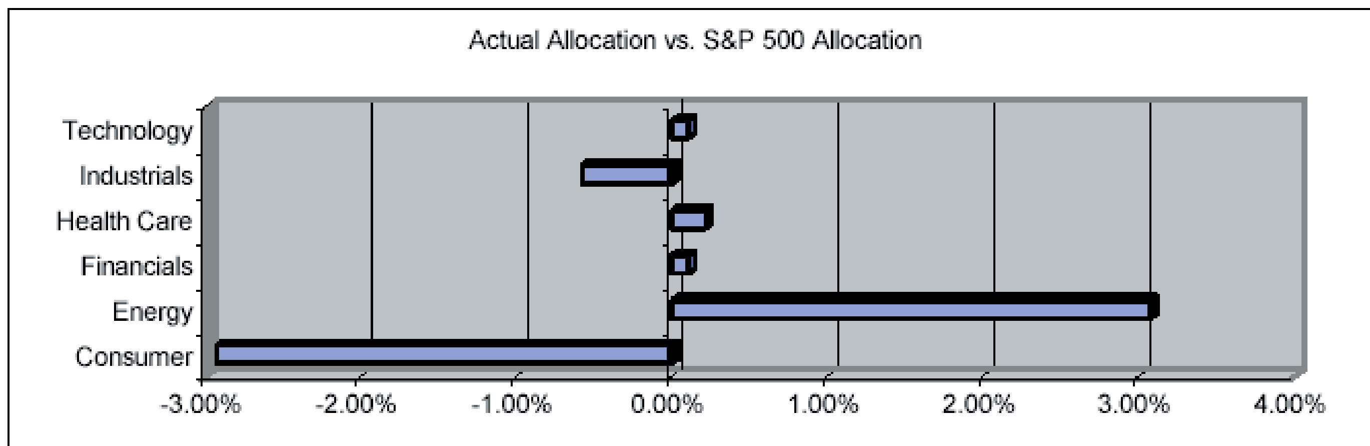
In future years, the Portfolio's growth prospects are superior to that of the market.
This is an indication the fund has been able to secure positions in high growth companies at discounted prices. In the coming years, if these firms are able to perform according to market expectations, the ARC Portfolio will be that much stronger.

Risk

The Fund's beta, a fundamental risk measure, is slightly below the market beta of 1. This means that the Fund is less sensitive to volatility than the market as a whole. This is an advantage to the class because we will still be able to achieve high returns if the recovery continues but can still limit downside exposure should more terrorism attacks or wars occur. The Fund's smaller long term debt to equity ratio indicates that our holdings are less levered than the market. Going forward, the Portfolio holdings will have cleaner balance sheets that will allow them broader financial flexibility.







EQUITY ACTIVITY BY SECTOR

I. CONSUMER SECTOR

Consumer demand is projected to grow more rapidly in 2004 than in 2003, at an average annual rate between 2.5 % and 3%. However, near term growth of consumption will remain slow as households save additional disposable income. Weak labor markets have suppressed growth of consumer income in recent years, but we expect moderate gains in employment as demand picks up in 2004. The consumer sector is divided into two sub-sectors: consumer staples (non-cyclical) and consumer discretionary (cyclical). Given the weakness of the labor market and sluggish near term consumption growth, we expect staples performance to be stronger than discretionary in the near term. Negative earnings in global staples in 2003 were driven by European companies and reflect the weak dollar, not weaker underlying growth. Signs of sector rotation, coupled with strong growth expected from emerging markets, suggest that investing in staples will continue to provide less volatility. In the long term, it would prove valuable to shift back toward the discretionary sector to gain a higher return if consumer demand and employment increase as expected.

SELL: COORS (NYSE: RKY)

Limited growth opportunity in slowing industry.
Coors Adolph's stock has a moderate downside given dependence on one product, Coors Light, and limited innovation in a slowing domestic beer market. RKY is currently overvalued. It will need to meet a 5% growth rate over the next fiscal year; the industry expected growth rate, set by Busch, is approximately 1%.

Delayed and poorly executed response to product innovation trends.
Anheuser-Busch is leading the light beer battle with both Michelob Ultra *and* Bud Light; Coors has not made a powerful entrance with Coors Light and will not capitalize on its brand equity with Aspen Edge.

High costs, no indication of changing structure.
Currently, Coors Adolph has the highest costs per barrel of beer in the industry. Driven by very high transportation expenses, distribution costs are unnecessarily high due to the reliance on one major brewery to produce 90% of the volume in the United States.

International market growth not expected.
Although Coors diversified its portfolio with its acquisition of Carling in the U.K., the beer market in the U.K. has reached maturity. Overall, beer consumption in the U.K. has declined around 0.7% annually since 1992 on a per-gallon-per person basis.

BUY: AUTOZONE (NYSE: AZO)

Autozone, Inc. (AZO) is a specialty retailer of automotive parts and accessories, with most of its sales to do-it-yourself customers. As of August 30, 2003, the Company operated 3,219 domestic auto parts stores in 48 states and the District of Columbia and 49 auto parts stores in Mexico. AutoZone also sells parts and accessories online at Autozone.com. Each of its stores carries a product line for cars, sport utility vehicles, vans and light trucks, including new and remanufactured automotive hard parts, maintenance items and

accessories. The Company also has a commercial sales program in the United States that provides commercial credit and prompt delivery of parts and other products to local, regional and national repair garages, dealers and service stations. In addition, AutoZone sells automotive diagnostic and repair software. The decision to purchase AutoZone was based on fundamental and valuation analysis.

Fundamental Analysis

Auto parts industry is an attractive industry to diversify our portfolio; auto parts retailing is a $48 Billion commercial market. This sector is characterized by low volatility and attractive expansion opportunities. This discretionary industry has remarkably stable demand. AutoZone offers a sound step as we wean away from consumer staples and into discretionary sectors.

Autozone is well-positioned within the industry; the Company has demonstrated excellence in providing customer service, breadth of product lines, multiple channels of distribution, and continued product innovation; all key drivers in differentiating oneself among the auto parts industry leaders.

Management's top-line growth initiatives will leave AutoZone as the fastest growing company in the industry with plans to open 195 new stores in 2004. Initiating "refresh" program to renovate stores and compete with newer entrants. The Company also has plans to normalizing and broadening of inventories as well as expansion of product lines to attract and retain more customers.

Valuation

Autozone is characterized as having the highest gross margin and EBITDA margin among comparable companies. Its PEG ratio of 1.29 is more attractive than comparable average of 1.66. Based on our discounted cash flow analysis, AutoZone is undervalued by a significant 21.1% indicating an appropriate time to enter into this industry and hold the Company within our portfolio.

II. ENERGY SECTOR

Energy

The price of crude oil is the engine that drives the energy industry. In the late 1990s, in the wake of the Asian economic downturn, oil prices sank to $10 a barrel. The slump drove many small independents into bankruptcy and some larger oil companies into mergers. Subsequently, drilling activities were curtailed, causing a ripple effect: Oil service companies (contract drillers, well maintenance firms, and others) had fewer rigs to service, pipeline and storage companies had less oil and gas to transport and store, and refineries produced less gasoline. But oil prices soared to more than $30 a barrel in 2000 (and again in 2003 in the run up to the Iraq war), and the industry has rebounded. The higher prices have reached most of the industry — producers, refiners, pipeline companies, equipment makers, oil field service providers, and gas station operators – which have all enjoyed new profits.

Utilities

About half the states in the US have taken steps to deregulate their electric utility industries, but many have delayed launching full retail competition because of one state's whopping failure. California's electricity crisis was brought on in part by a unique deregulation plan that forced utilities such as Southern California Edison and Pacific Gas and Electric to pay soaring wholesale power prices but prevented them from passing increases on to consumers. The result in the winter of 2000-2001: financial disaster for the utilities, and scarce power supplies for customers. Other states, notably Pennsylvania and Texas, have had

happier experiences with retail electricity competition, but many would-be supporters of deregulation are waiting to see what the long-term effects will be.

The electricity business gets more attention, but natural gas utilities also are being deregulated. In the US about 20 states have taken steps toward allowing retail customers to choose their supplier, but so far only five states and Washington, DC, are allowing full retail competition for all residential and commercial customers.

SELL: DUKE ENERGY CORPORATION (NYSE: DUK)

Duke Energy Corporation is Currently Overvalued by the Market

Duke's current stock price does not reflect the operating costs that will likely increase in the near term, driving the Company's earnings and stock price down. In addition, Energy Team believes that the market price does not account for the internal turmoil and restructuring that Duke is currently experiencing. Also, the stock price appears to reflect growth potential based on Duke's past success, which our research indicates will not continue.

Duke's Cost of Goods Sold will Rise in the Near Term due to High Natural Gas Prices

Energy Team confidently predicts that natural gas prices will remain stable at their current historically high level due to inventory shortages, increasing demand, and a lack of viable import opportunities. Duke uses natural gas to generate power for their plants and the high price of natural gas will drive up the Company's cost of goods sold, thus decreasing final profits.

Company Reorganization and Internal Issues will Prevent Growth in the Near Future

Duke recently hired a new CEO and management team. The Company is now in the midst of a massive reorganization, which calls for the exit of deregulated markets in favor of regulated markets. This shift impairs growth prospects because regulated markets have minimal growth potential. Additionally, the Company is too heavily focused on maintaining high dividends, which can only be achieved at the expense of other investment opportunities.

Valuation

Energy Team recommends selling Duke based on weakening fundamentals and rich valuation. Clearly, the Company's stock price is overvalued according the DCF analysis and its low potential for growth.

BUY: ANADARKO PETROLEUM (NYSE: APC)

Strike When the Natural Gas Market is Hot

Anadarko Petroleum Company is among the largest independent oil and gas exploration and production companies in the world, with 2.5 billion barrels of oil equivalent (BOE) of proved reserves as of December 31, 2003. The company actively markets natural gas, oil and natural gas liquids (NGLs) and owns and operates gas gathering systems in its core producing areas. Due to a unique position in the North American continent, an equally weighted reserve mix, and a new business plan to be implemented under new management, Anadarko is a company with great prospects not yet realized by the market.

Oil and Natural Gas Market Outlook

Consensus opinion predicts a decline in oil prices combined with no growth in natural gas prices. However, Energy Team disagrees with the consensus view regarding natural gas prices, as analysts have not properly accounted for the combination of increased demand and restricted supply. Energy Team is con-

fident that these factors will cause an increase in natural gas prices. Additionally, OPEC's recent actions concerning supply restrictions further support our positive outlook.

Ability to Capitalize on High Commodity Prices Based on Their Reserve Mix
Anadarko's reserve mix consists of 50% natural gas and 50% oil, which allows the Company to benefit from rising commodity prices on both fronts. Additionally, Anadarko's position in the onshore North American continent gives the Company and advantage over its competitors due to the difficulties of transporting natural gas.

Near-Term Growth
The Company's 2004 capital expenditure budget has been set between $2.6 billion and $2.9 billion. Anadarko has allocated $2.3 billion to $2.6 billion for worldwide exploration and development. Approximately 80% will be designated for development and about 20% for exploration. The primary focus of the 2004 budget is to direct capital to the areas that have shown the best performance and rate of return.

Valuation
Anadarko's PEG ratio is the lowest among its peer group at 1.28, signaling high potential for growth. In addition, the Company's EPS growth rate is extremely high at 53.15%. The gross margin for 2003 is 55.7%, which the Energy Team believes is sustainable with the current commodity prices. Anadarko's operating margin is 43.1% and its EBITDA margin is at an impressive 68.4%. The EPS figures for Anadarko are historically high compared to its peers and the DCF analysis indicates that the Company is currently undervalued by the market by approximately 36%.

III. FINANCIAL SECTOR

The Financials Sector as identified here consists of five primary groups: Diversified Financial, Insurance, Investment Services, Banks ex S&L, and Real Estate Investment Trusts (REIT). These groups derive their revenues from charging fees for specific financing-related activities. Companies in these sub-sectors focus on utilizing various cash resources and distributing them among various higher return projects and activities. They differ from many companies in other sectors in that there is often no physical product and hence no need for inventory and receivables. The Financials Sector is thus a highly focused service industry with experts in specific finance-related fields.

Diversified Financial

- *Citigroup*
  Citigroup first and foremost has tremendous market position creating eminent stability. On a comparable basis the company looks attractive; higher EBITDA margins, a PEG of 1.1 compared to and industry average of 1.6. We presume the market has not accounted for the projected 5 year growth rate that we contend to be obtainable.

- *MBNA*
  MBNA has a very clean balance sheet with strong growth prospects. Their strict credit approval keeps the risk of bad debt off their balance sheet. They also have a low debt to equity ratio of .37 which gives them the ability to take on more debt for future growth opportunities

Investment Services

Volatility in the capital markets increases fees, thus generating more revenue and growing profits. On the other hand volatility can cause an overall slowdown in IPO's and other fee generating activities creating a reduction in revenue growth and therefore profit.

- *Bear Stearns*
  The benefit from an increase in economic growth implies an increase in M&A activity and equity originations of secondary offerings will increase as well. Possible merchant banking activity could add significant boost to 2004 EPS.

Insurance

Due to the premium fees from customers, insurance companies have a very stable source of revenue. These large sources of cash allow insurance companies to take advantage of investments as they become available. Unforeseen extraordinary circumstances, such as 9-11, can cause tremendous financial pressure, forcing some companies into bankruptcy. This uncertainty may make insurance exposure attractive, except in periods of premium growth and prosperity.

- *American International Group*
  AIG has had strong premium growth in the past two years which we estimate to be sustainable. Consolidation and fallout from 9-11 has lead to decreased competition. Improving markets in Asia will help AIG as 28% of their 2002 revenue is derived from this market. AIG appears to be slightly undervalued on a comparables basis.

Banks EX S&L

- *Wells Fargo*
  Wells Fargo is the fifth largest bank in the nation. We believe that their strong market position helps to guarantee future business in securing loan agreements in the economic recovery. They have an ROE that is above the industry average. Their five year PEG of .59 shows that they have strong growth prospects and are not overvalued.

- *Synovus*
  Synovus has a solid business model that continues to focus on community banking while at the same time engaging in acquisitions of other regional banks. The bank also holds an 81% stake in the largest processor of credit card transactions in the nation, which provides diversification. With consumer spending remaining strong, we see this as a positive.

REITS

According to efficient frontier analysis by previous practicum classes we have a long term goal of holding 5% in real estate. With this goal in mind, allocating a portion of the financials funds will help bring our holdings in line with the aforementioned goal. Also, there is a relatively low correlation between REIT and publicly traded real estate stock returns and the returns of other market sectors. Thus, including REITs and publicly traded real estate stocks in your investment program helps build a diversified portfolio.

In addition to fulfilling allocation goals, real estate holdings will decrease some of the volatility associated with equity assets. It is well known that risk, or volatility, can be reduced through diversification. This principle applies not only to diversification within the stock market, but to diversification among different asset categories. Because returns to real estate, venture capital, foreign securities, oil and gas, etc. are not highly correlated with domestic stock and bond markets, including these asset classes within an endowment investment pool will reduce volatility.

BUY: DEVELOPERS DIVERSIFIED REALTY (NYSE: DDR)

DDR is well positioned to capture sustainable growth through its geographical locations and an increase in consumer spending through its retail outlets. DDR is undervalued compared to its industry and peers with a lower P/E and book to equity. The GLA is 5 percentage points higher than the nearest competitor.

Fundamental Analysis

- Creates valuable asset class exposure
- Helps us meet Equity Profile goal
- We are not overpaying for this security
- Diversified holding which helps provide portfolio stability
- DDR follows demographic shifts while maintaining important coverage
- Provides a stable stream of income for the portfolio

As compared to its competition, DDR is the most diversified across growing target regions as well as being a better value based on various valuation variables. One of the major factors in choosing a REIT is the dividend it pays out to shareholders. DDR has a strong dollar value dividend of $1.84 per share which is in the mid range of its comparables. DDR's dividend yield is also very strong at 5.53% which stands to grow considerably for reasons to be discussed.

DDR retained some of its earnings by lowering its payout ratio to 73% and by issuing stock for the remaining capital needed. With the merger completed, DDR will be able to increase its payout ratio back to the more standard 100% range which in turn will increase its dividend yield to a range higher than its competition.

DDR's tenant quality is very high as their major leases are focused on large profitable anchor tenants. This is important because peripheral leases are often contractually linked to anchor tenants. The better your anchors the better your peripherals and the more traffic you get at your centers resulting in increased rents and percentage rents. In their shopping center format DDR's top tenants are Wal-Mart/Sam's, Kohl's, TJ Max, and Lowe's all of which are stronger retailers in today's market.

Occupancy levels are very important in any real estate property and DDR has maintained an occupancy level company wide 95%. DDR's levels are 5% higher then the comparable companies. Management expects a continued growth in occupancy rates in their acquired properties which are currently occupied at 91%. This will bring the new properties in line with their past management performance.

IV. HEALTHCARE SECTOR

Gradually, medical progress has been expensive, and healthcare still represents the largest sector of the U.S. economy. United States healthcare expenditures have skyrocket from $4 billion in 1940 to $1.1 trillion in 1998, almost $4,094 per person. Further, this health care cost accounted for approximately 13.5% of the gross domestic product (GDP) or one-seventh of the U.S. total output. Total U.S. health care costs are projected to increase from $1.31 trillion in 2000 to $2.17 trillion in 2008, averaging a 6.8% increase per year. Health care spending in terms of GDP is expected to increase from 14% in 2000 to 16.2% in 2008. According to Plunkett Research, rising drugs costs amply contribute to the soaring health care costs. Since 1995, the price of drugs has been increasing more than 10% annually and has surpassed $110 billion annually. Most importantly, a large percentage of the U.S. population will also be aging. Baby boomers of 1946 to 1964 will reach retirement age and this retiring population will increase sharply. Demand for medical care, long-term care facilities, drugs, improved medical equipment technology, and other medical services will grow significantly.

Additionally, the drug market is one of the world's most profitable markets in terms of profit margin. For instance, "lifestyle drugs" alone economically and socially have been transforming the $98 billion U.S. pharmaceutical market. With the forefront of the biotech era, biotechnology is expected to produce up to ½ of all new drugs in the future. Further, one of the other healthcare sectors of interest include the Medical Equipment and Supplies market. In 2002, worldwide medical device business represented a global market of about $190 billion — an increase of about 10% from $172 billion in 2001. We expect that continued favorable demographics will drive further growth in this sector.

The outlook for healthcare technology will mostly encompass regenerative medicine, transgenics (use of organ and tissues grown in lab animals for human transplant), neo-organs, the human genome project, enhanced gene therapy, new drug delivery methods, new technology in hospital systems, support and services, nanotechnology and advanced in cancer research, diagnostic imaging and monitoring, laboratory testing, and surgery.

SELL: NOVARTIS AG (NYSE: NVS)

Novartis AG's core business involves pharmaceuticals and consumer health, which includes generics, over-the-counter self medication, animal health, medical nutrition, infant and baby products, as well as eye care products. High research and development expenditures and high levels of cash are common among the Drugs & Pharmaceuticals industry. Remaining innovative is key to being successful in this industry hence, the necessity for high R&D. Novartis has done a great job of controlling its R&D by keeping them consistent at 15% of revenues. However, if they do not receive the expected return on R&D, it could cause them to increase their expenditures or see revenues fall. Also, Novartis AG is expected to grow revenues at 7% per year. We feel this is fairly low for a company that has invested so much into research and development. Revenues may even fall below consensus estimates due to the market not widely accepting their two new drugs Zelmac and Xolair. We also are unsure of the effects of a possible merger with the French drug manufacturer, Aventis. Management has said they are not opposed to a merger however they will not behave illogically. Upon further quantitative analysis, we see that the P/E ratio is fairly high and their historical growth rates have been meager. We also found that they are not a leader of the industry in sales, EPS or growth in EPS. After running a DCF valuation model in which we grew revenues at 8% and kept costs and R&D constant, we found that NVS was slightly overvalued. Upon completion of our quantitative and qualitative analysis, we felt Novartis would not help us reach our investment goals.

BUY: MEDTRONIC (NYSE: MDT)

Medtronic is one of the largest medical technology companies that manufactures implantable biomedical devices. The company operates in five business segments: Cardiac Rhythm Management (CRM); Neurological and Diabetes; Spinal, Ear, Nose, and Throat and Surgical Navigation Technologies (SNT); Vascular and Cardiac Surgery. CRM accounted for 47% of 2002 sales and the Neurological, Spinal and Diabetes segment accounted for 35%. Although net income was down in 2001 and 2002 due to increased acquisitions and competition from drug-eluting stents, they are now stabilizing into some diverse product lines. After seeing these figures we were attracted to MDT because it has such a healthy and diverse revenue base.

Outlook

The shift in demographics, rising standards of living, and the customer base expanding overseas are expected to fuel the growth in the medical equipment and supplies industry. Market consensus expects 15% growth for 2004 and 2005, and earnings growth of approximately 18%-20% in 2004. The drivers of this growth are innovative high technology products such as drug-eluting stents, external and implantable cardioverter defibrillators (ICD's). Recently approved rate increase by the Centers for Medicare and Medicaid Services for ICD's will increase Medicare reimbursements by 3.9%. This guideline as well as some other legislation is expected to increase the number of people receiving ICD's by 65,000 per year. This is very positive for Medtronic because it accounts for 14% of the cardiology market.

Positive growth prospects

Another area where high growth is expected is in drug-coated (or –eluting) coronary stents. A coronary stent is inserted into a diseased coronary artery after an angioplasty procedure. One risk of the coronary stent is the artery may reclose at the site of the stent, which is known as restenosis. With drug-coated coronary stents, they are able to reduce restenosis, because they are coated with anticancer compound that inhibits cell proliferation and releases the drug over a period of time. This market is expected to double in growth to $4.5 billion by the end of 2004. Medtronic is in the process of getting FDA approval of their drug coated stent, Endeavor, and expects to enter the European market in late 2004 and the US market in late 2005. While they will be third to enter the market, they are the only company to currently have a bare metal stent out in the market.

Valuation

Upon a comparable basis, Medtronic ranks first in sales and net income. Of their sales, ICD's experienced growth of 47%, pacing systems experienced an increase of 10% and Spinal, ENT, SNT net sales increase 32%. They also enjoyed a high EBITDA margins and gross margins. When constructing our valuation model, we have determined that Medtronic is undervalued on a DFCF basis.

POSITION INCREASES: AMGEN (NYSE: AMGN)

In order to promote diversification and to realign our current asset allocated weights within our Healthcare sector to reflect the S&P healthcare sector weights, we choose to increase our positions in Amgen. For each holding, we performed due diligence and have come to the conclusion that there retains more potential growth among Amgen, considering favorable demographic trends. Further, qualitative and quantitative analysis indicate positive results, and we also believe Amgen is currently undervalued on a DCF basis.

V. INDUSTRIALS SECTOR

Industrials Sector Outlook

Capital Goods (Conglomerates):
Sentiment for 2004 is positive for conglomerates relative to the market, as the ISM index has been up for 6 consecutive months. Additionally, the weakening dollar will benefit US conglomerates with business in Europe.

Transportation Services (Airlines):
In 2003, favorable market conditions re-opened the capital markets to the airlines. However, labor appears to be gaining strength as industry becomes sounder operationally, and the airlines appear overvalued on an forward AEV/EBITDAR multiple relative to historical multiples

Materials Sector Outlook

Materials – (Chemicals):
Oil and natural gas are the major input for this industry, which should reduce the industry's attractiveness in the near term. Further, many chemical companies consider themselves undervalued as a result of the oil and gas price increases, and therefore M&A activity is rare.

SELL: DELTA AIRLINES (NYSE: DAL)

The decision to sell Delta was based on our analysis that indicated the market has been slow to recognize the problems Delta faces regarding rising fuel and labor costs as well as the increased competition from low cost carriers like Southwest.

Labor Costs
Delta's pilot contract expires in 2005, a period of projected industry strength, which increases labor's negotiating power leading to costs above consensus who currently forecast labor cost decreases. Furthermore, Delta's large cash balance will injure its ability to negotiate with labor.

Energy Costs
Furthermore, the market sees a decline in fuel costs, which our energy team does not foresee. Therefore, we do not believe that we should be long stocks with fuel as a major input until the market takes into account fuel costs at least at today's levels.

Competition
Lastly, the market growth potential in the major airline industry is limited as price competition intensifies with the expansion and creation of point-to-point low cost carriers. Low cost carriers and regional jet operators control 46% of the market (Department of Transportation) currently. It should be noted that major airline financial difficulties cannot just be attributed to the September 11th terrorist attacks as low cost carriers have made significant inroads in obtaining traditional major airline customers over the past few years.

POSITION INCREASES: ALCOA (NYSE: AA), UNITED TECHNOLOGIES (NYSE: UTX), and STERICYCLE (NYSE: SRCL)

In order to ensure proper diversification within the Industrial and Material's sector as the portfolio shifted assets out of fixed income to equity, we increased the above positions, so that they were approximately equally weighted to our new buy, World Airways.

However, we performed due diligence on each increased position. We chose to increase our exposure to Alcoa as we believe aluminum prices will remain high as the economy begins to re-inflate, which will boost top-line growth. Our exposure to United Technologies was increased due to continued positive developments in defense spending that we believe will continue to occur beyond consensus estimates. Lastly, we increased our position in Stericycle since we believe it is currently undervalued on a multiples basis.

SELL: TELEFLEX (NYSE: TFX)

Declining margins
The team believes that Teleflex will see its aggregate margins drop due to increased price pressure resulting from anticipated commoditization in all three markets.

Disappointing organic growth potential
Teleflex is highly dependent upon acquisitions to sustain its current growth rate. Underlying Q42003 revenue growth of 18% was 6% organic growth, 5% Foreign Exchange and 7% acquisitions. As the company in its Q4 earnings call did not mention anticipated acquisitions in 2004, but instead focused on aggregate streamlining and sell-offs, we saw future growth potential as limited.

Lacking innovation to enter new niches
Teleflex's past strategy of developing cutting edge products and timing entry into niche markets has been the backbone of its success and growth. 30% senior management turnover, plant closures, centralization and reducing investments in R&D will not, in our view, create a good foundation for innovativeness.

Ongoing CFO search sending the wrong signals
Teleflex is not getting any closer to the appointment of a new CFO. During Q4 earnings call, CEO Jeff Black told the market that he would be patient to find the right man for the job. We believe that the ongoing search for a CFO was making Teleflex a risky investment and that a further lagging of this process could put downward pressure on the stock price.

DCF implies stock is overvalued
Our DCF model, assuming more price pressure than consensus, priced Teleflex at $47.10 per share; a 4.2 % implied premium to the market price. Our sensitivity analysis yielded intrinsic a per share focus-interval of $43.45 to $52.45 running an after tax WACC from 6.9% to 7.3% and terminal growth rate from 2.5% to 3.9%. When we neutralized the margin compression assumption in 2007, our target price rose to $54.17 suggesting the stock was 8.2% undervalued.

BUY: WORLD AIRWAYS (NYSE: WLDA)

WLDA provides longer range charter cargo and passenger and ACMI wet lease transportation primarily "serving the United States Government, international passenger and cargo air carriers, tour operators, international freight forwarders and cruise ship companies" (Multex Investor). We feel World Airways presents an attractive opportunity to profit from the market's over emphasis of labor issues facing the Company and the slowdown in defense demand resulting from reduction of hostilities in Iraq.

Labor

Despite the fact that the company reached a tentative agreement with World Airway's cockpit crew members' union bargaining committee on January 16, 2004, on March 1, 2004 the Company announced that its cockpit crewmembers rejected a tentative agreement for contract extension. Management has indicated that both sides were caught off guard, and both sides are working to resolve the issue together. However, it should be noted that most of the disputed issues relate to cost-neutral work rule items, and the Company believes that it can still achieve a cost-neutral contract.

Iraq

Demand spiked for charter airline services (especially from the military) last year as the United States liberated Iraq. This demand has continued into the fourth quarter of this year, but consensus expects this demand to taper off next year with a reduction in hostilities. However, we disagree with consensus' outlook and point the fact that news reports indicate that the military is calling for 100,000 troops to remain in Iraq until at least until 2006, and the military is building 14 permanent bases in the country to house these troops (Wall Street Journal).

Valuation

Our discounted cash flow analysis suggests that the stock is 43% undervalued based on assumptions regarding their future fleet plan and future cost decreases as the Company disposes of less efficient aircraft and leases more efficient aircraft & demand.

While no other publicly traded Chartered Cargo/Passenger or ACMI airlines exist, we felt that comparing the Company to a few "distant" comparables in the scheduled cargo industry might prove beneficial. While we see these comparables as removed from many of the key business drivers at World Airways (especially World Airways' military exposure), we do note that in all multiples except NFY P/E multiple the Company trades below comparables. It is also interesting to note that the Company trades at lower multiples despite having higher EBITDAR Margins and ROA, and also is less levered, which should result in higher multiples than even these distant comparables.

V. INFORMATION AND TECHNOLOGY (IT) AND TELECOM SECTOR

Technology companies earn revenues through the design, manufacture, integration, and support of technology and associated products. The sector was a high-flier of 2003, showing record gains and outperforming majority of the market. We see these trends continuing in 2004 and on to 2005, fueled by major upgrades in corporations' systems and other avenues of capital expenditures. We also note how next-generation technologies are quickly becoming today's. Consumers purchasing WiFi equipment, high definition televisions, flat panel displays, 3G mobile telephones, and others will help contribute to the growth in the technology sector in 2004. Regarding services, the recent election year coverage of outsourcing seems

disapproving of this practice. In spite of this, our qualitative analysis indicates that the outsourcing trend will not be significantly impacted. We feel that government will understand the need for outsourcing, and expect the IT services sector to have a strong year in fiscal 2005. Voice over IP, a revolutionary new product, should also see strong gains (projected at 50%). This technology allows businesses to cut costs by using the Internet to place long distance phone calls.

SELL: EMC CORP. (NYSE: EMC)

We feel that the value of the service that EMC provides (setting up and maintaining storage devices) is very important to institutions. However, how often that valuable service will be used is questionable. Storage devices are not likely to be updated nearly as much as other computer hardware unless a company is experiencing excessive growth. The cyclical nature of corporate spending and upgrades is reflected in the financial healthiness of EMC.

With the average IT Executive planning to increase growth at a mere 1.6 percent in 2004, we do not think that EMC is positioned to see 80 percent growth. The storage industry should do fairly well in terms of growth and profits in the coming year. This growth, however, is already priced into the stock. Therefore, if these growth estimates are not met or even exceeded, we feel there will be a sharp correction in the price of the stock.

BUY: WIPRO (NYSE: WIT)

Wipro is a global information technology (IT) Services Company that provides a range of IT services, software solutions and research and development services in the areas of hardware and software design to companies worldwide. The Company uses its development centers located in India and around the world to provide cost-effective IT solutions to its clients. It also provides Business Process Outsourcing services, the practice of shipping clerical to analyst level services, to outsourcers. We especially like this company because of its diversification into in the Consumer Care and Lighting, and Health Sciences product groups.

The best of the breed

At the expense of others, Wipro is winning contracts with large companies such as Adobe, Boeing, Cypress, Nokia, and Ordina. Because of significant insider holdings (84%), we believe that Wipro is the least volatile to news among the top three Indian IT services companies. It's an important factor since these companies are volatile to news such as earnings misses. We feel that Wipro is the least susceptible to margin compression as they are a more diversified company in terms of product line. Their gross profit margin of 40% reflects this. Management exceptional abilities, proven track record, their integrity, and financial frugality make Wipro the best of the top three Indian IT services firms.

Valuation

Wipro has the lowest forward (2004 FY to 2005 FY) Price to Earnings to Growth of the group, 1.06 vs. 1.28. Their forward (2004 FY to 2005 FY) EPS growth of 33% is attractive when compared to 18% for Satyam and 26% for Infosys. Finally, Wipro is undervalued on the Discounted Cashflow analysis by 22% when using an Equity Free Cashflow model. We also expect Wipro to beat consensus earnings for 2004.

FIXED INCOME

The 2004 class was left with a 2003 fixed income portfolio with a 3.59 duration. The fairly low duration was a bet on rising interest-rates and the class chose a bullet strategy to reduce the convexity of the portfolio by placing most of the portfolio's exposure on the intermediate portion of the yield curve. They left the credit quality allocation inline with the Lehman, but under-weighted mortgages most notably.

Pre sale holdings (Exhibit I)

Fixed Income Holdings	Duration(Bloomberg)	Market Value	Weight of Fixed Income	Weighted Portfolio Duration
Ford Mtr Cr Co	1.69	$106,866.60	13.7%	0.232
Federal Natl Mtg Assn	2.38	$105,594.33	13.6%	0.323
Inter Amer Dev Bk	2.70	$67,404.00	8.7%	0.234
Southwest Airls Dev Bk	3.01	$28,873.72	3.7%	0.112
United States Tres Sc Strp Int	4.08	$311,664.00	40.0%	1.632
United States Treas Nts	6.51	$108,091.01	13.9%	0.903
Gnma Pool 5561116 (10-yr)	2.43	$50,576.27	6.5%	0.158
		$779,069.93	**100%**	**3.59**

Allocation

As the class decided upon a larger equity weight for the portfolio in 2004 (80%), fixed income investments had to be reduced substantially to approximately $430,000 (20%) of the portfolio versus last years approximately $780,000 allocation (45%).

Strategy

As we believed rising interest rates are likely to occur in Q3 or Q4 2004, we continued to make the bet on a low duration; our new weighted duration being slightly higher at 3.67, but our duration remains well below the Lehman Brothers Aggregate Bond Index. As we saw the chance of rapid interest rate movements as more plausible than in 2003, we decided to further reduce our convexity through selective sell offs. In terms of sector exposure and credit risk, the portfolio moved heavily into treasuries and high credit quality bonds (Exhibit III).

Post sale holdings (Exhibit II)

Fixed Income Holdings	Duration(Bloomberg)	Market Value	Weight of Fixed Income	Weighted Portfolio Duration
Inter Amer Dev Bk	2.70	$67,404.00	15.7%	0.424
United States Tres Sc Strp Int	4.08	$311,664.00	72.5%	2.960
Gnma Pool 5561116 (10-yr)	2.43	$50,576.27	11.8%	0.286
		$429,644.27	**100%**	**3.67**

Transactions

The class decided to sell Fannie Mae, Ford Motor Credit, Southwest Airlines and the U.S. T-notes. Beyond credit, duration, and convexity considerations, we sold Southwest Airlines as we were only receiving a few basis points above comparable transportation credits despite the fact we were taking airline industry risk.

Historical allocation (Exhibit III)

	2002		2003		2004	
Total dollar exposure	$731,001.00		$800,000.00		$430,000.00	
	ARF	*Lehman*	*ARF*	*Lehman*	*ARF*	*Lehman*
Sector exposure						
Treasury	27.3%	22.0%	49.3%	21.3%	72.5%	22.2%
Agency	13.5%	12.0%	13.3%	12.9%	0.0%	11.6%
Mortage	27.3%	35.5%	15.3%	34.9%	11.8%	35.6%
ABS	0.0%	1.7%	0.0%	4.3%	0.0%	4.3%
Industrial	3.6%	10.7%	3.6%	9.2%	0.0%	12.4%
Finance	27.7%	7.3%	15.4%	7.3%	7.8%	7.8%
Utility	0.0%	2.0%	0.0%	1.8%	0.0%	2.0%
Foreign	0.0%	8.8%	3.1%	8.3%	7.8%	4.2%
Cash	0.6%	0.0%	0.0%	0.0%	0.0%	0.0%
Aggregate fixed income	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Maturity						
Cash	0.6%	0.0%	0.7%	0.0%	0.0%	0.0%
1 to 3 years	27.8%	28.7%	27.6%	28.7%	11.8%	0.0%
3 to 5 years	27.1%	31.8%	58.9%	31.8%	88.2%	0.0%
5 to 10 years	30.[illegible]	16.1%	13.6%	24.6%	0.0%	0.0%
Greater than 10 years	13.[illegible]	11.8%	0.0%	14.9%	0.0%	0.0%
Aggregate fixed income	100.[illegible]	88.4%	100.8%	100.0%	100.0%	0.0%
Credit						
AAA+ (GTV)	54.[illegible]	69.2%	64.6%	69.6%	84.3%	69.1%
AAA	13.[illegible]	5.7%	6.3%	6.2%	15.7%	6.6%
AA3	14.[illegible]	5.0%	13.3%	5.3%	0.0%	2.7%
A3	13.6%	10.9%	3.6%	9.9%	0.0%	10.2%
BAA1	3.6%	9.2%	12.2%	9.0%	0.0%	11.4%
Sub-grade	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Cash	0.6%	0.0%	0.0%	0.0%	0.0%	0.0%
Aggregate fixed income	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Overall, we feel that the above structure of our fixed income portfolio will shield us from coming higher interest rates, and furthermore places us in only the highest credit quality instruments allowing us to gain our exposure to a growing economy through the equity portion of the portfolio, and using the fixed income allocation as a hedge as desired by our asset allocation mentioned above.

PERFORMANCE SUMMARY

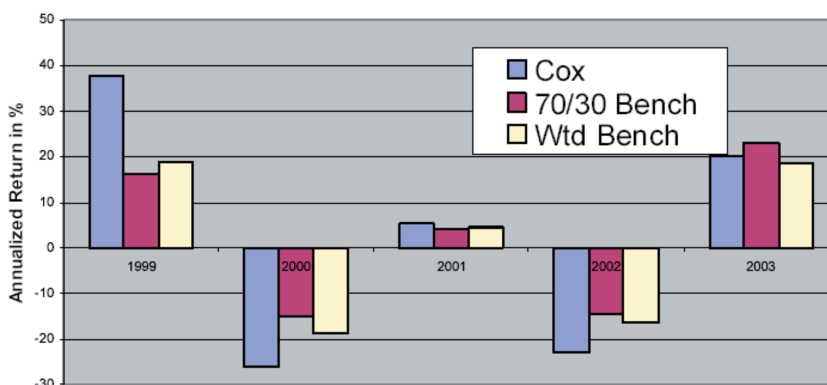
When evaluating the performance of the Anne Rife Cox Portfolio, the University has designated a blended benchmark of 70% Russell 2000 and 30% Lehman Brothers Government Credit Index. The portfolio class, however, feels that we should use a broader, more inclusive index drawing on allocations from the Wilshire 5000 and the Lehman Brothers Aggregate Index. Additionally, in determining portfolio performance on an annual basis, we feel that using April as the beginning of each year rather than January gives us a more accurate evaluation of the decisions regarding asset allocation, sector weighting, and security selection. In looking at data for the past 5 years, the Anne Rice Cox Portfolio has outperformed our five year 70/30 benchmark (Exhibit I). However, the conservative 55/45 allocation decision of last year resulted in a lower relative return due to decreased equity exposure, which filtered into both our one and three year average returns.

Performance of the Cox Portfolio over Various Time Periods

	Cox Portfolio	Wilshire 5000	T-Bills	70/30 Benchmark
1 yr	26.55	41.99	0.97	30.50
3 yr	0.85	3.60	1.84	4.61
5 yr	2.99	1.23	3.28	2.94

(Exhibit I)

In 1999, the overexposure of our portfolio to the technology/telecom sector resulted in abnormally positive returns. However, in 2000 the same overexposure lead to abnormally negative returns as much of this sector bubble began to burst. Our 2001 asset allocation of 67/33 closely resembled that of our benchmark, so there was no significant convergence between the two returns. As we increased our equity exposure for 2002 the free-fall of equity markets hit us harder at a 75/25 allocation than it did the benchmark, while additionally the equity we were exposed to proved to be relatively weak in terms of security selection. Last year, our portfolio experienced a significant rebound. This rebound however, was somewhat mitigated by our conservative asset allocation. The results of the preceding paragraph have been articulated in Exhibit II.



(Exhibit II)

To further examine the portfolio's performance, we ran two regression analyses. The analyses were run to determine if the portfolio has produced any level of alpha generated return, that being return awarded to the investor for taking some level of risk, rather than accepting the market return. In the first analysis we contrasted the excess returns of the Cox Portfolio over the risk free rate with the excess returns of our 70/30 passive benchmark. In our second analysis, we ran the regression on the Cox Portfolio's excess returns over the risk free rate with the excess returns of a passive benchmark that allocated itself in such a way as to mimic our own allocation decisions. By using a benchmark with our own allocations, we can focus on that excess return which is a function of security selection rather than asset allocation. The results of the two regressions are shown in Exhibit III.

Cox Portfolio vs.	Alpha
70/30 Benchmark	0.09%
Allocation Matched Benchmark	1.68%

(Exhibit III)

Final Thoughts

While it is comforting to know that over the past five years the Anne Rice Cox Portfolio has outperformed both of the fore mentioned passive benchmarks, it is worth noting that the primary purpose of the Portfolio Practicum class is to educate the students in portfolio management, an exercise with returns that can not be so simply measured.

THE UNDERGRADUATE PORTFOLIO PRACTICUM ONLINE

The Ann Rife Cox Underwood Fund Annual Report published by the BBA Class 2004 provides an overview of the course's activity with respect to performance, objectives, portfolio transactions, and future direction. We have reinvigorated the BBA Porfolio Practicum website with a breath of new life to provide a more in-depth discussion of our due diligent activities. We have made new additions, such as The Fund, Our Clients, Portfolio, The Team, Showcase, and Contact Us. These webpages as well as the Annual Report 2004 and our equity research are available online: http://people.smu.edu/undergrad_practicum.

Snapshots