



Global Equity

Performance

The Composite underperformed its core benchmark but was ahead of the growth style component.

Review and Outlook

The terrorist attacks have exacerbated an already present slowdown.

The policy responses seem likely to result in the impact on global growth being short lived.

Portfolio Review

Prices of many high-quality growth stocks are now very attractive.

We review research methodology using the example of WPP, a leading advertising and marketing services company.

Activity

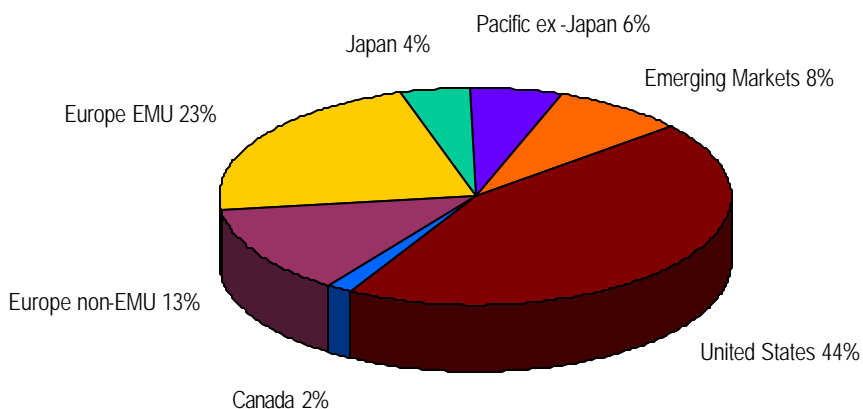
Bought: Deutsche Telekom, Imperial Oil, Novo Nordisk, Vodafone.

Sold: BellSouth, Eastman Kodak, Embraer, Enron, Tyco Int'l.

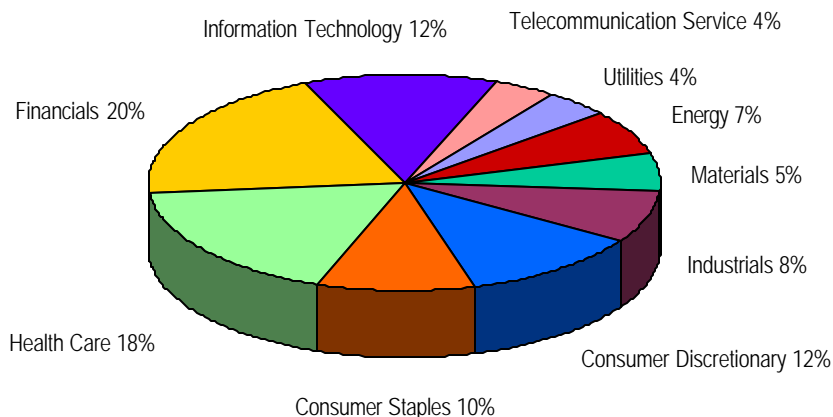
2001 Third Quarter Report

In a difficult quarter, the Composite fell 15.7%. Its MSCI benchmark fell 14.7%. Extreme market volatility has made it more important than ever to adhere to a sound medium-term strategy. We have reviewed all investments for adherence to our four key criteria as well as considered opportunities presented by the violent price moves in the month. A number of changes resulted.

Region Distribution



Sector Distribution



The charts above provide a 'snapshot' of the Model Portfolio at September 30, 2001.

Executive Summary

- The portfolio slightly underperformed the MSCI All Country World ex-USA Index but outperformed its Growth Style component.
- Before the terrorist attacks, the global economy was flagging. The policy response to the attacks suggests the severe slowdown at present will be short lived.
- We think the Dollar has entered a period of weakness against other major currencies.
- Many high-quality growth stocks now seem very attractive. We discuss WPP as an example.
- Our activity in the third quarter has reflected a heightened intolerance for signs of managerial weakness and enthusiasm for strong cash flows and balance sheets.
- **Imperial Oil** in Canada, 69% owned by **Exxon Mobil**, was purchased for its large reserves, excellent financial management and geographically secure location.
- Changes in valuation and the competitive landscape overseas have led us to make two investments – **Vodafone** and **Deutsche Telekom** - in the Telecommunication Services sector as replacements for **BellSouth** which has dramatically outperformed.
- Severe price weakness permitted an increase in exposure to high-quality holdings with funding from sales of investments with rising risks. **Hutchison Whampoa** and **Li & Fung** investments were increased (having previously being reduced at higher prices). **Eastman Kodak** (management concerns), **Tyco** (cyclical exposure) and **Enron** (regulatory concerns) were sold to fund this opportunity.
- Before the terrorist attacks, **Embraer** was sold on concerns that the shares failed to discount a cyclical deterioration in business. Proceeds were used to increase the **Taiwan Semiconductor** investment.
- New investment **Novo Nordisk** provides steady growth with the prospect of unanticipated advances derived from long-standing research.

- The overall result of transactions has been to decrease the weighting in US-domiciled stocks and leave the portfolio overweight in Continental Europe and non-Japan Asia.

Performance

The portfolio fell in value by 15.7% in the third quarter of 2001. Its benchmark, the MSCI All Country World Index, fell by 14.7% in the quarter. Growth stocks continue to lag their value counterparts: the global sub-index of value stocks fell by 13.8%, whilst the growth sub-index fell by 15.6%. Over the past eighteen months, value stocks have fallen by 18.9% against 48.4% for growth stocks.

The terrorist atrocities in the United States on September 11th led to sharp falls in stock prices throughout the world, compounding losses already seen in 2001. For example, the MSCI Europe Index fell 12%, to be down 27% for the year. Japanese stocks fell by 18% in the quarter, and are now down 25% in 2001. The US Dollar was weak in the immediate aftermath of the attacks, but stabilized when massive intervention by central banks absorbed selling pressure. For the quarter as a whole the Dollar fell by 7% against the Euro, and by 4% against the Japanese Yen.

Review and Outlook

Even before September 11th, the global economy was flagging badly. The world had become increasingly reliant on the US consumer as the main engine of economic growth. US consumers' willingness and ability to spend was fading, in the face of mounting employment insecurity and the bear market's destruction of household wealth. September's terrorist attacks pushed the US economy into recession. Beyond the production lost as the country stood paralyzed, watching CNN, the damage done to confidence in an atmosphere of heightened risk is of greater consequence. The impact of the attacks is to deepen the decline in economic activity, but also to change the nature and scale of the policy response.

In both the US and Europe, the immediate response has been twofold. Central banks have acted quickly to reduce interest rates, and provide liquidity to financial institutions. Perhaps more importantly, however, is the changed political consensus in the US, where the hard-won campaign for budget surpluses has now been forgotten, and politicians are scrambling to regain their spending credentials. In the US, Congress

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has authorized many billions of dollars in funds for damage repair, for aid to the industries and workers directly impacted by these events, and for wide-ranging new measures to punish the perpetrators and defend against future attacks.

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These shocking attacks on the United States came after a prolonged period in which US financial markets and the US economy benefited from continuous and massive capital flows from abroad, from investors confident of achieving superior returns from US investments. This virtuous circle of a strong US economy and associated capital inflows sustained the Dollar at a time when those inflows were necessary to finance a large and rising trade deficit. That financing need is now running at about \$1 billion a day.

The events of September change everything, shaking the confidence of foreign investors, and reminding domestic investors of the need to diversify out of the US Dollar. We think it likely that the Dollar has now entered a period of weakness against other major currencies, in particular against the Euro.

Portfolio Review

Prospects for recession in the US and increased uncertainty elsewhere have led to a long and severe bear market in stocks. We think that the prices of many high-quality growth stocks are now very attractive, basing that conclusion upon our extensive work in assessing the intrinsic value of the stocks of companies we research.

In making these assessments, we try to forecast the cash flows (dividends) that accrue to shareholders, and then discount those flows at an appropriate rate to arrive at an estimate of 'intrinsic value'. Future dividends, of course, are highly uncertain, and the appropriate discount rate is unknowable. We estimate dividends year-by-year using a detailed model that incorporates our company-specific expectations for revenues, profit margins and earnings retention rates. We establish the appropriate discount rate by combining an observable risk-free interest rate (that available in medium-term government bonds) and a subjectively-determined premium that compensates the equity investor for the uncertainty of the dividend stream.

Our estimate of the stock's intrinsic value is the result of these uncertain forecasts and this subjective discount rate. The value estimate is, thus, inherently imprecise. It is, therefore, most useful in illuminating large price anomalies, such as can occur during times of great stress, rather than in revealing minor mispricing that results from routine price volatility.

For example, consider the results of this exercise for **WPP**, a leading advertising and marketing services company, which we have held in the portfolio for several years. We start by creating forecasts of WPP's revenues and earnings:

- **Revenues.** We assume a very sharp fall for the second half of this year, and no growth at all in 2002. Thereafter, we assume the advertising industry returns to above-average growth, and that WPP can grow its revenues by 9% for five years, decaying over two years to 4%, which is the long-term rate of GDP growth.
- **Earnings.** The company has significant scope to reduce its variable costs, but we have assumed that its margins actually fall a little between 2000 and 2002. Over the following five years, margins expand—resuming their consistent trend of the past several years, supported by WPP's favorable position within the industry's attractive competitive structure. We do not, however, allow WPP's margins to reach the level that management has forecast, despite their good track record at achieving their stated goals. Moreover, we give the company no credit for its ability to buy back stock, to make accretive acquisitions, or to generate higher than average returns on its capital investments. These are, taken together, very conservative assumptions.

Under these assumptions, WPP's dividend per share grows at 14% a year, compounded, over the seven years from 2002. Applying our assumed discount rate of 7.3%, the intrinsic value of WPP's stock is £6.55—considerably above today's market price of £4.75. Put another way, if our discount rate is correct, today's market price is appropriate for a share whose dividends will grow at only 8-9%. Put yet another way, if our dividend forecast is correct, then the discount rate implied by today's share price is one that incorporates an equity risk premium over UK Government bonds of about 800 basis points—far higher than financial history or theory would suggest is justified. Similar analyses for other high-quality growth companies in our portfolio and in our closely researched universe produce similar conclusions. Collectively,

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they give a picture of global equity prices that, amidst gloom and anxiety, have overshot their marks and are now significantly below intrinsic value.

Activity

We only make the estimates, discussed above, of the appropriate price to pay once we have made more qualitative judgments about the company's outlook. Our stock selection process is one that seeks to identify companies with good growth prospects and durable competitive advantage. At times of great economic uncertainty, however, two additional requirements—for financial strength, and for good management—are even more important. Our portfolio actions in the third quarter reflect our heightened intolerance for signs of managerial weakness and enthusiasm for strong cash flows and balance sheets in the current environment. They also reflect our increased nervousness about operating conditions for even the best companies. Finally, they reflect highly opportunistic actions, in the aftermath of the atrocities, to take advantage of relative price moves to upgrade even further the managerial quality and financial strength of the companies in the portfolio.

We sold Brazilian aircraft manufacturer **Embraer**, which has seen rising secular demand for its smaller, short-haul passenger jets because passengers prefer jets to turboprop aircraft, and the airlines like their planes to fly full. The airline industry remains brutally cyclical, however. We believed that, after doubling in the last year, Embraer shares fully reflected the long-term market opportunity but not the short-term risks of a cyclical fall off in passenger miles and thus in carriers' appetite for fleet enhancement. We sold, fortuitously, prior to the unforeseen financial devastation wrought upon the airlines by the terrorist events. Those proceeds were reinvested in additional shares of **Taiwan Semiconductor Manufacturing**, a company also based in a developing country with strong secular demand for its chip foundry services, but whose shares already reflect the cyclical nature of its industry.

We sold shares of **Tyco**, the US industrial conglomerate, whose strong management and the leading positions of its various businesses have kept its shareholders loyal in a deteriorating economic environment. But its businesses, particularly electronics and connectors, are exposed to the rapidly slowing economy, and its share price has not fully reflected that, unlike many other companies with equally strong businesses and

management. One such company is **Hutchison Whampoa**, which was actively selling from its large portfolio of wireless telecom holdings (such as Orange and Voicestream) near the peak in the market for such assets, and reinvesting in more mundane assets such as port facilities and cash. Yet its shares have fallen 54% over the past eighteen months. Having sold half our holding in January, we have now doubled our stake once again with proceeds from the Tyco sale.

We sold our holding in **Eastman Kodak**, whose response to the greater degree of competition in its health and medical imaging business has been poor, raising doubts about management quality. Confidence in management was critical to the investment thesis for Kodak, which rests on a belief that the company can overcome a secular decline in its core business by building a franchise in digital photography, based on the company's very strong brand. The company has the cash flows to accomplish this goal, but, without strong and assertive management, it will fail.

We bought a new holding in **Imperial Oil**, 69% owned by **Exxon Mobil**, and Canada's largest integrated petroleum company. The company owns some of the world's largest, long-lived, heavy oil reserves, exclusively located in North America. Imperial focuses its energies on developing this Canadian reserve base with a goal of consistent production increases and falling unit costs. Despite large capital expenditures to fund its growth, cash flows are strong enough to permit dividend growth and share buybacks and still leave the balance sheet conservatively leveraged. We believe that beyond the short-term demand decline associated with the current downturn in economic activity, investors will be willing to pay a premium for geographically secure energy supplies.

We sold our holding of **BellSouth**, which, by not losing its head in the wireless and internet craze, has proven an extremely stable business in the aftermath of that bubble, and hence has dramatically outperformed the telecom sector. We sold the shares to take advantage of the substantial price declines in the shares of other strong survivors in the sector. We bought back a holding in UK-based **Vodafone**, the world's largest wireless telephone company, and bought a new holding in **Deutsche Telekom**, Germany's incumbent fixed line operator, which has expanded into global wireless telephony. Despite great growth in demand for telecom services, pricing has been dreadful, and earnings growth—which is what matters to equity owners—has been elusive for both incumbents and new entrants. The bursting of the bubble in

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Li & Fung's 75% decline in its share price since we sold half our holding last year reflects the compression of the company's valuation by investors who mistook its cyclicity for the absence of secular growth.

technology and telecom stocks, however, has begun to change all that. In particular, incumbency, size, and market leadership now confer significant competitive advantage, as it is the largest companies that are generating the most cash flow and can give the greatest assurance to nervous lenders. Access to capital for young companies seeking to attack entrenched positions has now dried up. Even their vendors are now unable to finance their equipment purchases. Both Vodafone and Deutsche Telekom, as market leaders, are beginning to enjoy this new competitive landscape, in rising revenues per customer, and in increased market share. Yet, in the stock prices we saw in late September, only very modest growth is discounted.

We sold our holding of **Enron**, due to heightened concerns about the Federal regulations prohibiting the company's use of information gleaned from its transmission network to benefit its proprietary dealings—a key to the whole investment thesis, along with rising concerns about the company's balance sheet (including increasing insight into its off-balance sheet liabilities). We worried that the market, for all it has marked down the shares, has not focused on these additional issues. We invested the proceeds into additional shares of **Li & Fung**, the Hong Kong-based trading company that has migrated from mere trading to virtual manufacturing, using its extensive worldwide logistics network to help a customer find the best products at the lowest cost. Li & Fung's customers—retailers in developed countries—mostly use them to capture the relative advantages of manufacturing in low-cost regions. Li & Fung is a beneficiary of the secular global trend to outsource product manufacturing, but the 75% decline in its share price since we sold half our holding last year reflects not just the downturn of consumer demand now upon us, but also the compression of the company's valuation by investors who mistook its cyclicity for the absence of secular growth.

We bought a new holding of **Novo Nordisk**, a Danish producer of diabetes care and other pharmaceutical products. The company operates companies and offices in approximately 61 countries and manufacturing facilities in six countries. We expect the company, which derives 70% of its revenues from the diabetes market via sale of insulin, insulin-injection devices and oral hypoglycemics, to maintain its position in that oligopolistic market. But future growth in areas such as blood coagulation products, human growth hormones and hormone replacement therapy appears underestimated by investors. The

company's longstanding research focus on recombinant methods and protein therapies should beget a number of valuable products over time.

Finally, we sold shares of **Zimmer Holdings**, received as spinout from **Bristol-Myers Squibb** in the quarter.

The overall result of these transactions has been to reduce the portfolio's weighting of US-domiciled stocks to less than half the total portfolio, at a time when changes to the benchmark (due to free float adjustments that mostly affect non-US indices) are actually increasing the weighting of the US. Correspondingly, we have increased our holdings and are overweight relative to the benchmark in Continental Europe and in non-Japan Asia.

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Global Equity Holdings as of September 30, 2001

Company	Country	Weight (%)	Sector	Description
Wrigley, Wm.	US	4.4	Consumer Staples	World's largest chewing gum maker
Baxter International	US	4.1	Health Care	Medical products supplier
Suez	FRA	3.8	Utilities	Multi-utilities company
Allied Capital	US	3.3	Financials	Financial institution providing small business loans
Hutchison Whampoa	HK	3.0	Industrials	Ports, telecom, & property conglomerate
American Int'l Group	US	3.0	Financials	Insurance holding company
Schering-Plough	US	2.8	Health Care	Pharmaceutical & consumer product manufacturer
Royal Dutch Pet	NETH	2.6	Energy	Global integrated oil company
Rio Tinto Ltd.	AUS	2.4	Materials	Diversified mining company
Taiwan Semiconductor	TAIW	2.3	Information Technology	Dedicated IC foundry
Exxon Mobil Corp	US	2.3	Energy	Global oil company
IBM	US	2.3	Information Technology	Integrated information technology company
Nestlé Reg	SWITZ	2.2	Consumer Staples	World's largest food company
Novo Nordisk	DEN	2.2	Health Care	Prescription drug manufacturer
Wells Fargo	US	2.2	Financials	Commercial bank
Bristol-Myers Squibb	US	2.1	Health Care	Pharmaceutical & specialty products manufacturer
Intel	US	2.0	Information Technology	Global semiconductor manufacturer
Allianz	GER	2.0	Financials	General insurance company
Berkshire Hathaway	US	1.9	Financials	Auto insurer & general reinsurer
Viacom	US	1.8	Consumer Discretionary	Diversified media company
Automatic Data Proc	US	1.8	Industrials	Business services outsourcing company
Air Liquide	FRA	1.8	Materials	Industrial gas company
JPMorgan Chase	US	1.7	Financials	Large money center bank
Colgate-Palmolive	US	1.6	Consumer Staples	Consumer products company
Vodafone	UK	1.6	Telecommunication	Telecommunication services provider
Deutsche Telekom	GER	1.5	Telecommunication	Incumbent telephone company & mobile operator
Deutsche Bank	GER	1.5	Financials	Universal bank
WPP Group	UK	1.5	Consumer Discretionary	Advertising & marketing services company
Atlantis Japan	JAP	1.5	Financials	Closed-end fund of small Japanese companies
Li & Fung	HK	1.5	Consumer Discretionary	Trading & logistics company
Imperial Oil	CAN	1.5	Energy	Integrated oil company
CGIP	FRA	1.4	Industrials	Investment holding company
Oracle	US	1.4	Information Technology	Database management software firm
Teva Pharmaceutical	ISR	1.4	Health Care	Producer of branded & generic pharmaceuticals
Sony Corp.	JAP	1.3	Consumer Discretionary	Global entertainment media corporation
Quintiles	US	1.3	Health Care	Outsourcing partner for healthcare companies
Wal-Mart de Mexico	MEX	1.2	Consumer Discretionary	Consumer goods & food retailer
Asatsu	JAP	1.2	Consumer Discretionary	Advertising company
Wolters Kluwer	NETH	1.2	Consumer Discretionary	Legal, tax, medical & business news publisher
DBS Group	SING	1.2	Financials	Singapore's largest bank
ISS Int'l Service	DEN	1.2	Industrials	Cleaning services company
Elan	IRE	1.1	Health Care	Drug research & development company
Luxottica	ITA	1.1	Health Care	Low cost producer of eyeglass frames
Hewlett-Packard	US	1.1	Information Technology	Computing, measurement, & communications device
SmartForce	IRE	1.1	Information Technology	Computer software training firm
Carrefour	FRA	1.0	Consumer Discretionary	Food retailer & hypermart operator
Dassault Systemes	FRA	1.0	Information Technology	CAD/CAM software designer
CVRD	BRAZ	1.0	Materials	Iron ore exporter & private railway operator
Close Brothers	UK	0.8	Financials	Small merchant bank
Cerus	US	0.8	Health Care	Biotechnology company
Grupo Televisa GDR	MEX	0.7	Consumer Discretionary	Spanish language media company
Pearson	UK	0.6	Consumer Discretionary	Print & broadcast media company
Amdocs	ISR	0.6	Information Technology	Telecom customer & billing solutions provider
China Mobile	CHINA	0.6	Telecommunication Svcs	Cellular telephone operator

Global Equity Composite Performance

As of September 30, 2001

	Annualized Returns for Trailing Periods (%)					Volatility**					
	1 Year	3 Years	5 Years	10 Years	Since Inception*	Since Inception*					
Global Equity (gross of fees)	-24.1	6.8	4.9	9.7	10.6	13.6					
Global Equity (net of fees)	-24.8	6.0	4.1	8.8	9.7	13.5					
<i>MSCI All Country World Index***</i>	-28.2	0.6	4.1	7.6	6.2	14.3					
<i>MSCI World Index</i>	-27.9	0.6	5.0	8.1	6.6	14.3					
	* Inception Date: 11/30/89 ** Annual Standard Deviation (%) *** Benchmark Index										
	Calendar Year Returns (%)										
	2001	2000	1999	1998	1997	1996	1995	1994	1993	1992	1991
Global Equity (gross of fees)	-24.2	1.3	38.9	2.3	11.0	17.3	19.0	0.0	24.3	8.9	29.4
Global Equity (net of fees)	-24.6	0.9	38.2	1.6	10.1	16.3	18.0	-0.9	23.2	8.1	28.3
<i>MSCI All Country World Index***</i>	-23.2	-13.9	27.3	21.7	14.7	13.1	18.2	5.4	25.5	-4.3	19.5
<i>MSCI World Index</i>	-23.2	-12.9	25.3	24.8	16.2	14.0	21.3	5.6	23.1	-4.7	18.7
	Composite Information										
	2001	2000	1999	1998	1997	1996	1995	1994	1993	1992	1991
Total market value of accounts (\$M)	\$132.3	\$107.5	\$95.7	\$179.4	\$251.3	\$188.1	\$146.8	\$112.5	\$80.2	\$63.3	\$41.8
% of total firm assets	12.7%	7.7%	6.7%	13.1%	16.5%	15.1%	23.4%	30.5%	31.8%	39.3%	29.3%
Number of accounts	7	†	†	11	15	13	13	17	16	14	12
Dispersion: asset-weighted standard deviation	NA	†	†	0.5%	0.6%	0.2%	0.6%	0.4%	1.1%	0.7%	†

† Five or fewer accounts

Portfolio Characteristics	
Weighted Average Market Cap (\$ million)	\$56,330
Price/Earning (2001 forecasted)	17.7 times
Price/Earning (2000 historical)	20.2 times
Price/Cash Flow	13.9 times
Growth Rate	13.4%
Price/Book	2.5 times
Yield	1.7%
Return on Equity	13.9%
Number of Holdings	54
% annual turnover (5 year average)	33%

Ten Largest Holdings	% Portfolio
Wrigley (United States)	4.4%
Baxter Intl (United States)	4.1%
Suez (France)	3.8%
Allied Capital (United States)	3.3%
Hutchison Whampoa (Hong Kong)	3.0%
American Intl Group (United States)	3.0%
Schering-Plough (United States)	2.8%
Royal Dutch (Netherlands)	2.6%
Rio Tinto (United Kingdom)	2.4%
Taiwan Semiconductor (Taiwan)	2.3%

Harding, Loevner Management, L.P. ('Harding Loevner') has prepared and presented this report in compliance with the Performance Presentation Standards of the Association for Investment Management Research ('AIMR-PPS™'). AIMR has not been involved with the preparation or review of this report. Harding Loevner is compliant with AIMR-PPS since 10/31/89. Compliance has been verified at Level II (gross of fee returns only), one quarter in arrears, by Ashland Accounting LLP.

NOTES:

- Harding, Loevner Management, L.P. is an independent registered investment adviser.
- Composite includes all US\$ based, fee-paying global equity accounts under discretionary management, including accounts no longer in existence, except those related to multi-asset wealth management programs sponsored by third parties. Harding Loevner's participation in third-party sponsored programs for global equity accounts commenced April 30, 2001. Accounts are included from the first full month following the date on which the account is deemed to be fully invested. No subsector or segment of a larger portfolio is included.
- Returns shown are time-weighted total returns in US\$, and reflect reinvestment of dividends and interest. Returns include the effect of foreign currency exchange rates. Returns are weighted by account size in the composite.
- All cash equivalents, bonds and/or convertible securities used in place of equities are included in return calculations.
- Composite returns (gross and net) are presented after reduction due to brokerage commissions but before reduction due to custodial fees and foreign withholding taxes. Net of fees composite returns are presented after reduction due to actual management fees paid. Management fees are described in our Form ADV Part II.
- Returns of all indices are presented before foreign withholding taxes, and do not reflect commissions or fees that would be incurred by an investor in the index portfolios. Additional information regarding the benchmark, including the percentage of the composite invested in countries not included in the benchmark, is available upon request.
- Annual standard deviations of returns (volatility) are estimated from monthly returns using a continuous return model to derive annual periodic standard deviation.
- A complete list and description of the firm's composites is available upon request.
- Past performance is not indicative of future results.