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**Performance**

	Last Quarter	1 Year	3 Years <sup>1</sup>	5 Years <sup>1</sup>	10 Years <sup>1</sup>	Since Inception <sup>2</sup>	Volatility
Global Equity (gross)	11.7	32.5	-3.1	5.0	7.3	10.3	13.8
Global Equity (net)	11.5	32.0	-3.7	4.3	6.5	9.4	13.8
MSCI ACWF <sup>3</sup>	14.5	34.6	-2.8	0.0	7.1	6.6	14.5
MSCI World	14.4	33.8	-3.5	-0.4	7.6	6.7	14.5

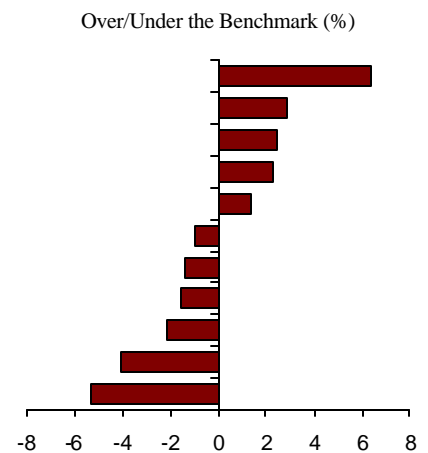
<sup>1</sup>Annualized Returns, <sup>2</sup>Inception Date: 11/30/1989; <sup>3</sup>The Benchmark Index

**Outlook**

- Worries over the ability of the US to fund itself at current interest and exchange rates
- The potential for market volatility is high—both up and down
- We are attracted to industry consolidators who can preserve pricing power

**Active Risk**

SECTOR	HL Global	ACWF
Info Technology	19.5%	13.1%
Cons Discretionary	14.6%	11.7%
Cons Staples	11.5%	9.0%
Cash	2.3%	0.0%
Materials	6.9%	5.5%
Industrials	8.7%	9.7%
Utilities	2.2%	3.7%
Energy	5.9%	7.4%
Telecom Services	3.3%	5.5%
Health Care	7.0%	11.1%
Financials	18.1%	23.4%



**Portfolio Activity**

Purchases	Sector	Sales	Sector
Comcast	Cons Discretionary	CVRD	Materials
Estee Lauder	Cons Staples	Genentech	Health Care
Kookmin Bank	Financials	Johnson Electric	Industrials
Qiagen	Health Care	POSCO	Materials
Sharp	Cons Discretionary	Yukos	Energy

All portfolio holdings and sector allocations are subject to review and may vary in the future; and are not recommendations to buy or sell any security.

***As monetary and fiscal stimulus gained traction, the outlook for riskier and cyclical industries became brighter.***

***Falling US Dollar augmented returns from non-US markets.***

## Annual Review

We labeled 2002 as the ‘year for stuff’, but in 2003, as we have noted before, ‘risk’ was the watchword. ‘Stuff’ turned in an even better year than last year, as the best performing industry was steel, followed by mining and by semiconductors. But 2003 was also a year in which things virtual saw a revival, as online retailing and internet software also ranked among the best-performing sectors. The common denominator was a declining risk premium: deeply cyclical industries, precarious financial structures, new-fangled business models, along with exotic locales were resuscitated by the dramatic and sustained fiscal and monetary stimulus applied by nearly all monetary and fiscal authorities. But the risk in fact has proven to be lower than the market was discounting: as the signs grew that the stimulus would gain traction in the real economy, the fundamental outlook for riskier ventures and more cyclical industries became much brighter. Emerging markets, generally riskier than developed markets and more cyclically volatile, turned in a stellar year, returning almost twice what the developed world returned.

On the other hand, companies in stable industries, such as food, household products, beverages, and pharmaceuticals—whose earnings prospects were perhaps only slightly diminished from their long record of steady growth in the disinflationary environment of the past twenty-three years—were ignored or deserted by investors. Geographically, it was the US stock market that was, if not ignored or deserted, then at least less preferred during the year, despite the fact that it is the US that has worked the hardest to revive growth, and indeed, has best succeeded in reviving growth.

It would be neatly symmetric to say that the most stable economy and most transparent and efficient markets were also just a victim to increasing risk preferences by investors, who chased more volatile but much higher returns available outside the US. However, we believe the key to understanding lies in the currency markets, as it is the falling US Dollar that has inversely augmented the returns to Dollar-based investors of most non-US markets. In fact, in local currency, the US stock market returns for the year actually beat all major regions

<b>Table 1. Market Performance (% Total Return)</b>				
<b>Market</b>	<b>CY 2003</b>		<b>4Q 2003</b>	
	<b>USD</b>	<b>Local</b>	<b>USD</b>	<b>Local</b>
Canada	55.4	27.1	16.0	11.1
Germany	64.8	37.1	31.3	21.2
Japan	36.2	23.0	8.4	4.0
United Kingdom	32.1	18.8	18.2	9.7
United States	29.1	29.1	12.3	12.3
Europe EMU	44.1	19.9	23.1	13.6
Europe ex-EMU	34.9	20.5	18.0	9.7
Pacific ex-Japan	47.0	20.4	14.1	6.0
Emerging Markets	56.3	46.7	17.8	17.6

Source: Wilshire Atlas

**We are seeing the price of US excess consumption via exchange rates.**

(both EMU and non-EMU Europe, Japan, and the Pacific ex-Japan) except for the aggregated emerging markets.

The Dollar's decline against most major currencies accelerated in the fourth quarter, but as we have noted before, it is a decline that began more than two years ago. The newspaper headlines and strategy pieces all trumpeted what we identified two years ago: that a US corporate world plagued by fraud and scandal would not continue to attract foreign capital with nearly the same ease as it once did, and a debt-laden US consumer could not forever have consumption of foreign-produced goods financed at both favorable exchange rates and low interest rates. Either the consumption would slow to a pace that could be more fully funded by current income, or else the price of the funding would rise—which ultimately would slow the consumption. We are merely seeing the price of US excess consumption rise via exchange rates.

The fourth quarter began with China launching a manned space flight, a symbol reminiscent of the Sputnik's launch forty-six years earlier that put the world on notice that the Soviet Union was an economic, scientific, and hence political power to be reckoned with. The world largely reacted with a yawn, partly because manned space flight is, in fact, old hat, but partly because the world has already come to recognize that China's economic significance is large and growing, and that its economic clout has translated into political clout. Its impact now goes far beyond the inexpensive assembly or manufacture of consumer goods that have redefined numerous industries in developed countries. This year, voracious Chinese imports of iron ore, aluminum, copper, and steel have absorbed excess capacities of those metals, sent prices climbing, and propelled steelmaker and mining share prices to record highs. Chinese imports of capital goods have revived the fortunes of Japanese companies who had despaired of domestic capital expenditures recovering. Chinese export earnings and capital inflows have yielded the foreign reserves (now close to \$400 billion at the central bank) that have propped up the US Treasury market when many other buyers have defected to less prosaic investments. And it is to China that the US has turned for help in disarming North Korea.

**Steel and mining stocks soared as commodity prices rose on voracious demand from China.**

So it is that in the quarter, shares of steel and mining stocks around the world soared (+27% and +33% respectively), as evidence of further commodity price rises became visible: the single best performing industry in the US market, in the broad European market, and in the Japanese market was steel and non-ferrous metals. Shares of Chinese companies listed in Hong Kong (and therefore available to foreign investors) soared. Shares of basic materials companies (aluminum, coal, and oil, for instance) based in China went stratospheric. Equity markets in countries with large resource sectors, such as Australia, Canada, Brazil, Norway, and South Africa, performed well, as did their currencies. But, somewhat surprisingly in an environment of accelerating global growth, long-term US bonds rallied as well—perhaps having sold off too violently in the summer, perhaps reflecting confidence in the Fed's ability to control both interest

**US companies have begun to respond to steady demand by resuming capital expenditures.**

rates and price inflation, perhaps reflecting growing confidence that the Chinese and other Asian buying of the US bonds would persist indefinitely.

That is not to say that nothing was happening in other regions or sectors. Indeed, the acceleration of growth in the United States (the third quarter GDP growth rate of 8.2% was reported in the fourth quarter) has been both the fuel for growth in world economy (through sustained imports) and the reason why demand for raw materials threatens to catch up with supply. America's high level of demand has barely wavered, as the auto and housing markets continue strong due to the willingness of the US consumer to defy the pessimists (including ourselves!) and continue to borrow at the low rates engineered by the Fed. US companies have begun to respond to that steady demand by beginning the resumption of capital expenditures for productive equipment after the longest and deepest decline in post war US economic history. So the global automobile industry (+19%) performed well in the quarter (as it did all year), as did the capital goods industry (+16%), and stocks of manufacturers of semiconductors, now central to many durable consumer and industrial goods (+17%).

**Table 2. Sector Performance (% Total Return)**

Sector	CY 2003	4Q 2003
	USD	USD
Consumer Discretionary	38.3	14.9
Consumer Staples	18.1	10.7
Energy	29.6	18.4
Financials	39.8	15.5
Health Care	20.5	10.4
Industrials	39.4	15.3
Information Technology	48.1	11.8
Materials	47.9	23.3
Telecommunication Services	27.7	17.3
Utilities	30.9	12.9

Source: Wilshire Atlas

**The banking industry emerged from three years of a bear market.**

The reviving global economy, combined with the stabilizing bond market and positive yield curve, meant that conditions in the banking industry were improving rapidly in the latter part of the year, with banks emerging from three years of bear market and two years of recession enjoying not only resuming demand for their services but also falling credit losses. Loan demand is not yet growing in most regions, but interest spreads have stopped falling as excess liquidity has been diverted from deposits to securities or other more risky uses. Japanese banks have benefited more than anyone from these factors, as the stronger, export-led growth in the Japanese economy reduced credit losses while rising stock markets rescued equity portfolios from still further write-downs, staving off the loss of tax loss carry-forwards. German banks, enduring a few similarities to Japanese banks (industrial portfolios that required write-offs in the bear market, large, low margin corporate loan exposure with high credit risks, and one of the most sluggish economies) were also significant beneficiaries of improving economic conditions and stronger stock markets. Both countries' banks managed strong performances in the quarter along with banks from other

regions that are likely to see the first shoots of loan growth: Asia, peripheral Europe, and Latin America outpacing an already strong global industry performance (+18%).

## Performance

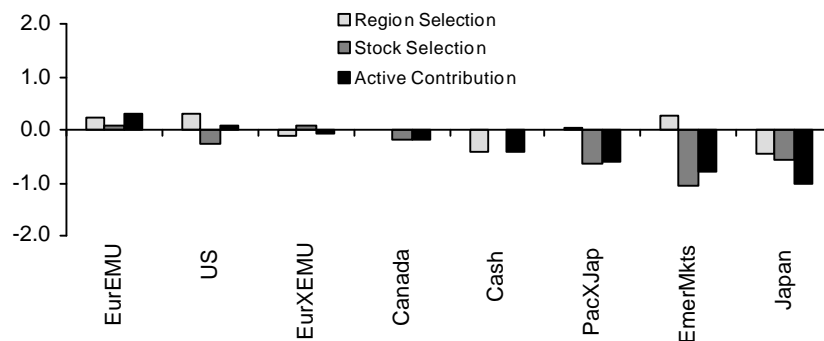
The Composite rose by 11.7%, in the fourth quarter, trailing the 14.5% increase for its benchmark, the MSCI All Country World Free Index. For the calendar year to date, the Composite rose by 32.5%, just behind the rise of 34.6% for its benchmark. Standardized performance and details are on front and back covers of this report.

The portfolio was hurt in the quarter by being overweight the lagging Consumer Staples sector, and underweight the surging commercial banking industry. Those effects were partially offset by our overweight positions in basic materials, and by good stock selection in the insurance and diversified financial industries. Excellent performance from **Denway Motors** and **BMW** was another bright spot for stock selection, but generally our stock selection in the quarter subtracted value: Our large holding of semiconductor companies, a sector that outperformed in the quarter, failed to help our performance, due to disappointing earnings at **Rohm** and a large offering of shares in **Taiwan Semiconductor Manufacturing ('TSMC')** by a strategic shareholder. **Johnson Electric**, **Colgate**, and **Merck** each produced profits warnings in the quarter, and hurt performance. Finally, **Yukos**, the Russian oil company, was sold in the quarter after a reappraisal of the sovereign risks it ran, given its high profile but controversial chief executive.

**The Portfolio was hurt by being overweight Consumer Staples and underweight banking.**

**The stance against the US in favor of the emerging markets was correct.**

**Graph 1. Region Value Added Relative to MSCI ACWF Index  
4Q 2003**



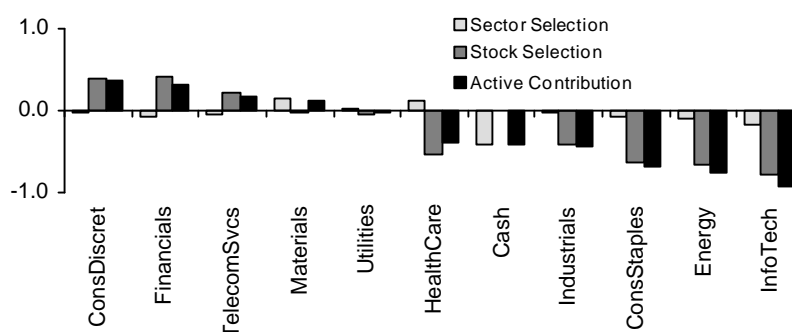
The portfolio's stance against the US in favor of emerging markets was the correct one, along with larger holdings of companies in the Eurozone. But stock specific declines by TSMC and Yukos, by Colgate and Merck, and our overweight holdings of Japanese companies more than offset the beneficial geographic effects in the quarter. For the year overall, however, the light holdings of US companies, combined with overweight positions in Japan, in

***In the year overall, our emphasis on strong management and financial quality were attributes not prized by risk-seeking investors.***

emerging markets, and in Europe were all additive, although as in the quarterly results, stock selection dragged performance down. Unlike the fourth quarter, however, in the year overall we would put the blame for ‘poor’ stock selection on our emphasis on strong management and financial quality, which were attributes not prized by risk-seeking investors this year.

In the twelve months, our large holdings of semiconductor, technology hardware, and capital goods companies were additive to performance, outweighing the negative effects of the large holding in consumer staples and the small holding in banks. Individually, the biggest contributors to performance in the year were **Genentech, Dassault Systemes, Caterpillar, and Deutsche Bank**, offsetting the negative effects of **Rohm, Baxter, Merck, and TJX**.

**Graph 2. GICS Sector Value Added Relative to MSCI ACWF Index 4Q 2003**



***The Fed remains wary of deflation, notwithstanding the falling exchange rate, rising commodity prices and signs of speculative investor behavior.***

## Outlook

The Fed, while congratulating itself over its prompt and deft response to the economic after-effects of the stock market bubble, remains wary of deflation. In the minutes of a recent Board of Governors meeting the Fed worries about ‘inflation too low for comfort.’ The Fed’s pledge to keep short term interest rates low ‘for a considerable period’, notwithstanding a falling exchange rate, rising commodity prices, and signs of a return of speculative investor behavior, indicate that it is actively working to create at least the risk in investors minds that inflation could rise instead of fall (or even disappear).

Currently, the markets believe the Fed will succeed in managing this feat with aplomb. The US bond market has rallied significantly from its lows of mid-August, despite the dramatic report of Chinese-like economic growth for the US in the third quarter; US TIPs (inflation-indexed bonds) are implying long-run inflation of only 2%, and real rates have fallen along with nominal ones; and the decline in the Dollar thus far has been orderly. But awareness of what the true risks the Fed runs is only now dawning on market participants.

**Asian central banks are the main buyers of US Treasury securities, so the US is beholden to a few foreign governments to fund itself.**

**Countries whose currencies have most appreciated against the Dollar face a growth headwind as their exports and overseas profits suffer.**

The effects of Fed policy do not end at the borders of the United States, but rather interact with policies of other fiscal and monetary authorities. The main interfaces are through the balance of payments, meaning the trade and current accounts, plus the capital account. As we have highlighted before, the US current account deficit is so large that it requires a sustained effort on the part of investors outside the US to maintain. That effort has, until recently, gone little noticed within the US because foreign investors have willingly flocked to US capital markets in pursuit of high equity returns and political stability. That willingness has waned after three years of bear market, corporate scandal, and increasing indebtedness of both government and consumer. Private portfolio investment flows from abroad, rather than increasing (as would be necessary to fund the daily dose of deficit), have declined by \$100bn during 2003, leaving Asian central banks as the main buyer of US Treasuries. This puts the US in a far less advantaged financing position than it is used to, beholden to just a handful of foreign governments to fund itself at current prices of its debt and its currency. The low short-term rate policy by the Fed limits the rates on the debt, leaving the currency as the only outlet for changing the appetite of private buyers. A general perception that the Fed is explicitly (and successfully) creating inflation potentially could spark faster desertion of private investors and further deterioration of the US bargaining power versus its foreign suppliers of capital.

The ‘orderly decline’ of the Dollar has been unevenly distributed amongst US trading partners; European countries and countries with large commodity exports (such as South Africa, Australia, and Canada) have sustained the greatest appreciation of their currencies against the Dollar. These countries now face a growth headwind as their exports and overseas profits suffer from their appreciating currencies, but their imports cost less, and they are free to stimulate their large domestic sectors through fiscal and monetary policy. However, because economic growth in most Asian economies has been dependent on exports to the United States, their monetary authorities have adopted a currency policy that targets stability against the Dollar. This amounts to a new ‘Bretton Woods’ regime, referring to the post war system of fixed exchange rates with the US Dollar at the center that ended in the dollar devaluations of 1972. Asian economies cannot tie their currencies to the US Dollar without abdicating monetary policy to the Fed, because to run a divergent monetary policy for any length of time will result in unbearable pressure on the currency peg, such as happened in 1997-8, albeit in the opposite direction to now.

This constraint on monetary policies has forced Asian central banks to be as stimulative as the Fed has been over the past two years. They were happy to do this when Asian economies were still mired in the debt deflation stemming from the 97-98 crisis: the ample liquidity could be channeled into government securities via banks that were trying to heal themselves from large corporate defaults. More recently, as their exports have rebounded and domestic demand begun to recover, the ample liquidity has become more problematic as it has begun to fuel more speculative flames, in real estate, commodities, and equities.

**Asian central banks have a domestically-driven interest in keeping the US economy healthy.**

**An alternative scenario of high interest rates and slowing spending in the US bodes ill for Asian employment.**

Private sector investors in Asia have reduced their appetite for both US securities markets as well as domestic government bonds, in favor of domestic real estate and equities, clearly seeing higher returns from those asset classes than from low-risk bonds and US Treasuries. With rising returns attracting not only domestic capital, but foreign capital as well, exchange rate stability has become much harder to maintain.

Still, it is unlikely that these Asian banks will give up their FX targeting any time soon, because they have a domestically-driven interest in keeping the US economy healthy and importing large amounts of goods. As Peter Garber, Deutsche Bank strategist, has summed it up for the IMF, *“The fundamental global imbalance is not in the exchange rate. The fundamental global imbalance is the enormous excess supply of labor in Asia now waiting to enter the modern global economy. The exchange rate is only the valve that controls that rate of entry.”* If China were to back off its accumulation of Dollar reserves with the consequent funding of the US deficits, and allow the revaluation of its currency, it would forego the entry into meaningful employment of tens of millions of its people, with unpredictable consequences for its unreconstructed political system. If Garber is correct in thinking that Asian central banks will fund the US deficit for a long time, then the bull market in commodities and in capital goods will last longer and reach higher than history would suggest—because Asian and particularly Chinese expansion will keep absorbing resources.

The alternative scenario sees the US consumers and businesses reacting not just to higher import and commodity prices, but to higher interest rates demanded by foreign central banks (in a reversal of currency policy), or imposed by the Fed (in reaction to rising inflation) and dramatically slowing spending, leaving Asia—China, India, Indonesia, Malaysia—with a sharply reduced market for their wares, and thus without employment for their large number of workers leaving both the countryside as well as jobs at restructuring state-owned businesses. Even Mr. Garber, an optimist about how long Asian central banks stick to current policies, believes it will not last forever and the current mutually beneficial arrangement will end ‘badly.’

However, there may be a less extreme effect of the growing avoidance of US assets by international investors that are not central banks with political agendas: US money supply (‘liquidity’) may begin to shrink as private corporations accelerate repatriation of sales proceeds and dividends, as private investors abroad elect to hold liquid assets in non-Dollar currencies, and as worried US savers begin to look for non-Dollar investments. It is little remarked on that there already has been a sequential decline in US monetary aggregates for the past few months, simultaneous with the exchange rate decline gathering more steam and garnering more press. Is it possible that the resolve of the Asian central banks to continue funding the US current account deficit may be insufficient to keep the US securities markets, if not its economy, rising?

**The potential for market volatility is higher than usual—both upwards and downwards.**

**Japanese and Korean companies' traditional strengths in branding and mass production have reasserted themselves.**

We conclude the following, not being able to predict which (if any) of these scenarios will play out over the coming year. First, given the extreme differences in the scenarios and where the external influences lie, the potential for great volatility in markets is higher than usual—both upwards and downwards. Second, that in spite of the current availability of markets for debt and equity issuance, it is quite likely that access to capital for companies becomes difficult once again. Nominal interest rates seem set to be trending higher after a very long period of decline, either from demand for business expansion, from shifts in asset class preferences by investors (in anticipation of higher inflation?), or through central bank actions. Third, that the success of companies to navigate these widely varying outcomes will depend on the ability of their management, the degree of their self funding for expansion, and the nature and durability of their competitive advantages.

We are more comfortable making predictions regarding more microeconomic subjects, such as in trends based on industry and company observations. For instance, capital expenditures by companies have been through their worst recession in post war history, and have begun to rise again as corporate profitability has been restored through cost cutting. Technology spending once accounted for half of capex spending, but was reduced more drastically than more traditional industrial plant and equipment after the boom of spending that coincided with the internet bubble. However, given the rapid obsolescence of technology, and the constant need for productivity gains to stay competitive, we have believed that the recovery in technology spending would be sharp, and that the strongest companies, which continued investing in R&D and facilities during the downturn, would garner even greater share within their segments. A significant number of those segment leaders have the additional attraction of being domiciled in countries where investment sentiment had been even more negative (Japan, South Korea, and Taiwan) than in the US, and hence are more attractively priced. In addition, in the ever-changing world of technology, the demand for products is shifting away from telecoms and Internet infrastructure toward consumer electronics—the range of digital and networked products that is now proliferating in the home, car and pocket. Japanese and Korean companies' traditional strengths in branding and mass production have reasserted themselves as valuable sources of competitive advantage, and we believe that the combination of this trend with broadening restructuring and reviving capital expenditures for consumer electronics companies bodes well for technology suppliers there.

Given our investment criteria, we are unsurprisingly attracted to companies in the food, beverage, and cosmetics industries. Companies such as **Coca-Cola**, or **Nestle**, or **L'Oreal**, have portfolios of powerful, well-established brands and vastly efficient distribution systems. These have enabled them to generate earnings growth through brand extension, through access to faster growing markets, particularly in developing economies, or from using their large cash flows to make acquisitions, acting as consolidators in important segments and

helping to preserve their pricing power in a world where consolidation of their customers (the retailers) has reduced their bargaining power. Their stocks have lagged in a year in which the value of higher certainty and longer duration of their growing cash flows has been ignored in favor of stocks previously priced for the possibility, now much reduced, of corporate failure. What *is* surprising to us, though, is the extent of the discounts at which these companies' shares now trade. Whereas early in the year stocks of most companies were priced as if earnings and dividends were not going to grow (ever!), now stocks of companies in many cyclical sectors are priced as if historically volatile earnings are assured for a long time to come.

### **Active Risk**

The stance of the portfolio has changed but little in the quarter. Although the risks are rising, as noted above, we are reluctant, so far, to wager against the broadening of global economic growth and the resumption of corporate expansion. We retain our large holdings of companies in the Information Technology sector (**Analog Devices, Canon, Hirose, Keyence, Qualcomm, Rohm, Samsung Electronics, Taiwan Semiconductor**) along with less pronounced overweight holdings in the capital goods and basic materials industries. As the recovery has progressed, we have become even more enamored of the power of concentration and consolidation within an industry to confer stable economics and pricing power, rendering the need to forecast demand rises less important. This feature has been key to our holdings of industrial gas companies such as **Air Liquide** and new holding **Praxair**, as well as mining companies such as **Rio Tinto**. We are likely to increase exposure to other companies in Materials sector, in the belief that these industries were woefully underinvested in the last decade, have consolidated significantly and in addition have environmental constraints on expansion. Hence we believe that the supply response to greater demand will be more restrained and extended rather than massive and concentrated. This portfolio shift will likely come at the expense of Technology holdings. Within Consumer Discretionary, we are overweight media and broadcasting, at the expense of other industries.

We also remain overweight the Consumer Staples sector. As noted above, we believe the sector's stock prices are an anomaly, and that conclusion is reflected in the overweighting of this sector in the portfolio. We own **Coca-Cola, Colgate, Estée Lauder, Heineken, L'Oreal, and Wrigley**.

These weightings are funded by underweight positions in Utilities, Telecommunication Services, and Health Care, and banks.

Geographically, we retain the large holdings in the traditionally cyclical emerging and Japanese markets, funded by a significant underweight position in the US. It is the US underweight that causes us the most concern: the stance against it has been right, but seems now to be consensus. We are mindful that a depreciating currency is very stimulative to cyclical and export-oriented

*While we see risks rising, we are reluctant to wager against the broadening of global economic growth and corporate expansion.*

*Our overweight in Japan and the Emerging Markets is funded by the significant underweight in the US.*

**We purchased six  
stocks . . .**

businesses, and we are actively seeking to add US companies with those broad characteristics. Any additions to the US weight would likely mean reductions for most of the other regions, but it is Europe that strikes us as most hurt by the current alignment of forces, in particular by the 50% rise in the Euro against the Dollar over the past two years, a factor that affects export performance and translated profits of European multinationals.

### **Portfolio Activity**

We bought:

**Estée Lauder**, the world leader in prestige cosmetics, boasting 45 years of consecutive sales growth. The company has significant non-US revenues and earnings, and it benefits from both demographic and income growth trends, while ample free cash flows allow development of new products, expansion into new regions, and acquisitions. The shares had underperformed when profits declined after the terrorist attacks in the US as higher promotional and marketing spending was required to revive sales growth, a factor we believe is temporary.

**Kookmin Bank**, Korea's largest and strongest retail financial services company. Kookmin's dominant share of the mortgage market and leading share of credit card receivables and consumer deposits give it a significant competitive advantage in exploiting both the government-encouraged secular growth in consumer financial services in Korea, and the temporary financial distresses that too-rapid growth has brought about. Its able and well-incentivized management is aided by advice from outside the bank, notably 4% shareholder ING.

**Medco Health Solutions**, owned in small amounts since it was spun out to **Merck** shareholders in the summer, is the largest pharmaceutical benefits manager in the US. The aging US population will inevitably require more drugs for chronic illness, which will add to the pressure to reduce the costs of providing them. Generic substitutions represent an important part of this effort, as do distribution systems that streamline costs. Medco benefits from these trends, since its scale and its substantial investments in mail order distribution make it the lowest cost manager of prescription benefits, and because generic substitutions raise its margins.

**Praxair**, the largest producer of industrial gases in North and South America, discussed earlier.

**Qiagen**, a small Dutch/German supplier of laboratory consumables and testing equipment for the separation and purification of nucleic acids (DNA/RNA), used in biologic research by universities, biotechnology companies, and the pharmaceutical industry. The GE acquisition of Amersham crystallized for us the view that an evolution of diagnostic medicine towards DNA testing and tailored pharmaceuticals as a structural change in the industry will accelerate, and the elevation of Qiagen's longtime chief operating officer to CEO signals a new

phase for the company. The shares have doubled since the first quarter, but have fallen 80% in the last three years, or down from 300x eps to 30x eps, as earnings continued to grow. Our belief is that the testing consumables will sustain the business, but the upside not yet priced is a significant increase in the demand for its testing machinery for a broader array of diagnostic processes. The investment is a 'pick and shovel' approach to the biotechnology industry, which is an approach that requires less clever insight about specific R&D developments, and more reliance on our traditional focus on growth opportunities, competitive advantage, and management.

**Sharp**, the Japanese manufacturer of consumer and industrial electronics. The company has a long history of innovative product design, and currently boasts leadership in liquid crystal display (LCD) technology. As such, Sharp is well placed to benefit from rising demand for displays both as a supplier of components, such as for advanced cell phones, and as a producer of its own branded LCD-based television and computer screens. The company has implemented a multi-year restructuring program, streamlining its product offering, cutting costs and focusing on its free cash flow. Since it has a debt-free balance sheet, these improvements should accrue to shareholders through higher dividend growth.

We also added to our holdings in **Comcast**, **Samsung Electronics**, and **Viacom**.

We sold:

*. . .and sold five.*

**CVRD**, the Brazilian iron ore miner. The company has met all our milestones for corporate performance, its management is prudently invested or returned rising cash flows, and the external environment for its industry has improved with the emergence of China as the consumer of 30% of the global output of iron ore. But CVRD's shares have returned nearly 100% since we bought them halfway through the bear market two and a half years ago, and its price has begun to reflect a continuation of very high returns (i.e., high price/sales and price/book ratios) even if it is not expensive relative to the earnings growth we forecast. With all its production located in one emerging country with a history of volatility due to government missteps, and its dominant market a single emerging economy whose government policies are opaque, we took profits.

**Genentech**. We sold our final shares in the company. Genentech shares have risen 180% since it was bought exactly a year ago, and has more than fulfilled the investment thesis. It has been 'fully valued' for some months, but the difficulty is in putting a price on the option value that lies not only in its own research pipeline, but also in the pipeline of smaller biotech companies that seek it out to partner their own discoveries due its strength in the development phase of getting drugs to market. In declaring victory, we hope to reinvest when some disappointment or market sentiment shift makes it less highly priced, now at more than 70x current earnings and 50x next year.

**Johnson Electric**, where management warned that our and others' earnings growth expectations were too optimistic. The stock's price remains too high for the lower earnings growth rate going forward.

**POSCO**, the Korean steelmaker. We needed to make room under our 15% [10% for Pinnacle] risk limit on emerging market holdings to accommodate both stock appreciation and other new holdings, and concluded that the run-up in steel shares over the year was the least likely to be due to a particular company insight.

**Yukos**, where the 'non-trivial risk of de facto expropriation' became more pronounced, as the Russian prime minister used government agencies to assail his political rival, the CEO, who is now in jail. The government has confiscated blocks of shares, threatened to revoke oil production licenses, and presented a large bill for back taxes, all of which combined to scotch the merger with Sibneft, one of the underpinnings of our original investment thesis.

We also reduced holdings of **Johnson & Johnson**, **Novartis**, and **TSMC**.

## Global Equity Holdings as of December 31, 2003

Sector	Company	Country	Weight (%)	Description
Consumer Discretionary	Bayerische Motoren Werke	Germany	1.1	Manufacturer of luxury automobiles & motorcycles
	Comcast	United States	1.4	Cable operator
	Denway Motors	China	1.8	Automobile & bus producer
	Pearson	United Kingdom	1.9	Education & publishing company
	Sharp	Japan	1.0	Consumer & industrial electronics manufacturer
	TJX Companies	United States	2.7	Off-priced name brand stores
	Television Francaise	France	1.1	Dominant French television channel
	Viacom	United States	2.2	Leading media & entertainment group
	WPP Group	United Kingdom	1.5	Advertising & marketing services company
Consumer Staples	Coca-Cola	United States	1.4	World's largest soft drinks company
	Colgate-Palmolive	United States	2.0	Consumer products company
	Estee Lauder	United States	1.1	Manufacturer & marketer of skin care, makeup & fragrances
	Heineken	Netherlands	1.6	International brewing company
	L'Oreal	France	2.0	Personal care products manufacturer
	Nestlé	Switzerland	1.1	World's largest food company
	Wal-Mart de Mexico	Mexico	1.4	Consumer goods & food retailer
	Wrigley	United States	0.9	World's largest chewing gum maker
Energy	EnCana	Canada	2.4	Producer of natural gas
	Exxon Mobil	United States	1.0	Global oil company
	Sasol	South Africa	1.4	Refined petroleum products producer
	Schlumberger	France	1.1	Oil services company
Financials	Allied Capital	United States	1.0	Financial institution providing small business loans
	American Int'l Group	United States	2.3	Insurance holding company
	BBVA Bancomer	Mexico	0.8	Commercial bank
	Bangkok Bank	Thailand	1.6	Large commercial bank
	Berkshire Hathaway	United States	2.0	Auto insurer & general reinsurer
	Deutsche Bank	Germany	2.8	Universal bank
	JPMorgan Chase	United States	1.8	Large money center bank
	Kookmin Bank	South Korea	1.0	Large, retail-oriented bank
	Munich Re	Germany	2.3	Largest provider of reinsurance worldwide
	Nomura Holdings	Japan	1.3	Brokerage firm
	Standard Chartered	United Kingdom	1.7	Multinational commercial bank
Health Care	Abbott Labs	United States	1.3	Health care products & pharmaceuticals producer
	Johnson & Johnson	United States	0.7	Consumer health care & pharmaceutical company
	Medco Health Solutions	United States	0.9	Pharmaceutical benefits manager
	Merck	United States	1.6	Pharmaceutical company
	Novartis	Switzerland	2.2	Multinational life sciences company
Qiagen	Netherlands	1.0	Laboratory equipment supplier	
Industrials	Caterpillar	United States	2.8	Producer of earthmoving equipment
	Emerson Electric	United States	1.6	Global industrial & electronics controls company
	Fanuc	Japan	1.0	Global producer of CNC machines & robots
	Mitsubishi Corp.	Japan	3.3	Trading company
Information Technology	Analog Devices	United States	2.2	Analog mixed-signal computer chip maker
	BEA Systems	United States	0.8	Internet software developer
	Canon	Japan	2.1	Maker of image & information equipment
	Dassault Systemes	France	2.7	CAD/CAM software designer
	Hirose Electric	Japan	1.3	Manufacturer of electrical connectors & components
	Keyence	Japan	2.0	Detection & measuring control equipment maker
	Qualcomm	United States	1.8	CDMA wireless communications technology firm
	Rohm	Japan	1.9	Custom chip producer
	Samsung Electronics	South Korea	3.0	Electronic equipment maker
	Taiwan Semiconductor	Taiwan	1.6	Dedicated IC foundry
Materials	Air Liquide	France	2.2	Industrial gas company
	Air Products & Chemicals	United States	1.1	Leading industrial gases company
	Praxair	United States	1.1	Leading industrial gas company
	Rio Tinto	United Kingdom	2.4	Diversified mining company
Telecom Services	Vodafone	United Kingdom	3.3	Telecommunication services provider
Utilities	Kinder Morgan	United States	2.2	Natural gas transportation & logistics company

All Portfolio holdings and sector allocations are subject to review and may vary in the future and are not recommendations to buy or sell any security.

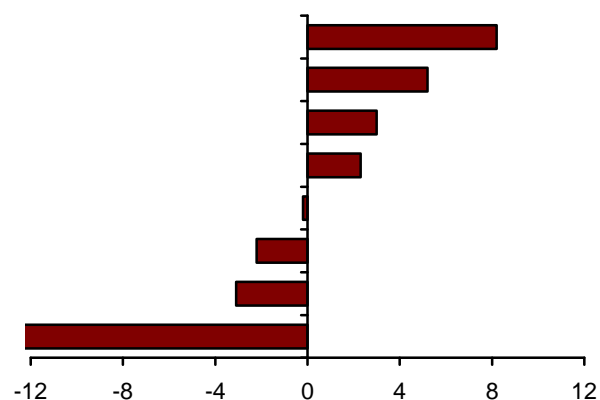
## Ten Best Stocks by Absolute Return

HOLDING	GICS SECTOR	REGION	RETURN %	END WEIGHT %
Denway Motors	Consumer Discretionary	Emerging Markets	76.6	1.4
Deutsche Bank	Financials	Europe EMU	36.2	2.7
Bangkok Bank	Financials	Emerging Markets	34.8	1.3
Medco Health Solutions	Health Care	United States	31.1	0.9
Dassault Systemes	Information Technology	Europe EMU	30.1	2.9
Qualcomm	Information Technology	United States	29.6	2.0
Rio Tinto	Materials	Europe ex-EMU	29.6	1.0
Munich Re	Financials	Europe EMU	28.4	2.4
Air Liquide	Industrials	Europe EMU	25.0	2.2
Vodafone	Telecom Services	Europe ex-EMU	24.5	3.4

## Active Regional Exposure

REGION	HL Global Equity Portfolio	MSCI ACWF
Emerging Markets	12.7	4.5
Japan	13.8	8.6
Europe EMU	16.8	13.9
Cash	2.3	--
Canada	2.4	2.5
Europe non-EMU	12.7	14.9
Pacific ex-Japan	--	3.1
United States	39.3	52.5

Over/Under the Benchmark (%)



## Portfolio Characteristics

Characteristic	HL Global Eq	ACWF	Characteristic	HL Global Eq	ACWF
Avg Wtd Market Cap (\$B)	\$42.6	\$67.6	Alpha	0.39	0.00
Price/Earnings (Trailing)	27.9	25.6	Beta	1.02	1.00
Price/Cash Flow	14.8	13.4	R-Squared	0.92	1.00
Price/Book	2.6	2.5	Sharpe Ratio	0.04	-0.04
Dividend Yield	1.4	2.0	Standard Deviation	5.04	4.70
Return on Equity	18.9	15.7	Correlation	0.96	1.00
Number Holdings	58	2203	Turnover (5-Year Average)	42%	---

Source: Wilshire Atlas

*Alpha* is a measure of risk-adjusted return; *Beta* is a measure of the portfolio's sensitivity to the market; *R-Squared* is a measure of how well a portfolio tracks the market; *Sharpe Ratio* is the return over the risk free rate per unit of risk.

# Global Equity Performance Summary

## 2003 Year End Report

	HL GLBL EQ (Gross)	HL GLBL EQ (Net)	MSCI ACWF <sup>1</sup>	MSCI WORLD	Internal Dispersion <sup>2</sup>	Number of Accounts	Composite Assets (\$M)	Firm Assets (\$M)	% Firm Assets
2003	32.5	32.0	34.6	33.8	†	†	127	1357	9
2002	-19.4	-19.8	-19.0	-19.5	0.6	6	118	1082	11
2001	-14.9	-15.5	-15.9	-16.5	0.4	7	152	1154	13
2000	1.3	0.1	-13.9	-12.9	†	†	108	1392	7
1999	38.9	38.2	26.8	25.3	†	†	96	1423	7
1998	2.3	1.6	22.0	24.8	0.5	11	179	1372	13
1997	11.0	10.1	15.0	16.2	0.6	15	251	1521	17
1996	17.3	16.3	13.2	14.0	0.2	13	188	1247	15
1995	19.0	18.0	19.5	21.3	0.6	13	147	635	23
1994	0.0	-0.9	5.0	5.6	0.4	17	113	369	31
1993	24.3	23.2	24.9	23.1	1.1	16	80	252	32

<sup>1</sup>Benchmark Index; <sup>2</sup>Asset-weighted standard deviation (gross of fees); † Five or fewer accounts

Global Equity Composite contains fully discretionary U.S. dollar-based global equity accounts and for comparison purposes is measured against the MSCI All Country World Free Index (gross dividends). Effective October 31, 2001, MSCI has discontinued the original version of the All Country World Index series in favor of the 'Free' version of the series, which excludes a portion of the market capitalization of several emerging markets that is restricted to foreign investors, but is otherwise identical. Returns include the effect of foreign currency exchange rates. The exchange rate source of the benchmark is Reuters. The exchange rate source of the Composite is Bloomberg; prior to January 1, 1997 it was Reuters.

The MSCI All Country World Free Index is a free float -adjusted market capitalization index that is designed to measure equity market performance in the global developed and emerging markets. The Index consists of 49 developed and emerging market countries. The MSCI World Index is a free float -adjusted market capitalization index that is designed to measure global developed market equity performance. The Index consists of 23 developed market countries. You cannot invest directly in this Index.

Harding, Loevner Management, L.P. has prepared and presented this report in compliance with the Performance Presentation Standards of the Association for Investment Management and Research (AIMR-PPS®), the US and Canadian version of the Global Investment Performance Standards (GIPS®). AIMR has not been involved with the preparation or review of this report. Ashland Partners & Company, LLP has verified firmwide compliance since October 31, 1989, one quarter in arrears.

Harding, Loevner Management, L.P. is an independent registered investment advisor. The firm maintains a complete list and description of composites, which is available upon request.

Results are based on fully discretionary accounts under management, including those accounts no longer with the firm. Non-fee-paying accounts are not included in this composite. Composite performance is presented gross of foreign withholding taxes. Past performance is not indicative of future results.

The US dollar is the currency used to express performance. Returns are presented both gross and net of management fees and include the reinvestment of all income. Actual returns will be reduced by investment advisory fees and other expenses that may be incurred in the management of the account. A fee schedule is available upon request and is described in Part II of the firm's ADV. Actual investment advisory fees incurred by clients may vary. The annual composite dispersion presented is an asset-weighted standard deviation calculated for the accounts in the composite the entire year.

Balanced portfolio segments are not included, nor is this composite a sub sector of a larger portfolio. Leverage is not used in this composite.

The Global Equity Composite was created on November 30, 1989.

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