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Brown Bag University

We are traversing difficult times. Over the past few years, Americans have had to face the news that a President had sex with an intern and then lied about it; an election was determined by the courts and not the voters; and corporate corruption has vaporized at least three companies with maybe more to come. A series of lurid revelations about improper conduct by certain Catholic priests has pummeled us daily, and perhaps most importantly, our nation has been attacked on our own shores with our own planes by people to whom we had offered our hospitality.

All these events, and more, have led to a crisis of confidence that now weighs heavily on our capital markets. The stock markets have been called a measure of our nation's psychology. If so, we are wounded. Our trust of the most important institutions in our country has been shaken. In our June 18th Special Report we concluded by saying that prices and values in the stock market were disconnecting to an extent seldom seen. There are no cases in the history of the capital markets where stock prices have not, eventually, reconnected with the trend of economic growth and true underlying values. However, there have been a times, like today, when issues of trust have sent stocks prices spiraling, while economic growth continued unabated. The most recent time was in 1962 when President Kennedy accused the steel industry of price gouging and used the full force of the US government into coercing them into a price rollback. Eventually, US Steel did roll back steel prices, as did all the other steel producers, but the capital markets were already shaken by a long string of price fixing scandals involving a wide range of industries. Fears ran rampant of more corporate scandals followed by more government controls and stocks sold off almost 30% during the six months following the confrontation with US Steel. Finally, the continuation of good economic and corporate profit growth combined with Kennedy's backing away from rhetoric about more government controls stopped the stock market slide and it recovered almost all that it had lost in the next six months. We continue to believe that the current stock market slide is at its root mostly psychological and does not reflect the reality of what is going on in the economy. The question then is how do we extricate ourselves from the fearful and depressive mania that has gripped us for the last 10 months?

In the last few quarterly letters and special reports, we have reported our own views and those of our research resources concerning what was going on and how long it might last. In this quarterly letter we would like for you to hear from a source we prize very highly, our employees. Donaldson Capital Management is blessed with a group of outstanding professionals on our staff. Most of them are not directly involved in the investment research process, but all of them eat, drink, and sleep the investment business.

Every Thursday at lunch at Donaldson Capital Management, we conduct "Brown Bag University." BBU attempts to lift the knowledge and skills of everyone who works here so we can each be of more value to our clients. Our most recent BBU module has been on learning to write well. As a writing exercise, we asked everyone on our staff to write an essay explaining why we should trust our nation and its important institutions. The product of that exercise so impressed us with its depth of thinking and conclusions, that we have chosen to share excerpts of each essay with you. We hope you appreciate the insights of the authors. Please feel free to contact any of them directly for an amplification of their views.

Carol Stumpf
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Director of Client Services

A graduate of Butler University. Carol loves to write and feed the deer that visit the home she shares with her husband, John, in Santa Claus, Indiana. Their two children are grown and gone.

“We are our nation. This is the basis of democracy. William Tyler Page wrote in *The American Creed* in 1917: “I believe it is my duty to my country to love it, to support its Constitution; to obey its laws; to respect its flag, and to defend it against all enemies.” The issue, as I see it, is that in general, “We, the people,” have become far removed from our government’s institutions. However, amid this whirlwind of change and volatility that is churning up fear and unrest in our nation, it is important to continue to believe in our nation and to seek out faithful leaders and give them our prayers and support.

“So, I believe, this is an important time to stand unified as a nation and show the world our character. Let us not be led by fear and greed, and let us not forget the principles upon which this nation was founded. The motto that appears on our US currency, “In God We Trust,” should be a reminder of the true values of our nation. We must keep this faith alive. I believe that our President is a man of faith. We must support him with our prayers.

“We must continue to trust in our nation, pray for our leaders, and seek God’s will in every event. We must pray that they see God in all people, whether they are close to us or strangers, and make correct judgments about the true meaning and value of temporal things, both in themselves and in their relation to our nation’s goals.”

Justin Donaldson

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Computer Programming Consultant.

Justin found time, following his graduation from Depauw University last year and prior to attending graduate school, to design a new contact management program for DCM’s computer system

“Many of you have watched the World Cup these past couple of weeks. You’ve seen David and Goliath stories played out on an international level, and you’ve witnessed the rise of a new soccer world power, namely, the USA. What you may have also noticed, or at least heard about, is the utter contempt foreign journalists have for US soccer. For many nations, this same sentiment has been extended to include nearly every aspect of our country. We are “The Great Satan” to some, and we are “Capitalist Pigs” to others. The world markets know that we are currently under a siege of terrorism, and more importantly, that we are not immune from these attacks.

“There has been a whole lot of speculation over the ‘real’ reason for the lingering slump to the markets. Whatever the real reason is, the market won’t turn up again until everyone’s status and place in the world is resolved. Much like the US national team, whose recent performance threw the football world into disarray, the US as a country has demonstrated that we will not accept hostile regimes any longer, and this has many neutral foreign countries upset and confused. The maps and national borders of the world will change once again – especially in the mid-east. We will probably acquire new enemies, or maybe even gain new friends, but there is no question that we are forcing a reorganization of our global society. It is going to be a messy, drawn out ordeal, but it is one that we really have no choice but to accept.

“The markets are suffering because the predictions made back in the mid 90’s have been wrong. The promise of a digital revolution that was driving the markets back then has not ushered in an effortless increase in efficiency. These promises have ushered in frail ‘weeds’ of companies that grew fast but lacked the root structure of experience and profitability that has been the backbone of American industry. These weeds have been rooted out by impatient stockholders. The ground that they previously occupied, however, is just as fertile as ever. Profitability will find these places once again, and this time they will use more responsibility and practicality in how they grow. Our investments in the market will be better off for it.”

Kyle Markle

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Summer Intern.

Assisting DCM between his freshmen and sophomore years at the University of Cincinnati, where he pitches for the Bearcats' baseball team.

"The norms have changed, and things are looked at differently now than they were when similar events occurred in the past. Television and the internet have become the norm allowing Americans to get a better picture of what is happening around the world -- as it happens. The market and economy are also different in some ways now than they were earlier in the century. Today, more people own stocks and bonds than ever before. In the past, many people may not have realized the impact such events play on the market because it did not play a major role on their personal assets. Today they do.

"Our nation has usually prevailed, whether it means going to war to defend our nation or stopping tyranny in other lands. Nothing can permanently bring our great nation down because we have trained ourselves in the past by dealing with similar events and over time gotten stronger. Although the recent events with Enron and WorldCom seem devastating, these things have gone on forever, but just recently have we begun to crack down and eliminate corporations that act the way these two did. This, in essence, could and should be looked at as our nation progresses and eliminates cancers from the business world. This will also set an example for other corporations who could have been accused of wrongdoing in the past, but will change their ways now because they see what is going on with the companies who were caught. All of these events should be looked at as measures that in time will make our nation stronger. Although these devastating events seem to all come at once, they will over time make this great nation even better than it already is."

Laura Roop

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Vice President of Operations

Graduate of Indiana State. Mother of two teenagers. And, still playing softball.

"I love this country. Every day I thank God for the freedoms I have, and I ask him to bless those whose jobs are to protect those freedoms. By living in America, I enjoy certain rights given to me by its constitution: freedom of speech, freedom of religion, the right to vote, etc. I believe this country is the safest place on earth to live. My children are growing up during a time of peace in America. Their lives consist of movies and football games. On September 11, 2001, everything changed.

"The terrorist attacks seemed to be the tip of the iceberg. Over the next several months, Americans watched scandals unfold that involved many of our most trusted institutions. Not only did Americans take notice, but so did the rest of the world. The markets went down; many foreign investors pulled out their money; and others ran for cover. The great superpower was vulnerable after all.

"Confidence in America's most important institutions may be shaken, but America is still the greatest country on earth. These set-backs forced us to see our weaknesses, to examine more closely how companies do business, and to deal with these revelations. It may take a while to "clean house," but America will emerge stronger than ever.

"Our president is a Christian man, a moral man, and a man who means business. He was put in that office for a reason that will be revealed to us one day. He asks for the prayers of a nation and he gets mine, every day. I believe that God is leading him to bring America through these tough times. My faith is in God and America."

Beth Dietsch

Client Services Representative

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Recently promoted, Beth has kept Greg and Mike in order for the last two years. She and her husband, Mike, live in Newburgh, Indiana with their two small, adorable children. We call her "Sassy" for a reason.

Our current economic situation has made a negative impact on our society. Our nation has been faced with sexual allegations against the Catholic Priests and our past President. The stock market, unfortunately, has been negatively affected by corrupt organizations. All of these situations have a tendency to create distrust among the Americans.

Not only are we faced with negative situations, but we also face the act of terrorism, which creates fear and infringes upon our freedom. However, I strongly believe that when we are faced with these tough situations, our country becomes stronger and more united than ever.

During my interviews with several people about the economy, everyone kept saying the same thing: "We have to believe that it will get better." Others have said that they do not feel that there is distrust in the U.S. Government among the Americans. We as Americans must have faith and trust in our President in hopes that he will make the right decisions for our nation.

Rick Roop

Director of Portfolio Management

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A graduate of Murray State University (where he met Laura) with an MBA from Indiana State University, Rick is a bulldog when it comes to uncovering difficult-to-find information on companies we are researching.

"Rich DeVos, a writer for the Saturday Evening Post, recently wrote, "the very principles that this great nation was founded upon are still intact and guiding Americans each and everyday. Hope, persistence, confidence, optimism, respect, accountability, family, and freedom are all essential elements of the American way of life." The vast majority of Americans are religious and carry a deep personal faith in God. Our Godly faith is a foundation on which all things in life revolve. In a sense, faith is the most important asset believers have in a world filled with so much uncertainty, according to DeVos.³

"Faith is a blessing that rewards those who are vigilant, but sometimes practicing our faith is difficult. When we face fear such as we experienced with terrorism on our home soil, compounded by the never-ending dosages of bad news, we begin to lose focus and want to throw in the towel.

"When Americans feel that some of their most trusted institutions have failed them, faith is what is left when all else has evaporated. It fills the gap when we do not know what is going to happen next. It's the choice to go on living our lives, even in the face of such negativity and uncertainty brought about by the news media. It's the willingness to take a risk and to get back on our feet and get back into the market, even when the odds appear overwhelmingly adverse."

Tom Piper

Manager of Information Technology

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DCM is terribly dependent upon computers; Tom keeps them going and makes us more efficient through the use of technology. He came to us after a long stint in a variety of positions with Old National Bank and Digital Equipment. He and his wife, Brenda a teacher and Lutheran preacher, have two sons still at home with them.

“There is hope. According to the Gallup organization, even though Americans' confidence in organized religion and big business has fallen significantly over the last year, their confidence in the military and the presidency has increased. Overall, the military, the police, the presidency, the U.S. Supreme Court and banks are the five institutions out of 16 tested in which the American people have the highest degree of confidence. Interestingly, this corresponds with Maslow's Hierarchy of Needs, with safety and security poised close to the base of the needs pyramid. As Maslow taught us, these basic needs must be fulfilled before we can turn our attention to higher aspirations.

“I believe that as we see our government perform its duty of defending and shielding our nation from attack, not only will our trust in the government continue to increase, but we will then feel the freedom to trust big business and our other ailing institutions during their healing processes. We can then turn our attention to the higher aspirations of life and again begin to tap into the vast resources that we have been graciously given in this remarkable country of ours.”

Just as the staff at DCM has done, every investor will have to come to their own resolution of what they can trust and what they can't. Until that time, the current lack of confidence in American corporations will maintain the gap between market prices and the true value of those companies. In the end, however, the economics will prevail. They always do. Prices must, in the long term, reflect the worth of each company's stock.

So, what is a stock worth, anyway? In an upcoming Special Report, we will show the relationship between dividends and prices. Dividends paid out by public companies fell in 2000 and 2001 for the first two consecutive years since 1972 and 1973. Interestingly, 2000 and 2001 were down years in the market, and 1972 and 1973 were also the last two consecutive down years in the market. We think there is some connection between dividends and market prices. And, here is the good news: dividends for the companies in the S&P 500 have again begun to rise. In the month of June, among companies reporting a dividend action, dividends rose 50% over the same month last year. For the first six months of this year, the ratio of dividend increases to dividend cuts for the companies in the S&P 500 was 10-to-1. We think this dividend action is long over due and will help rebuild trust because dividends are really money. They are not accounting, vague promises that have gotten so many companies in trouble. Look for our report on this issue to arrive soon.

Blessings to you and your family, from all of us at DCM,

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