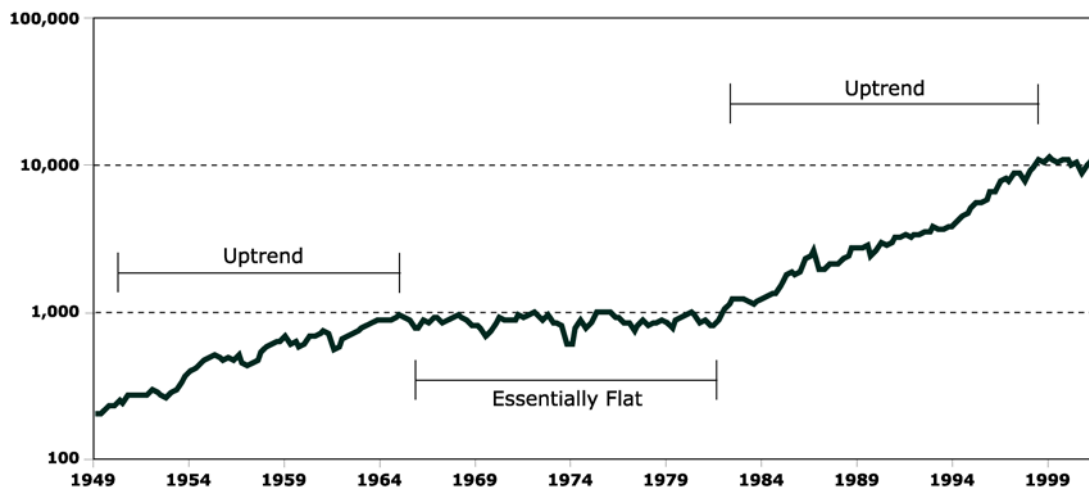


Can Active Managers Add Value in Bear Markets?

As the length of the current bear market approaches three years, investors may wonder if active money managers can produce favorable returns when the overall market slumps for an extended period. After all, if a rising tide lifts all boats, what happens when the tide goes out? Are investors better off on dry land?

To answer this question, we surveyed performance during the 1965 to 1982 period – an 18-year stretch in which the Dow Jones Industrial Average seemed trapped beneath a ceiling at the 1000 level. Our findings suggest that active managers can earn solid returns for investors, even when the broad market is relatively flat.

A Half-Century of the Dow – 1949-2002



Source: Bloomberg, as of 6-30-02.

As the chart above indicates, stocks generally advanced in the bullish periods of 1949 through 1965 and 1983 through 2000. While both of these periods included market dips, declines were short-lived. In virtually every year, the Dow closed at a higher level than it opened.

From 1966 through 1982, however, the gains posted by the Dow were repeatedly countered by its retreats. This era was characterized by unusually tumultuous social, political, and economic climates: civil rights unrest, the Vietnam War, the end of the Nixon presidency, an oil crisis in the Middle East, and high inflation all shook investor confidence. The Dow opened 1966 at 969 and did not begin a sustained move past 1000 until 18 years later, at the end of 1982.

Across the entire 18-year period, the Dow's price level advanced at an annualized rate of 0.6%. Even with dividends reinvested, index returns were relatively weak: the Dow gained 5.7% per year, while the S&P 500 appreciated at a rate of 7.1%. So how did the average money manager fare over this tough stretch?

To find out, we searched the Morningstar database, which includes performance history for thousands of mutual funds going back several decades. We focused on mutual funds instead of managed accounts because mutual fund performance for the period discussed is readily searchable, while managed account performance is not. While we recognize that managed accounts and mutual funds do not share the same fee structures, regulatory structures, or expenses, we believe mutual funds represent an acceptable substitute for composite performance for our purposes here.

Our search focused on actively managed, large-cap mutual funds with track records that spanned the entire 1965-1982 period. These criteria yielded a sample of 47 funds. As the table below indicates, the funds tended to outperform the Dow and the S&P 500 by substantial margins.

Performance – 1965-1982

	Annualized Performance	Growth of \$100,000
Dow Jones Industrial Average	5.7%	\$271,214
S&P 500	7.1%	\$344,332
Average of 47 Mutual Funds	10.2%	\$577,265

Source: Bloomberg, Morningstar; as of 6-30-02.

From 1965 to 1982, an investment of \$100,000 in the Dow or in the S&P 500 would have grown to \$271,214 or \$344,332, respectively. The same investment in the average fund in our study would have appreciated to \$577,265 over the 18-year period. (Fund performance includes fees and expenses and does not include tax implications.)

Because this study excluded funds that may have ceased operating between 1965 and 1982, it may contain a significant survivor bias. At the same time, we believe it demonstrates that – even when the overall market is not charging upward – active managers can deliver strong long-term returns. Amid stormy investment seas, climbing aboard with a knowledgeable captain could be an investor’s smartest move.

The information provided in this material should not be considered a recommendation to purchase or sell any particular security or mutual fund. It should not be assumed that any security transactions, holdings, or sector discussed were or will be profitable, or that the investment recommendations or decisions we make in the future will be profitable or will equal the investment performance discussed herein. Strategies discussed herein are subject to change at any time by the investment manager in its discretion due to market conditions or opportunities. Please note that all indexes are unmanaged and are not available for direct investment. Past performance is not a guarantee of future results.

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