In the following Salomon Smith Barney report, Outlook 2001: Leading Money Managers Share Their Expectations for the Future, a blue ribbon panel of portfolio managers offers their outlook on the future for the stock market. We are pleasantly amused by comments of J. Thomas Antonelli, Jr., CFA, Portfolio Manager and Principal, Flippin, Bruce & Porter, Inc. We don't know Mr. Antonelli, but we assume that Flippin, Bruce & Porter, Inc., is among the top investment managers in their field, and we further assume they select investments on the basis of fundamental valuation.

Mr. Antonelli states – "large-cap quality companies such as Microsoft, Hewlett Packard and WorldCom are in our portfolios. Given the life cycle of the technology sector, it is realistic to expect further revenue expansion towards the end of 2002. Reacceleration of earnings in the sector will not become apparent until well after the equity prices rebound."

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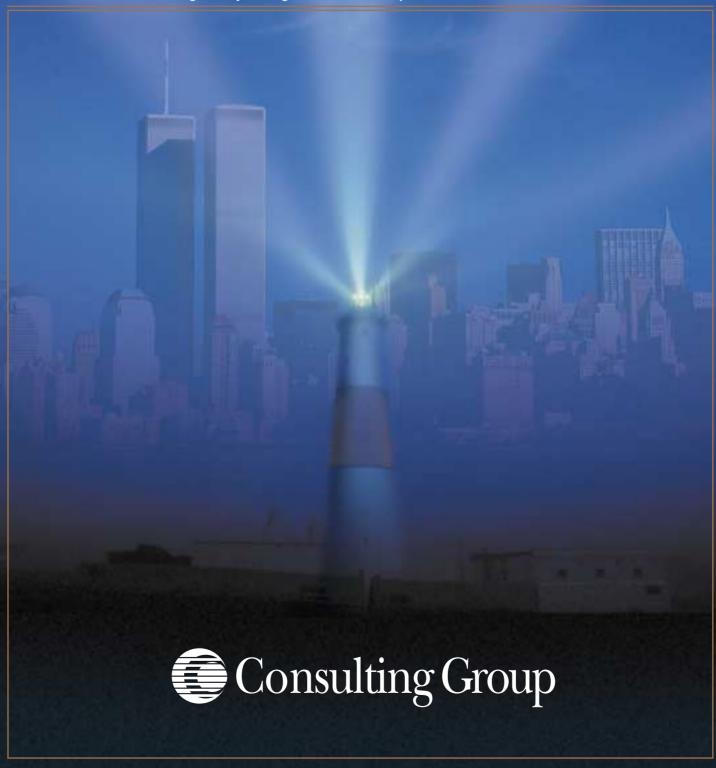
In other words, what this Portfolio Manager is saying is that price changes lead important fundamental changes. As technicians, this idea seems oddly familiar to us! What is funny (or sad, depending) is that we do not recall this kind of warning from the fundamental analysts or portfolio managers in 1999 or 2000, i.e., that de-aceleration of earnings in the sector will not become apparent until well after equity prices disintegrate.

S A L O M O N S M I T H B A R N E Y . C O M

OUTLOOK

Leading Money Managers Share Their Expectations for the Future

Summer



LARGE-CAPITALIZATION VALUE STOCKS

J. THOMAS ANTONELLI, JR., CFA Portfolio Manager and Principal Flippin, Bruce & Porter, Inc.

Does the general outperformance of value stocks, compared to growth stocks over the past year, indicate a return to a more fundamental approach to stock selection?

It certainly appears to be a logical reaction of investors to the collapse of the narrowly focused, technology-driven markets of the 90s. The enthusiasm for the "new age" of technology was reflected by an insatiable demand for investments in these hypergrowth companies. The explosion in the Initial Public Offering market coupled with the scorching advance in the Over-the-Counter markets left analysts wondering how best to value companies with tripledigit growth in revenues but equally high cash-burn rates. Excessive capital flowing into this sector contributed to inflated equity values, fueling both internal expansion and acquisitions using their equity currency. As a result, investors abandoned traditional valuation metrics, thinking these tenants could no longer capture what everyone "knew" was intuitive. Increasing stock prices confirmed acceptance of investing's "new paradigm," much like the crowd approved of the emperor's new clothes.

By the middle of 2000, investors returned to more rational means to arrive at their conclusions. With more realistic appraisals of earnings growth rates and fundamentally sound business models, traditional valuation techniques became much more relevant. The results so far indicate the validity of this valuation shift, with investors placing greater value on those companies with measurable revenues, earnings and cash flows. History has shown that in an environment of declining rates of earnings and returns, conservative fundamental analysis becomes more critical when evaluating investment options.

With interest rates dropping, will stock dividends become a more important consideration to investors?

Over the past five years, dividend yield has diminished as an indicator of relative value for a company. With the accelerated growth in share prices in the market, without a corresponding increase in dividend flow, investors became more enamored with the prospects for capital appreciation rather than the taxable income flow of dividends. Sensing this desire for increased equity value, beginning in early 1996, companies shifted their funds available for dividends to more capital uses, making acquisitions and boosting their paid in capital. As a result, the dividend yield as a percentage of the 30-year Treasury bond yield began a dramatic decline, from an average of 42% in the late 80s and early 90s to 25% in 1998. In the

later part of 1999 and early 2000, companies were forced to redirect cash flow from dividends back into the company as revenue shortfalls mounted. This resulted in the dividend yield as a percentage of the Treasury bond (T-bond) yield hitting a low of 17%.

Historically there has existed some correlation between a decline in interest rates and increases in the amount companies pay out as dividends. It now appears that investors will start to value dividend yield as a measure of a company's relative strength, given the current economic backdrop. There has been a marked spike in the aforementioned dividend yield/T-bond relationship to 26%, reflecting the current decline in rates coupled with the relative stability of dividend flow over the past six months. Maintaining or even increasing dividends during periods of economic decline bodes well for the health of a company.

History has shown that in an environment of declining rates of earnings and returns, conservative fundamental analysis becomes more critical when evaluating investment options. What groups or sectors look attractive to you over the next 18 months?

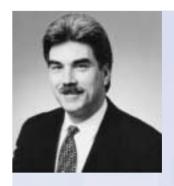
Although we are primarily driven on a stock-by-stock basis, there are times when we see a number of stocks within a sector show up on our valuation measures. With the demise of the technology sector beginning in mid 2000, there have been a number of opportunities emerging. Our focus upon this sector was increasing during 2000 and has intensified. Given the more realistic Price/Earnings (P/E) and Price/Earnings to Growth (PEG) ratios for stocks in the sector, there are substantially more stocks that are appealing to our value style. As a result, large-cap quality companies such as Microsoft, Hewlett Packard and WorldCom are in our portfolios. Given the life cycle of the technology sector, it is realistic to expect further revenue expansion towards the end of 2002. Re-acceleration of earnings in the sector will not become apparent until well after the equity prices rebound. The key, from our perspective, is to identify those companies who have the financial stability and flexibility to weather the economic decline.

Financial Services is a sector that should benefit as the economy continues to slow and rates are further reduced. Companies such as American Express and Freddie Mac should see the reduced cost of funding flow back

to the bottom line. These companies over the past ten years have made major strides in integrating their product offerings, streamlining their distribution networks and maintaining tight expense control. The recent declines in their prices can be attributed to worries of credit risk that appear to be overblown. These large multi-national companies have taken aggressive steps to mitigate the risk carried on their balance sheets. The hidden value of these companies lies in their franchise value. Their ability to attract and develop customer relationships is enhanced by the visibility of their brand name.

We're looking at an economy with little or no growth. Should this continue, what will that mean for value stocks?

Historically, value stocks have performed very well during times of economic disruption. The most recent period in which the economy experienced little or no growth was 1992 through 1993. During this period, value stocks performed very well, with the Russell 1000 Value index showing returns almost double the S&P 500. As investors become fearful of a recession, they gravitate to those investments they perceive as "safe havens." Traditional value stocks with low price-to-earnings ratios, low priceto-book ratios and high dividend yields, appeal to the investor who views the near future with trepidation.



J. Thomas Antonelli, Jr., CFA
Portfolio Manager and
Principal

Mr. Antonelli has over 24 years in the investment industry. Prior to joining Flippin, Bruce and Porter in 1993, he was a Senior Vice President with Wheat First Securities and investment executive with Legg Mason Wood Walker. Mr. Antonelli graduated from Mount Saint Mary's College with a B.S. degree in Business Administration.

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