

DIXON, HUBARD & FEINOUR, INC.

INVESTMENT COUNSEL

601 S. Jefferson Street, Suite 410
 Post Office Box 2768
 Roanoke, Virginia 24001-2768
 Telephone (540) 343-9903
 Fax (540) 343-7684

SUMMARY

- Equity market reacts poorly to earnings missteps.
- Technology and communication issues continue correction.
- Bond yields continue to drop.
- Previous Fed hikes slowing economic growth rate.

THIRD QUARTER 2000 REVIEW

The equity markets of the third quarter reminded us that patience truly is a virtue, especially when it comes to long term investing. The markets continued to digest the outsized gains of late '99 and early '00 by essentially going nowhere. Each attempt to rally was squelched by selling pressures as investors fretted over higher oil prices, the anemic euro and slowing profit growth. An August rally was all but entirely reversed in September. Never mind that the Federal Reserve finally stopped raising interest rates, which was what had everyone worried in the first half of the year. The rather modest action in the major averages disguised the market's move to a defensive posture. The bloodletting continued in technology and communication services while utilities, energy and financials surged. Please see the Performance by Sectors chart on page two for more details.

For the quarter, the Dow Jones Industrial Average gained 1.9% but continues in negative territory for the year, down 7.4%. The S&P 500 slipped lower for the quarter, off 1.2%, and

Year 2000 Stock Market Performance

	Third Quarter	Year to date
S & P 500	-1.2%	-2.2%
Dow Jones Industrial Average	+1.9%	-7.4%
NASDAQ Composite	-7.4%	-9.7%

down 2.2% for the year so far. The NASDAQ Composite, no longer a prospect for a speedy recovery, lost 7.4% for the quarter, widening the year-to-date loss to 9.7%. The international markets have fared even worse with the Morgan Stanley EAFE Index down 8.3% for the quarter and down 12.6% for the year to date.

On a more positive note, broader market indicators such as the Value Line Arithmetic Index and the NYSE Advance/Decline Line provide evidence that more stocks are performing better. Strong positive returns for a

(Continued on page 2)

Third Quarter 2000 Review (continued)

(Continued from page 1)

number of mid-cap and small-cap indices offer further evidence. Since mid-1998, continued strength in the large-cap dominated major averages disguised the fact that most stocks were depressed.

In the bond markets, yields continued to retreat with what appears to be the resumption of a long-term downtrend. The yield on the ten-year Treasury dropped from 6.02% to 5.82%, and the thirty-year yield finished unchanged at 5.88%. The inversion of the yield curve continues with short-term rates higher than long-term rates. The inversion implies little expectation of higher inflation and interest rates in the future, even though the Federal Reserve has forced short-term interest rates higher.

On the economic front there are a number of concerns investors must come to terms with. The old line about good news and bad news has never been more appropriate than now. The good news is that inflation remains

under control, thanks to the Fed's determined efforts to slow the rate of economic growth via higher interest rates. It looks as if the Fed has finished raising rates for this cycle and engineered a "soft landing." The bad news is that a more slowly growing economy means slower growth of corporate earnings. Since growth of corporate earnings has become the most important variable that Wall Street uses to value stocks, the market has reacted very poorly to recent revenue and earnings missteps by high profile companies such as Kodak and Intel. Investor response has been swift and brutal, but there is also a creeping realization that the outsized gains of the past five years are not likely to resume. Expectations for profit growth and stock market returns are being adjusted downward.

Constraints on the supply of crude oil and natural gas have conspired to drive energy costs to the highest levels in a decade. These higher energy costs only put more drag on a slowing

economy and corporate profits. Abroad, higher energy costs are of even greater concern as the economies are not as strong and oil prices are a larger component of the economy.

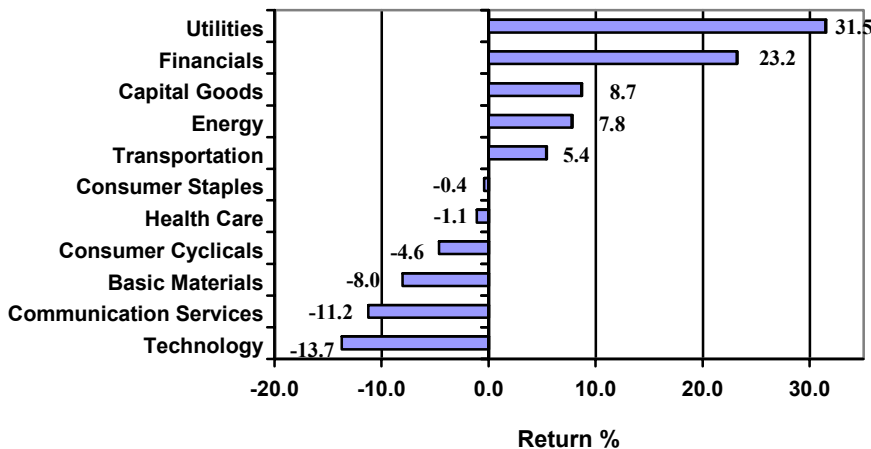
Additionally, renewed economic weakness abroad, both in Europe and Asia, has brought further profit woes to foreign corporations and U.S. corporations with significant overseas markets. The euro has continued to reach new lows against the dollar only to add currency translation losses to the list of profit pressures for the U.S. multinationals.

The best we can make of all this economic stew is that most of the bad news is probably already out. The markets have proved to be a very effective discounting mechanism and have likely worked all the negatives into current equity prices. The next move by the Fed, though not soon, will probably be a reduction of interest rates after the economy has cooled to the extent that the Fed realizes it may have slowed too much. Already, monetary conditions are improving since the Fed has stopped tightening.

On balance, we continue to expect improved market action in the last quarter of the year. The years of gains in excess of twenty percent are over for now, and a return to the long run historical averages would argue for a few years of negative returns. But, seasonal factors, improving monetary conditions and continued sound economic fundamentals in the U.S. help make the case for a better finish to the year. Positive returns for the year would mean the continuation of the great bull market of the past two decades. We remain optimistic and continue to look for rewarding opportunities in the stock market.

- Whitney Brown

**Third Quarter 2000
S & P 500 Performance by Sectors**



Markets Could Use Traditional Election Year Boost



After three quarters of going nowhere in a hurry, U.S. stocks are in dire need of a boost if they are to finish the year

with a convincing gain. After the fireworks of the first quarter, the three major market averages have marked time in a limited trading range. Each attempted rally has failed to overcome renewed selling pressures.

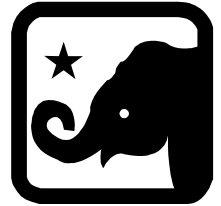
Bulls make take heart in a recent statistical analysis of stock market performance in presidential election years. Ned Davis Research has determined that the median performance of the Dow Jones Industrial Average for the past 25 presidential election years, going back

to 1900, has been a gain of 8.4%. The NDR analysis also indicates that in the 16 out of 25 times when the incumbent party has remained in power, the Dow has done even better, sporting a median gain of 13.3%. Investor's distaste for the uncertainty of change may explain the median gain of only 4.3% in years when the incumbent party lost.

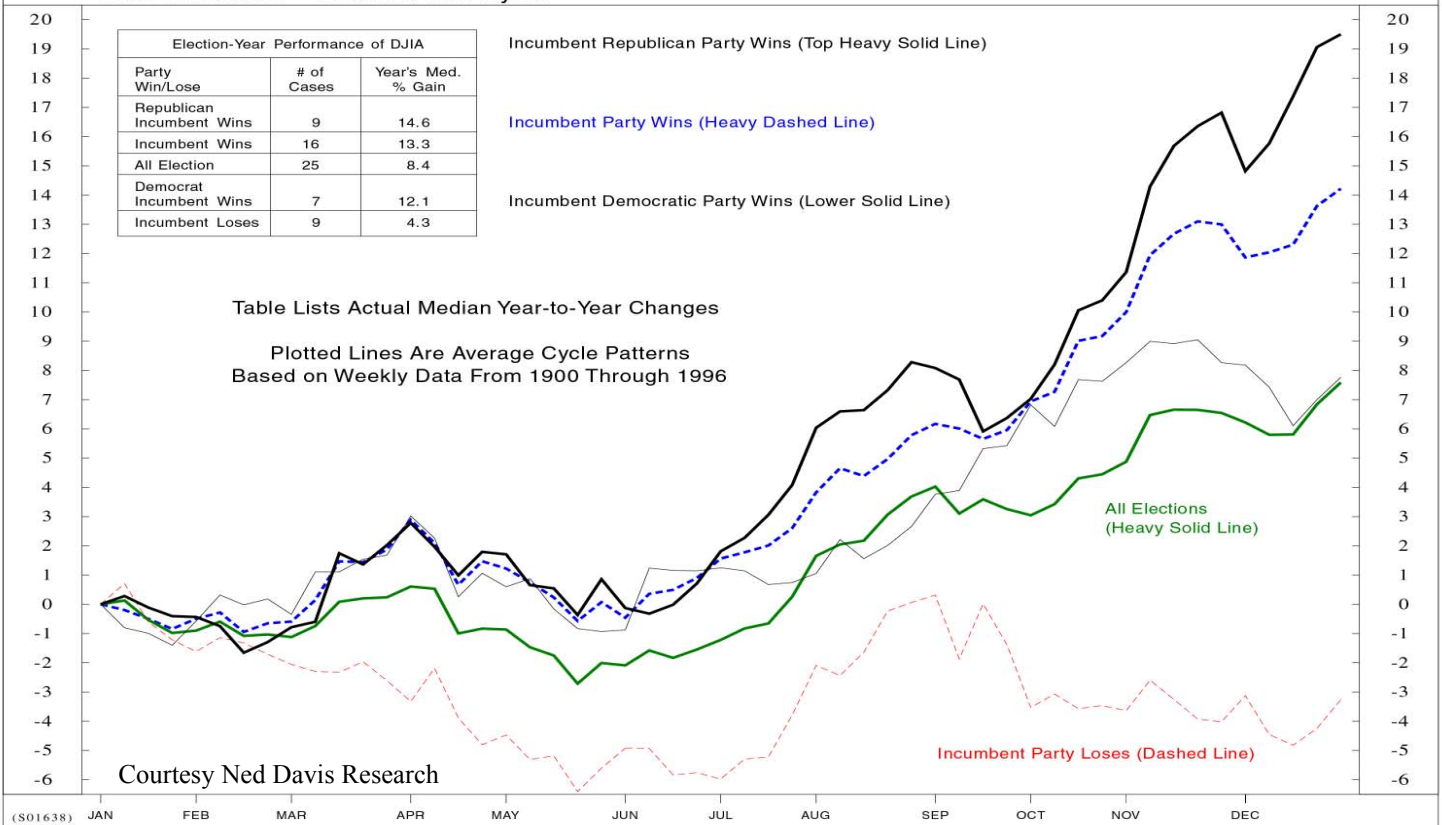
If this year is to follow the pattern of the median year (see chart below), we would expect a very robust fourth quarter since, thus far, the Dow is down for the year. In fact, the NDR analysis indicates that the first half of the median election year is weak with a stronger second half, including a significant correction in September. Sounds like déjà vu all over again.

Digging a little deeper and

without taking sides, NDR has determined that the Dow has done better in years when the White House and the Congress were controlled by opposing parties. The best combination has been a Democratic President and a Republican Congress. Regardless of the parties involved, investors may find some comfort in the gridlock effect which prevents either party from accomplishing anything too extreme. The founding fathers strike again. NDR recognizes that there are many other factors at play in the financial markets, and this particular study is not to be used as a serious investment tool. -Walter Dixon



Dow Industrials -- Election-Year Cycle



Decimalization

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Decimal pricing, simply put, is the listing of the price of something in dollars and cents, with a decimal point between the two. For example, if your local grocery store advertises the price of a pound of rib-eye steak at \$5.99 per pound, that is decimal pricing. You will encounter decimal pricing virtually everywhere that monetary transactions take place, with the exception of the U.S. securities markets. The U.S. securities markets have traditionally traded in fractions. For example, you might purchase a stock at a price of 42 ½. Under decimal pricing that would be \$42.50.

Although you are probably already used to seeing decimal pricing reflected on your portfolio statements and possibly even broker confirmations, stocks actually trade in fractions such as eighths and sixteenths. The New York Stock Exchange (NYSE) and the American Exchange (AMEX) have handled stock trades using fractions for more than 200 years. However, a test program for trading in decimals using one-penny increments was mandated by the Securities and Exchange Commission and was implemented on Monday, August 28th. The pilot program for the NYSE included seven stocks, whereas the AMEX

began testing with only six stocks. Phase II of the pilot program took effect September 25th with the inclusion of even more stocks. Expect the markets, including the NASDAQ, to be completely converted to decimal pricing sometime in 2001.

The move to decimals from traditional fractions was intended to give investors better execution prices by narrowing trading spreads, or the difference between what a potential buyer bids for the stock and the price a seller asks for the stock. Other advantages accrue from the fact that decimal prices are easier to understand and that decimalization will help ensure that U.S. markets remain competitive with foreign exchanges, which already use decimals.

If you want more information on decimal trading or would like to see which stocks were included in Phase I and II, visit the websites for the New York Stock Exchange (NYSE) at www.nyse.com/decimalization and the Securities Industry Association (SIA) at www.sia.com/decimalization. You can email questions about decimalization to the National Association of Securities Dealers (NASD) at decimals@nasd.com.

-John E. Grace

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601 S. JEFFERSON STREET, SUITE 410
POST OFFICE BOX 2768
ROANOKE, VIRGINIA 24001-2768
TELEPHONE (540) 343-9903
FAX (540) 343-7684
E-mail: *last name@dhfinc.com*