

## MARKET OVERVIEW

### THE STRATEGIES

#### BETTER THAN BONDS / INCOME

A fixed income alternative/equity income approach utilizing reliable dividend growth companies from across the broad market. Stocks are conservative, high quality, high yield, and are projected to have a rising stream of income.

#### BETTER THAN BONDS / UTILITIES

A conservative, socially responsible strategy offering growth and income for total return investors by focusing on opportunities in the broad utilities sector: electric, gas, telephone, sanitation and water.

#### DISTRIBUTION / EMERGING UTILITIES

An opportunistic portfolio focusing on companies that are likely to be acquired during an era of utility consolidation and convergence, as well as companies poised to benefit from deregulation.

#### THE SBI PORTFOLIO

Based on the strategy detailed in Lowell Miller's book, *"The Single Best Investment,"* the SBI Portfolio combines value analysis with stable, moderate growth prospects from all sectors. The portfolio emphasizes companies with reliable dividend growth as well as strong fundamental characteristics.

*"Most Americans, even those resentful of the growth of government, have come to realize that Washington will not allow another major depression to take place. Over the past two decades there was a rapid growth of investment pools, such as mutual funds, defined benefit pension funds, and defined contribution pension funds (401K's, etc). These large pools hold well over half of all securities, and their trading accounts for even more than that. Fund managers are limited in their investments by various laws, but are nevertheless able to exert great pressures on the market. New money continued to flow into the market, month after month, and the fund managers vie with each other for positions in growth equities. And the flow seemed endless, insuring higher and still higher prices for good stocks. Individual investors competed with the funds for such stocks, and when inexperienced hands entered Wall Street, large-scale fluctuations were inevitable.*

*"As the prosperity bull market took hold, prices began to soar, and although there were corrections, stocks continued to rise. The forces behind this rise—a "goldilocks" economic scenario and apparently unlimited funds in the hands of institutions and individuals—were well known and constantly repeated by market analysts, most of whom praised what had become the greatest bull market in American history.*

*"True, there were some problems lurking. Confidence in the new President was lacking, as he seemed unable to act forcefully, though most were in support of his proposals for tax cuts and programs to aid education as well as a medical-assistance program for seniors. There were problems with China, problems in Africa and in Southeast Asia. But despite the problems, most experts in the investment community thought the long-term values were good, and continued to counsel purchases.*

*"The averages told only part of the story when stocks were rising, though. The stable, old economy issues participated, but they lagged far behind the glamour stocks, which skyrocketed. Most were technology issues, companies with intellectual property and outstanding managements. But soon even these stocks were priced in rarefied air, and speculators were more than ready to join in on a rising IPO boom.*

*"But cracks began to show. It was discovered that many of these new issues were manipulated by syndicates or by underwriters even before they were offered to the public. Accounting practices had grown slipshod and "creative." Despite this, the new issues boom continued. Women's clubs*

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*“These were all scary times, to be sure, but not bad times to be a buyer. In fact, these were the best times to be a buyer. Will history repeat? Does history ever not repeat?”*

*abandoned lectures on art for discussions of investments. Brokers reported record crowds in their offices at lunchhour. Tape-watching became baseball’s new rival spectator sport. “We all know this is ridiculous”, said broker S.L., “But the stock market reflects every human frailty, and the big one is now greed. Others are fear and stupidity. They’ll come a little later.*

*“Nevertheless, more than 50% of mutual fund managers expected a new market high early in the year, and only 10% expected a decline. Mutual fund redemptions, however, began to pick up steam. Yet stock prices moved higher early in the year, buoyed by fantastic and glamorous tales of the future. Repeating what had become a standard Wall Street joke, The Journal noted that stocks were not only discounting the future, but the hereafter as well.*

*“When one considers the profit picture over the longer range, the picture was even more striking. In the previous 20 years, the price of common stocks had risen 601%, while corporate profits increased only 169%. Was there a mismatch?”*

As you might have guessed, we dipped into history for the above text. It’s not an excerpt from a current magazine, it is a description of the times and the events of the bull market in stocks that led to the crash of 1962, shortly after Kennedy was elected, during which most stocks lost 30-50% in the first five months of the year. The description comes from Robert Sobel’s *Panic On Wall Street: A History of America’s Financial Disasters* (pp 400-416), published in 1968.

We changed remarkably few words, in an effort to disguise the historicity of the text, since it is, in fact, so current. Indeed, Sobel goes on to quote Burton Crane, who had long thought prices were too high (every era, apparently has its Cassandra named Burton. Ours is efficient market pioneer and stock skeptic Burton Malkiel):

*“This happens to coincide with a growing belief that the rates of earning growth for*

*some of the glamour stocks were no longer justifying the high price-earnings multipliers conferred by the market in the past.”*

Sound familiar? Edwin Posner was quoted during the decline of 1962 ; *“ this is definitely not panic selling. We have had a ten-year bull market, and this evidently is the time for an adjustment. Stocks are now getting down to a realistic level.”* A broker noted, by contrast, that *“people have been sitting around praying all day.”*

But 1962 wasn’t really a crash, and no depression ensued. Indeed, there has not been a crash since 1929, and no market decline has determined the future course of the economy since then either (not that we know of, at least). In the intervening years, Federal Reserve powers, the SEC, and a unified banking system have all stood firm against true panic. 1962 wasn’t a bad time to buy stocks, whether at the beginning of the year or after the decline. Neither was 1974, nor 1982, nor 1991, nor 1998. These were all scary times, to be sure, but not bad times to be a buyer. In fact, these were the best times to be a buyer. Will history repeat? Does history ever *not* repeat?

SELECTED INDICES		
	1 <sup>ST</sup> Qtr’01	12 Mo
S&P 500	(11.61)	(21.46)
Equity Inc	(6.18)	1.34
Util Fund	(6.42)	(5.53)
DJUA	(6.71)	35.34
LB Treas	1.37	12.82
LBGC	3.20	12.41
S&P 400	(10.77)	(6.96)
Value Line	(6.16)	(13.86)
Rus 2000	(5.24)	(14.18)
Rus 2000 Val	0.97	19.45

S&P 500 = Standard & Poor’s Index  
Equity Inc = Ave Equity Income Fund (Lipper)  
Util Fund = Ave Utility Fund (Morning Star)  
DJUA = Dow Jones Utilities Ave  
LB TREAS = Lehman Long Treasury  
LBGC = Lehman Bros. Gov/Credit Bonds  
S&P 400 = S&P Mid Cap Index  
Val Line = Value Line Price Index  
Rus 2000 = Russell 2000  
Rus 2000 Val = Russell 2000 Value Index

**Performance Disclosure**

**Yield-Oriented Portfolios:** Gross of fees performance is based on actual results according to standards set forth by the Association for Investment Management and Research (AIMR). Miller/Howard Investments has prepared all performance results. AIMR was not involved in the preparation or reporting of these results. Net of fees performance is calculated by deducting a weighted average annual fee of 75 basis points from gross of fees performance. A complete list of all the firm’s composites is available. Portfolios are matched across all accounts so that each client holds substantially the same issues at the same weights. Portfolios are typically fully invested, and hold minimal cash although cash holdings may fluctuate somewhat on a residual or transitional basis. No representation is made that future returns will approximate past results, and none should be implied.

**Benchmarks:** The benchmark data from which this report is prepared has been provided by sources generally considered reliable. Except for benchmark returns based on published mutual fund net asset values, and unless otherwise stated, the index performance figures contained in this report do not reflect the deduction of investment advisory fees. Mutual fund data published by Lipper and Morningstar are net results after deductions of all annual fees and expenses by the advisor. Benchmark returns are presented on a total return basis.

**W**hen last we wrote, the California situation was beginning to bubble over, and we suggested that our returns might be due for a rest, after the excellent results of the past one, three, and five years (our portfolio is ranked #1 for risk-adjusted return among all U.S. equity mid-cap managers for the past five years by *Money Manager Review*—a fact about which we ought to be more humble but cannot resist blurting out—and has outperformed the S&P 500 as well as every equity category for five years on both an absolute and risk-adjusted basis). The portfolios did rest this quarter, but only a little, providing one of the few shelters in the storm as the sky continued to fall on the broad market. Indeed, every sector of the S&P 500 showed negative returns for the quarter, a rare and unusually bad showing.

## OH CALIFORNIA!

California seems to be the first word on everyone’s lips when the word “utility” is mentioned, so we’ll put in our six cents now (two cents, and two cents, and two cents). We had intended to do a special report on the situation as soon as there was more clarity, and while the situation is clearer than before, turbidity remains the salient feature in that state, that state in which politics trumps rationality at nearly every turn.

In 1996, California “deregulated” their electric markets. The plan was to have the existing major investor-owned utilities (Edison International, Pacific Gas and Electric, and Sempra—San Diego Gas and Electric) sell off their saleable plants, be reimbursed for any losses, and participate in an open market for power run by a new government agency, the ISO, or independent system operator. As we recall, this system was devised by a professor at UCLA, and we here refrain from casting

aspersions either on that fine school or the esteemed university teaching profession. But let us note that early on, Enron entered the market to participate on the retail side and pulled out within one year, saying “this is not deregulation.”

The rub in the California plan, as most have now learned, is that in order to push the program through politically, Sacramento had to sell it as a money-saver for taxpayers/ratepayers. “You’ll pay less,” was the pitch, and to that end the California Public Utilities Commission (CPUC) capped rates for consumers in the neighborhood of where they had been under the old, fully regulated regime.

Meanwhile, the state’s utilities, fearing that new competition would cherry-pick its best commercial and industrial customers with lower rates, had used political clout to successfully prevent new generators from siting plants in California. In the past 10 years, essentially no new plants were built in the state.

Nevertheless, the CPUC and elected officials were in denial about their new system and about the socio-economic environment in which it needed to function. For California had experienced years of boom times, rising up to become one of the leading economies of the world. New roads were built, new phone lines were run, even whole new towns and cities were built, but no new power plants were built. To make matters worse, the economic boom was based on the state’s role in the Digital Age. This was a boom that used, in its chip installations and vast server farms of web-hosting companies, in the armies of computers sitting atop every desk and typically remaining powered-up 24/7, more electricity per unit of growth than had ever before been seen. So: more power needed, no more power supply added.

Further, the state’s transmission grid was inadequate to bring enough power from other areas. If there was a surplus in the south, for example,

*“Immediately the blame fingers arose high, accusing the generators of gouging or price fixing, when in fact they were only supplying the market where the market was (and is).”*

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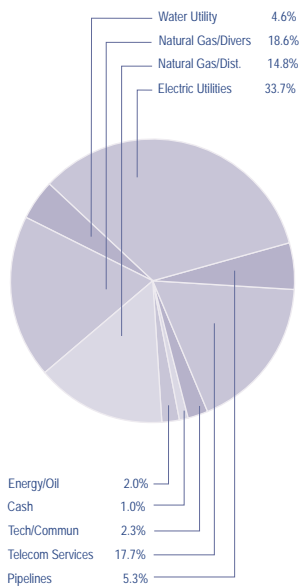
Quarter Composite Net of Fees*	
BTB/Util (Preliminary)	(2.76)%
DJUA (total return)*	(6.71)%
LBGC*	3.20%
Ave Util Fund*	(6.42)%

12 Month Composite Net of Fees*	
BTB/Util (Preliminary)	13.35%
DJUA (total return)*	35.34%
LBGC*	12.41%
Ave Util Fund*	(5.53)%

3 Year Composite Net of Fees*	
BTB/Util (Preliminary)	10.70%
DJUA (total return)*	14.24%
LBGC*	6.80%
Ave Util Fund*	7.73%

*\*See Performance Disclosure on page 9.*

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#### UTILITIES PORTFOLIO CHARACTERISTICS

Beta*	0.46
Dividend Payout	46.53%
Sharpe Ratio	0.95
Projected Dividend Growth	3.98%
Treynor Ratio*	22.24
Current Yield	3.43%
Annualized STD	10.87
Market Cap (MDN)	\$5.1 Bil
Price/Book	2.53
Quality (Equity Rating)	B++
P/E Ratio (MDN)	16.04

\*Relative to DJUA, 3/31/94-3/31/01

it was difficult to bring it to San Francisco, because, according to electrical engineers, the north-south major transmission lines were about 30% short of necessary capacity. This made San Francisco, in particular, what's known as a "load pocket"—an area with inadequate supply and inadequate availability for the importation of auxiliary supply. We discussed this at length in 1996 (though you probably don't remember) in making the case that deregulation was unlikely to lower power bills for consumers.

But the CPUC and the legislature insisted that rates could be frozen, despite the growing imbalance between rising demand and static supply. Further, for reasons unknown, the ISO was set up to distribute the available power based on a spot market for electricity—the price on any given day, at any given time of day. The utility companies—now largely distributors with a vastly shrunken generation base—weren't allowed to enter into long-term contracts for power. This, despite the fact that in all and every commodity market in the world it has long been known that long-term arrangements create more stable and generally lower pricing (producers accept lower prices in exchange for greater certainty, much like stock investors are willing to accept theoretically lower returns in conservative stocks in exchange for a higher likelihood of receiving positive returns). Exacerbating the matter, the ongoing system of offering and bidding in the ISO system favored the higher prices submitted rather than the lower.

The rest is recent history. So many users, so few electrons. Immediately the blame fingers arose high, accusing the generators of gouging or price fixing, when in fact they were only supplying the market where the market was (and is). The Federal Energy Regulatory Commission investigated this, and came to the conclusion that the play was basically fair. At the same time, natural gas prices rose nearly fourfold at their high, driving electricity prices yet higher, since gas is the primary fuel for all new generation.

Governor Davis finally "relented" under the pressures of the situation and permitted a roughly 10% rate hike—something like dropping a piece of bacon on a red-hot griddle, as far as the utilities were concerned. They were still buying electricity at a multiple of what they were able to sell it for. And it was all about California, not the principle of deregulation. Even today, in other parts of the country electricity sells on the wholesale market for a quarter of the price in California, that state in which until a few days ago both the people and the government somehow believed that they didn't have to pay more for something that costs more.

Now a substantial rate hike has been put into place. (We noted last time that "...consumers will always, finally, pay for their energy..."). It's probably too little, too late, for the utilities, but at least the state is heading in the right direction. In a free market, if that's what you want, prices at retail must be as free as prices at wholesale, or the system will come to a screeching halt. If there are disjunctions within that system of free prices the issues can be addressed directly. But there is no hope when the system itself is asymmetrical.

Lots of slightly irrelevant proposals have been floated, in the governor's effort to look busy. Perhaps the state will wind up owning the transmission grid in exchange for giving the utilities billions to make up the current deficits. If we were Californians we would think twice about having the same entity which created our "deregulation" take over the all-important long-distance transmission grid, a grid which is currently too small and which is...old.

And now, as we go to press, PG&E has filed for Chapter 11 Bankruptcy, with Edison likely to follow suit. This was the best option available, we think, for now there is an impartial third party able to effect some solutions, both short and long term, into the situation, which can benefit all the stakeholders. Surely no one would assert that reasonable solutions were about to emerge from the legislature or the governor. Now a judge with some powers—albeit

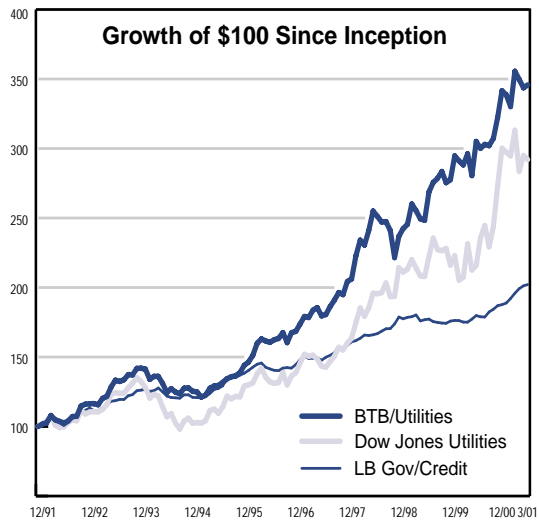
debatable powers since this situation is novel and has little precedent—makes for a new and potentially healthy, or at least rational, factor.

The best option, however, would be indecision and muddling through. For the crisis in California at this point is not so much a problem of system as it is one of timing. In a way, it is a kind of cruel joke of timing. For the siting and permitting process has been vastly speeded up (it always takes a crisis to get government action!) and there are now so many plants under construction or about to break ground that within two years, three at the outside, California will be a *net exporter* of electricity! According to the state's energy secretary, California will have a 50% electricity surplus by 2003. Meanwhile, conservation and alternative production efforts have been mobilized. It's all quite reminiscent of the late 1970s and early '80s, when fears of \$100 per barrel oil were rampant, only to be followed by a 15 year decline in the commodity price. We assume the judge will take this impending surplus into account in fashioning a solution that really only needs to address the next two or three years.

Will the problems hit your home town? Given the wake-up call that has sounded from the West, it is unlikely that similar events will unfold anywhere else, though some power problems may occur in the Northeast and other regions as the ramp-up in plant construction may have lagged demand a bit. But plant operators and entrepreneurs nationwide have seen the need and are out to fill it, and legislators have seen the requirement that they become facilitators. We are not going down an energy hole now, we are coming out of one.

## PORTFOLIO HIGHLIGHTS

A number of our stocks were jostled by the California-related activity in the electric utility sector this past quarter, though we do not hold any companies substantially and directly affected by the state's power crisis (there is some small exposure from pipelines, though

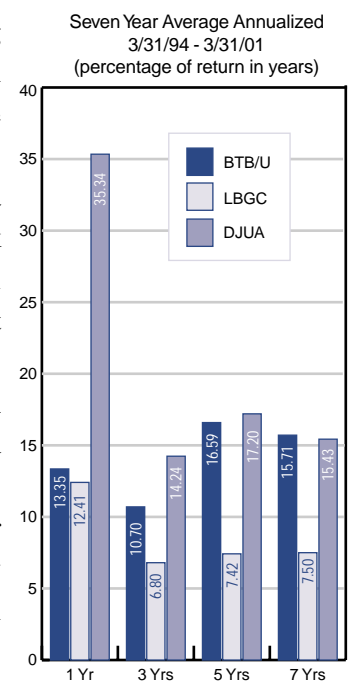


*"It's all quite reminiscent of the late 1970s and early '80s, when fears of \$100 per barrel oil were rampant, only to be followed by a 15 year decline in the commodity price."*

that's fairly indirect). Still, a difficult tone was set, and it was about time for some profit-taking anyway; this combination was enough to break a recent march of positive quarters. Stocks that had nothing to do with California, such as DQE, NSTAR, and Energy East saw declines in the low teens, though their fundamentals were unchanged or improving. This kind of action reminds us of the summer of 1998, when prices on some of our issues inexplicably declined as though they might somehow be affected by an Asian currency crisis, only to rebound sharply the following quarter. Montana Power, which is actually a telecom company now, continued its spiral down—it is a mercifully small weighting in the portfolio—in a world in which independent fiber optic carriers have become anathema.

On the other hand Worldcom began a recovery, and was our best performing stock for the quarter, up over 30%. Kinder Morgan Energy Partners continued its consistent appreciation, rising about 12% in a tough stanza. Towards the end of the quarter American Water Works found enthusiastic buyers, as did Williams and MDU Resources.

In addition to DQE, we beefed up our position in NiSource, which has become a key utility investment, in our view. The stock still trades at a utility valuation, though it now has an outstanding set of assets through its takeover of Columbia Energy, and proven management to run them. Valued more like the pipeline that



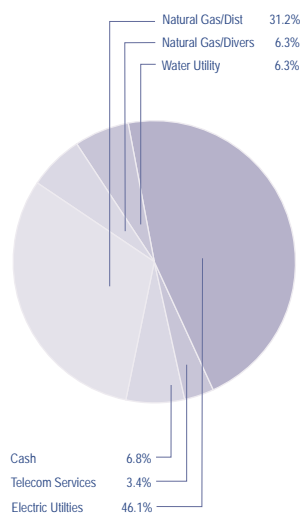
*“But within the industry it has become clear that California is sui generis, a unique situation brought about by poor planning and analysis. There are many states, like Pennsylvania, where deregulation is working just fine.”*

#### BTB/Utilities Review continued...

it is, NI would be selling at least 30% higher today. We bought AES, the world’s largest independent power producer, on a downswing into the mid-40’s. This is an outstanding company with an impeccable track record and truly de minimus exposure in California, which had been too rich for our blood for some time, but was knocked down to a decent buy price by the turmoil in the market. Our position is small at this point, however, since there remains some risk to generators on a price basis (the group has been a standout) and the volatility of the stock isn’t a great match for our portfolio. We also bought IDACORP (Idaho Power) at the end of the quarter. This one had been run up early last year due to its interesting exposure to the fuel cell marketplace (the company is one of the leaders in this area), but had come all the way back down to “normal” utility pricing, complete with a 5% yield. We’ve acquired a fine utility at a good price, with clear potential for a future upside surprise. Just the way we like it.

#### LOOKING FORWARD

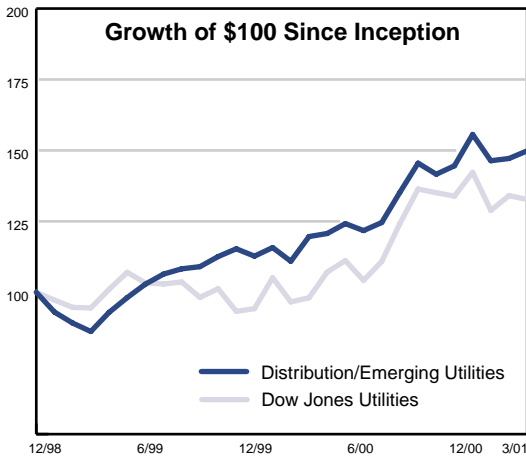
We find it difficult to imagine much more downside in an environment of falling rates. While our portfolio has become quite divorced from rate movements in recent years, declining rates have consistently been a positive factor. Though the tech wall may crumble, and Californians may grumble, we all still need to light and heat our homes, and make phone calls. Utility usage does not really decline significantly when the economy slows, and is obviously the first area to feel a comeback, so the broad picture appears benign. Investors have returned to value stocks and real companies, and as we have been heard to whisper in the evenings: “we’ve got real companies.” □



**A**lthough it truly makes no sense, the turmoil in California appeared to have a noticeable impact on our stocks this quarter. Put simply, with the exception of one water company (which has nothing to do with the power or regulatory situation in California), we’ve got no stocks west of Montana. And our stocks are distributors, not generators. In the end, our returns didn’t reflect much of a setback—no more than you’d expect from normal profit-taking after a 38% return for year 2000—but we’re still scratching our heads to have seen Northeast gas and electric distribution companies decline with excess volatility on days in January when the major California investor-owned utilities were getting justifiably pummeled. In fact, we’ve spewed quite a few words on the California situation in our BTB/Utilities quarterly report herein, to which we refer you.

At first, we were concerned that the level of crisis in California would change the complexion of deregulation in a broad way, and alter the thesis upon which this portfolio is built. To some extent it would appear inevitable that the pace of deregulation will slow—and legislation or implementation has already been put on hold in a number of jurisdictions—but that’s not a big concern considering the high quality of the companies we hold. But within the industry it has become clear that California is *sui generis*, a unique situation brought about by poor planning and analysis. There are many states, like Pennsylvania, where deregulation is working just fine. In the future, regulators in other states will have the golden opportunity to copy successful jurisdictions and avoid the mistakes made in CA, now that those blunders are clear. Regulators will just have to find some other mistakes to make.

A slowing of deregulation doesn’t necessarily mean that deals will slow, and we



already have two this past quarter in our portfolio. Utility companies are thinking long term, and the long term still means that size matters; economies of scale are crucial to the utility of the future, especially the multi-service utility model that has become all but universal. The true agenda of utility consolidators is to layer unregulated profit centers on the utility cash flow base, and for that reason the purchase of a utility in a still-regulated district is still consistent with the long-term plan. Only if a proposed deregulation format is deeply threatening to the incumbent in an area would potential suitors need to look elsewhere.

## PORTFOLIO HIGHLIGHTS

Our portfolio was helped by two takeover deals this quarter, even though they weren't the richest of transactions. Energy East, the pac-man of utilities in the Northeast, has made an accepted offer for RGS Energy, formerly Rochester Gas and Electric. At this point Energy East has so many pieces on the monopoly board of New England and is so cheap, that it is itself a deal candidate, one which we hold at a decent weight. Potomac Electric (another acquirer which itself may be acquired) offered a fairly skinny price for Connectiv, a company that has failed so

miserably in its various diversification attempts, like a wild and inept party-boy, that it is virtually forced to throw in the towel and get married. We bought Connectiv only in January, however, (having trimmed some of our re-rated winners such as Keyspan, TECO, and Utilicorp to do so), so the rapidity of the deal rather makes up for the smallish premium. We also bought DQE, which would be a nice fit, as it is contiguous to Potomac-Connectiv.

Elsewhere winners and losers were a mixed bag, Sprint was bouncing and Energen rode higher on firm energy prices, while at the same time Questar eased lower in single digits despite its strong and growing presence in gas production. Whether gas distributor or electric distributor (pipes or wires) it did not seem to matter. Some were up and some down in each category. GPU fell on fears that its deal with FE will not conclude. We disagree quite emphatically and have kept our high-yielding position. In a similar vein, we'd thought another suitor might arise for Empire District, and had added more shares, but a terrible ruling from the Missouri PUC prompted us to think it might be painful to wait, so we sold.

## LOOKING FORWARD

Looking forward, we're optimistic that general factors favor these stocks: their yield, their reality, their reliability. As some have come back in terms of price we're able to boost weights. Unlike the telecom zone there are many potential acquirers with plenty of cash as well as buoyant stock "currency." A number of these players, such as National Grid and National Power from England, should be just about done with digesting earlier deals and ready to dine again (at our restaurant, we hope). □

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### Quarter Composite Net of Fees\*

Distribution (Prelim)	(3.70)%
DJUA (total return)*	(6.71)%

### 12 Month Composite Net of Fees\*

Distribution (Prelim)	25.26%
DJUA (total return)*	35.34%

### 2 Year Composite Net of Fees\*

Distribution (Prelim)	31.87%
DJUA (total return)*	18.52%

\*See Performance Disclosure on page 9.

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### FUNDAMENTAL CHARACTERISTICS

Yield	3.96%
Proj Div Gro	4.25%
Payout Ratio	68.47%
Market Cap (MDN)	\$1.8 Bil
Price/Book	1.83
P/E Ratio	14.66
Quality (Equity Rating)	B++
Beta*	0.41

\*Relative to Dow Jones Utilities Index (3/31/99-3/31/01)

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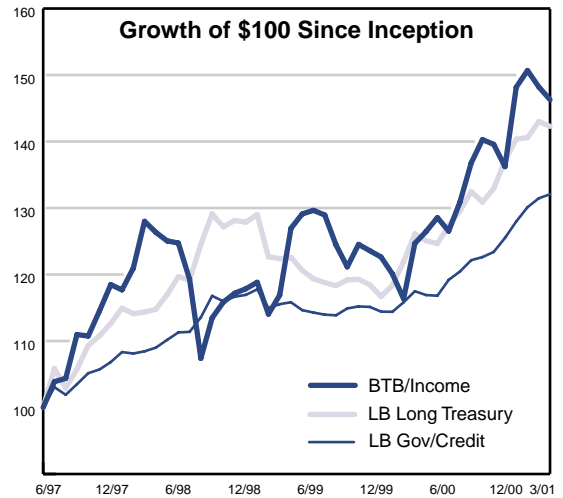
*"In a time of declining interest rates, one can only be optimistic about a portfolio of equities with rising income whose current yield is well above that of the 30-year treasury bond."*

We thought this portfolio would continue on with positive performance during the first quarter, especially in a declining interest rate environment, but the overall tone for equities was so dreadful that we were fortunate to come in a tad less than flat. That's hardly a bad showing at a time when many strategies were down 20-30% and the S&P 500 was down (11.61)%, and, importantly, our income was untouched by the overall market turmoil (indeed, it even grew a bit).

In recent years many advisors and investors have taken the view that if income is required from a portfolio, let it come from total return. Basically, this view has said "go ahead and spend principal, money is money." While it seemed like a bull market idea to us, few listened when we challenged the notion that you could always withdraw capital to provide for income needs. Now we wonder how those same partisans enjoy meeting their income needs through spending capital losses? The capital that's needed to make up for current losses when better markets return won't be there. It will have been spent. And this is particularly woeful, since you always require a gain that is greater than your loss to return to breakeven in an investment. Talk about the magic of negative compounding!

**PORTFOLIO HIGHLIGHTS**

We've kept a relatively small portion of the portfolio in REITs almost as much a diversification measure as an act of investment enthusiasm. But lo and behold, two REITs led our list this past quarter as investors sought "shelter" in the real. Both United Dominion and Hospitality Properties have been undervalued for some time, in our view, but seemed to lack a catalyst to spark investor interest. Frankly, we're in the dark about any concrete change



which brought these two closer to fair value, but both rose in the 17% range, which was particularly satisfying since the REIT index was up only 0.39%.

Our other leadership stocks were a mixed assortment, often gaining while companies of a similar type were lagging behind. Energy transport related companies such as El Paso Energy Partners and Kinder Morgan provided double-digit gains, though Keyspan and Peoples Energy took a rest and provided only gravity. Dana bounced up over 10%, and we've taken notice: there are many depressed issues in the automobile and related area, and we'd love a heavier weight in them, since many are really excellent well seasoned companies that have simply been hamstrung by difficult conditions in their markets.

Suburban Propane continued to rise, and this one has caught our attention as well. Propane is likely back in the game now, after a normally cold winter finally arrived, preceded by four straight years of abnormally warm weather. There are several propane MLPs and they have become lean and mean during the famine. But what's really of interest—though we're quite early with this view, we think—is that when fuel cells become commercial there

**Quarter Composite Net of Fees\***

BTB/Income (Preliminary)	(1.28)%
LBGC	3.20%
LB Long Treasury Index	1.37%

**12 Mo Composite Net of Fees\***

BTB/Income (Preliminary)	17.31%
LBGC	12.41%
LB Long Treasury Index	12.82%

**2 Year Composite Net of Fees\***

BTB/Income (Preliminary)	11.86%
LBGC	6.92%
LB Long Treasury Index	7.81%

\*See Performance Disclosure on page 9.

are two logical markets: users requiring the utmost perfection in their power stream, and users in exurban or rural environments, where propane is commonly used for heat or cooking instead of natural gas. For this second group, propane companies are the most likely purveyors of fuel cell equipment and service, because they are going to be the suppliers of the fuel the fuel cells use. There could be a huge jump in business down the road. Admittedly, it may be quite a ways down the road, but in the meantime the demographics for propane distributors are fine, the stocks are cheap, and the yields are at the top of the range for companies of acceptable quality and financial strength.

In general, we're happier with the MLPs than we have been in some time (not to say that we haven't been happy; they've included some of our best performers). Many now have very strong general partners, who use the MLPs to control assets that are strategically key but which might not pass muster in a taxed corporate environment. Assets get moved to the MLP in exchange for limited partnership units (the same that we buy), and tax-deferred income comes back to the corporation. It's a nice maneuver that Kinder Morgan, in particular has used to great advantage, and it means that the type of assets which go into an MLP, as well as smaller MLPs, are now definitely acquisition candidates. So expect to see more.

There are some interesting items which we call "MBA securities," newer kinds of vehicles invented on Wall Street that are basically variants of convertibles, which have worked well for us. NiSource mandatorily exchangeable PIES are an example, as are Lincoln National PIES. We also had a bit of a hiccup this quarter, taking a small (2%) position in Morgan Stanley Dean Witter PERQ

securities, which have an enormously high current yield guaranteed by AA-rated MSDW but which are tied to the movement of, in this case, JDS Uniphase. Each PERQ converts to .4 shares of JDSU in about a year. We're down on this so far, but in the meantime we collect strong income and these stocks give us a chance to get some diversification into technology with lower volatility and infinitely higher yields than would be possible any other way.

LOOKING FORWARD

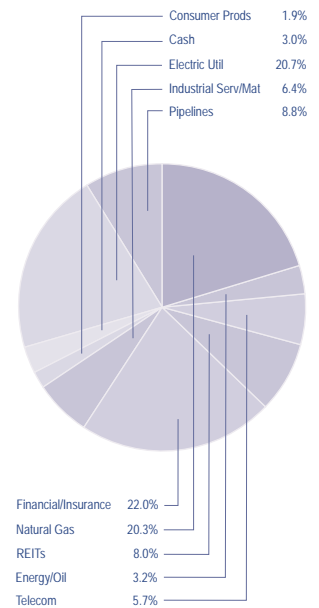
We like our income and we like our stocks. In a time of declining interest rates, one can only be optimistic about a portfolio of equities with rising income whose current yield is well above that of the 30-year treasury bond. As we write, the equity markets are in the midst of a maelstrom and that certainly can have a dampening effect. But our values are solid and even if some patience is required, returns going forward are likely to be satisfying. And patience is so much easier with a current yield just over 6%. □

Performance Disclosure

**Better Than Bonds/Income:** Included in the results are all portfolios that are unrestricted and that have been managed for at least one full quarter. The number of accounts in the composite as of 3/31/01 was 27, which represents 57% of total assets managed in this strategy with a measure of dispersion of 0.79. Inception of the composite was May of 1997.

**Better Than Bonds/Utilities:** Included in the results are all portfolios that are unrestricted and that have been managed for at least one full quarter. Number of accounts in the composite as of 3/31/01 was 219, which represents 92% of total assets managed in this strategy with a measure of dispersion of 0.59. Inception of the composite was September of 1991.

**Distribution:** Included in the results are all portfolios that are unrestricted and that have been managed for at least one full quarter. Number of accounts in composite as of 3/31/01 was 20, which represents 99% of total assets managed in this strategy with a measure of dispersion of .14. Inception of the Distribution composite was December of 1998.



FUNDAMENTAL CHARACTERISTICS

Yield	6.07%
Proj Div Gro	6.13%
Payout Ratio	65.44%
Market Cap (MDN)	\$3.9 Bil
Price/Book	2.17
Beta*	0.61
P/E Ratio** (MDN)	13.42
Quality (Equity Rating)	B++

\*Relative to LBG, 3/31/98-3/31/01  
 \*\*Reit's use P/FFO ratio rather than P/E Ratio

*"In this atmosphere it's easy to believe that the world must be over, that there is no value, no growth, no possibility of a recovery any time soon. Conditions couldn't be riper for an equity buyer with a long-term perspective."*

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#### Quarter Composite Net of Fees\*

SBI (Preliminary)	(6.76)%
Value Line Index	(6.16)%

#### 12 Month Composite Net of Fees\*

SBI (Preliminary)	(8.30)%
Value Line Index	(13.86)%

#### 2 Year Composite Net of Fees\*

SBI (Preliminary)	2.0%
Value Line Index	(5.01)%

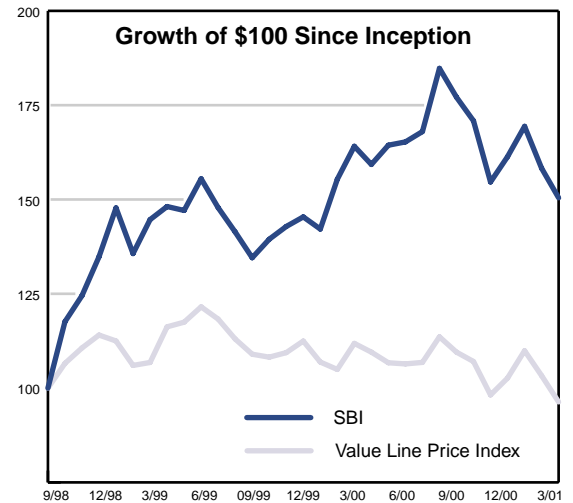
\*See Performance Disclosure on page 11

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The first quarter of the new administration got off to an inauspicious start in the markets, with every single sector of the S&P 500 declining. A much anticipated rate cut appeared to be pushing on a string as the markets staged a brief and elusive rally, only to promptly fall off a cliff. Grim earnings reports, lowered consumer confidence and layoffs drove the markets, especially the tech driven Nasdaq, to the levels not seen for several years as the new economy bubble continued to burst. Our SBI portfolio couldn't fully avoid the volatility of the markets, though we were certainly down much less than the major indices. The magnitude and depth of this most recent hysteria is astonishing: good names are being wiped out along with the bad ones, bad news from the former market darlings crash over the rest of the world like a tsunami wave. No one seems to have faith in the US economy, analysts are throwing in the towels on their "strong buys" at the lowest possible low... In this atmosphere it's easy to believe that the world must be over, that there is no value, no growth, no possibility of a recovery any time soon. Conditions couldn't be riper for an equity buyer with a long-term perspective.

## PORTFOLIO HIGHLIGHTS

Retailers across the board enjoyed a few months of good performance, although nothing came close to the "toy story" in our portfolios. Our best performer for the quarter, Toys 'R' Us, climbed slightly over 50% since early January compared to the specialty retail index +13.4%, giving us an unrealized gain of over 70%. We first noticed the stock approximately a year ago, when the mismatch of fundamentals and its price valuation gave us a reasonably high confidence level in the stock. At that point our buy was



purely a contrarian value play, with catalysts for a turnaround including a new management direction and the demise of threats from the internet. In early January all the pieces of the puzzle fell back into place. TOY reported excellent Christmas sales and overall booming business, though the season in general was not a great one at retail.

Our long-time holding, Williams, enjoyed a decent quarter, up over 7% in spite of the volatility in the utilities sector caused by the continued California crisis. The news stream just keeps getting better and better for this one, and we're likely to die holding it unless the picture changes radically in the interim. The spin off of Williams Communications that has been in the works for over a year now is coming to a close in the end of April, when WMB will distribute the telecom stock to it's shareholders. On the earnings front the news is impressive as well. Shortly following the 4<sup>th</sup> quarter during which WMB earnings almost quadrupled on energy trading profits, the company just raised expectations for the first quarter of this year, making the numbers even more remarkable. We do realize that California problems are far from being over, and though WMB has a minor exposure which might

increase volatility short-term, the future for this company is as bright as ever.

To continue our utility theme, we added utility service company Quanta Services, a builder of infrastructure for electric and telecom utilities. Quanta Services looked like an excellent choice in this area that is likely to ride the wave of explosive generation capacity growth in the near future. In addition it is a very inexpensive stock, trading at a P/E of 11 with a 25% projected growth, growth supported by several years of backlogs.

At the other end of the spectrum, Darden Restaurants appeared on our radar screens as an excellent value play with superb financial characteristics, relative valuation and everything else that comes with an SBI stock. This number one casual dining restaurant chain in the country provides sustenance to nearly 5 million famished folk each week, and gives our portfolios some exposure in this interesting group which has low economic sensitivity.

MGIC Investment Corporation was also recently added to our financial services representation mostly for its appealing valuation and takeover potential. Speaking of financials, our American General (AGC) has become the object of desire for both Prudential PLC of the UK, and American International Group. As we write two premium offers are on the table. There's no way to know right now who will win, but it's clear that AGC is a willing bride for *someone*, and we're as certain to come out well-rewarded as you can be in the always changeable world of investing.

On the sell side, we decided to get out of Norfolk Southern promptly after the company announced that it will cut its dividend by 70% along with the layoffs of several thousand employees as the US economy slows. No matter how inexpensive the stock was at the time, we

could not see ourselves making an exception in this case, since one of the major principles underlying the strategy—no dividend cuts—has been violated. We prefer to be safe rather than sorry, especially when there are clear and present warning signs.

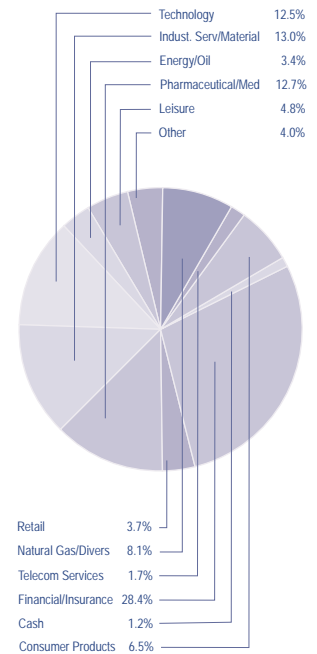
This quarter did bring several disappointments, mostly in tech-related issues. Comdisco seemed quite attractive from a valuation perspective, but conditions deteriorated after we bought, and we were fortunate to change course, bailing out just before the stock totally collapsed. As for tech names EMC, Medtronic, Wind River, and Citrix, we believe that these stocks are among the best in the technology world, with unique niches, strong markets, fine managements, good financials, and fine futures. They could not avoid the general technology slide, but are definitely buy candidates at current prices.

## LOOKING FORWARD

Although we don't like the volatility of this market, it may continue a while, since high volatility generally persists once it arrives, and is also associated with bottoming activity. Declines always produce opportunities, though, and we're constantly taking the pulse of the market to identify good holdings across all market sectors. □

### Performance Disclosure

**SBI:** Included in the results are all portfolios that are unrestricted and that have been managed for at least one full quarter. Number of accounts in the composite as of 3/31/01 was 8, which represents 91% of total assets managed in this strategy with a measure of dispersion of .25. Inception of the SBI composite was September of 1998.



### FUNDAMENTAL CHARACTERISTICS

<b>Yield</b>	0.99%
<b>Proj Div Gro</b>	13.30%
<b>Payout Ratio</b>	16.08%
<b>Market Cap (MDN)</b>	\$11.9 Bil
<b>Price/Book</b>	4.14
<b>P/E Ratio(MDN)</b>	18.43
<b>Quality (Equity Rating)</b>	B++
<b>Beta*</b>	0.84
<b>STD</b>	17.31
<b>Sharpe Ratio</b>	(0.22)
<b>Treynor Ratio*</b>	(4.47)

\*Relative to Value Line Index  
(3/31/99-3/31/01)

**SPECIAL REPORT INSIDE  
ON THE CURRENT ENERGY CRISIS IN CALIFORNIA**

*“If we were Californians we would think twice about having the same entity which created our “deregulation” take over the all-important long-distance transmission grid, a grid which is currently too small and which is...old...The best option, however, would be indecision and muddling through. For the crisis in California at this point is not so much a problem of system as it is one of timing...”*

*- page 4*

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