

MARKET OVERVIEW

THE STRATEGIES

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.

INCOME-EQUITY STRATEGY

A fixed income alternative, income-equity 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.

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.

ALPHA-BASED STRATEGY

An aggressive strategy focusing on small and micro-cap stocks using both value and momentum analysis. Seeks high returns and protects against high volatility with strategic use of cash.

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With war on, nearly all bets are off; the broad market is leaderless, trendless, volatile in the short-term, buffeted and jostled by news developments, and the underlying forces that might suggest future behavior are increasingly vague.

Lest that glowing characterization prove overly heartening, with every day that passes in a period of historically low interest rates which fail to ignite any economic growth whatsoever, the air becomes spookier and spookier. We began wondering last Spring why the relentless interest rate reductions had not been able to spark the economy. While there are explanations available (overcapacity, geopolitics, risk-aversion), they offer little comfort to investors who have grown up both learning and being taught that the economy is stimulated by lowering interest rates, and all the Fed has to do is dial down rates to the ignition point—after which the rockets will launch and the band shall strike up once again.

Obviously, we are in a unique environment, one in which broad pronouncements or divinations are based on little more than chutzpah. Investors have not faced this before; neither have corporate executives or federal policy makers. Perhaps we are in an aberrant trough which will heal quickly once productive capacity is slowly soaked up by a gradually expanding economy over time. That's surely a potential scenario, but it's only one of many, and investors need to be alert now for alternate possibilities over the next 1-3 years, some of which may be a good deal more stressful.

Despite the failure of corporate revenues to grow at all in recent quarters (meaning, of course, that profits have not grown either), lawmakers in Washington don't seem yet ready to acknowledge the unusual economic circumstances we face. Rather than provide maximum fiscal stimulation, as we write, the plan is to cut the Bush tax reduction package in half, and, we presume, to push back the dividend tax elimination. There's still time to write your representatives. This economy is going to need all kinds of stimulation—based on recent ISM and employment figures it may already be back in recession—and the government ought to do it now rather than later. Real stimulation will boost the market, both because the funds flow first to financial instruments and because stimulation is what the economy needs, but it doesn't seem to be in the cards for the short term.

Fortunately, the world seems to have returned to a favorable view of dividends and dividend-paying stocks, after abandoning the concept in the 1990s, with or without tax relief. If you want to avoid getting Enronned or Worldconned or Scrushied, dividends are your first line of defense. As they say, if you pay it, that means you have it.

The ten points we began looking at last year at this time remain worthwhile points of analysis in attempting to determine when a change in the economic

and market environment might be forthcoming. Below we review the changes or lack thereof, retaining, in italics our original comments.

“...the quest for attractive investments seems to result in a message of slow and careful action, until we are all better able to understand the elements of the current moment.”

1) *The Fed is loose.* The Fed has cut rates repeatedly, and has threatened to get even “looser,” using unusual techniques to prime the pumps if necessary. As before, we are nervous that the long string of interest rate reductions has not had much bite and has not inspired higher valuations from investors. The longer interest rates are low, the more negative our view.

2) *Investor confidence in corporate governance is at the lowest point since the 1930s.* The tide of revelations has ebbed, especially for utilities, but we, and we suspect several generations of investors, have become permanently cynical. This is good for the markets, long term. Upon closer study we find that Sarbanes-Oxley may prove quite effective in dampening chicanery and deceit. The provisions dealing with auditing are significant. Still, this is a wound that will only heal slowly.

3) *Sentiment measures are inadequate to support an intermediate-term rally.* Ever since these measures turned negative there have been nothing but short-term rallies (three weeks or less). “Talking head” sentiment is clearly negative, but quantitative measures are only neutral, after some improvement over the past few months. Advisors and Wall Street firms are still bullish. In these conditions, short- or intermediate-term rallies are unlikely to persist and would be unlikely to mark the beginning of a new cycle. Some improvement here, but not yet bullish—though bullish enough to support a war-end rally.

4) *Short-term options activity has improved to neutral, but stocks are not currently oversold.* Stocks are off the bottom, and put/call volume measures have been erratic. On the other hand, advance/decline measures have shown enough improvement to speculate that the October lows may

have demarcated a longer-term pricing low. Should the March low hold for some weeks, technicians will be bothering one and all with the assertion of a “triple bottom,”—a feature more easily viewed in retrospect than in real time but a very positive factor if true. For now, the traditional technical situation remains as it was at the end of the 4th quarter. From a technical perspective, we would want to see new record volume or something close to it before considering the possibility of a new secular market cycle. Instead, volume has been mostly punk.

5) *Valuations support upward price adjustments in some sectors but not all.* Now that stocks are “off the bottom” there won’t be much justification for upward re-valuation until the economy appears less questionable. We must see revenue improvement. Stocks with high dividends, on the other hand, should be marked up in the event of a dividend tax reduction. This factor remains as it was.

6) *The dollar has weakened and may well have reversed its long-term uptrend.* War is distorting dollar pricing, though the reversal of the long-term uptrend still seems valid. Good for internationals and exporters, not so good for inflation and the overall financial system and borrowers such as the U.S., which increasingly looks like it’s headed for a Reaganesque borrowing splurge. The dollar’s weakness appears to be proven by now.

7) *The macro-environment has changed from peaceful prosperity to a kind of nervous struggle.* When the Berlin Wall came down, companies and investors could focus on growth in a world without real enemies. Now we have real enemies again. Surprise attacks are always possible, and this is bad for confidence among economic decision-makers as well as investors. Consumer confidence has been making new lows, after attempting to buck up during 2002. The unpopularity of the Iraq War across the Middle East provides a renewed threat to stability. Worse.

SELECTED INDICES

	1 st Qtr’03	12Mo
S&P 500	(3.15)	(24.78)
Equity Inc	(5.18)	(22.81)
Util Fund	(3.89)	(25.63)
DJUA	(2.14)	(28.68)
LB Treas	1.39	20.42
LBGC	1.65	13.40
S&P 400	(4.43)	(23.45)
Value Line	(7.39)	(35.36)
Rus 2000	(4.49)	(29.96)

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
 Value Line = Value Line Price Index
 Rus 2000 = Russell 2000

8) *Earnings comparisons are easier... investors may be free to once again extrapolate limitless growth.* Ah, nobody was fooled. Revenues haven't risen, and earnings gains have come from cutting, which is exactly negative for the overall economy. The markets won't rise sustainably without revenue increases, and such increases are few and far between. Company guidance to the downside overwhelmingly predominates. Worse.

9) *The old highs reflected a vastly different economic and sentimental framework.* As businesspeople as well as investors continue to sober up, the old highs look more and more like innocence, or youth, or lost love, or some other unrecoverable thing. Becoming clearer to the chastened masses. The further away those peaks appear, the more likely a more rational base is being built for the future.

10) *Corporate insiders have not been buyers...a negative factor for the six-month outlook.* Few insiders are buying, and "normal" insider selling continues. We might liken insider buying now to the IPO market: dried up. Markets can rally without insider buying, but investors need to ask themselves how good the current prospects can be if insiders are not believers. This factor has worsened during the first quarter from already low levels. In technology, for example, there have been about 20,000 shares sold for each share bought by insiders.

In all, an antidote to the Wall Street strategists who continue to harp on the "prospects for growth after the war." Maybe they'll be right, but the handles we have are attached to a random number generator right now. Cash flow from dividends is attractive, and so is natural gas, which is in short supply. Beyond that, the quest for attractive investments seems to result in a message of slow and careful action, until we are all better able to understand the elements of the current moment. □

The operating environment for gas and electric utilities continued to show steady signs of improvement this winter, further distancing the industry from the *Perfect Storm* conditions of 2001-02. Though a disappointing regulatory ruling for the Baby Bells at the FCC weighed heavily on the phones, our portfolios showed a modest underperformance relative to the Dow Jones Utilities Index this quarter. As Murphy's Law would dictate, of course, the Bells enjoyed a mini-rebound on the first two days of the new quarter, nearly bringing the portfolio into line with the DJU for 2003. Our strongest performance came from conservative gas distribution companies that also engage in domestic natural gas production and, thus, enjoy increased earnings from rising natural gas prices. Though current stock prices continue to reflect a degree of negative market sentiment toward the industry that might be best characterized as suggesting a "show me" attitude, the quarter just concluded represents the second consecutive period of improved fundamentals and will produce a flurry of earnings reports indicating solid growth from core utility operations.

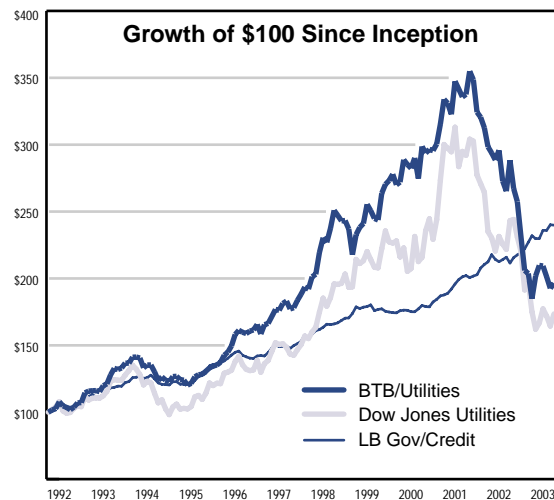
Most utilities have successfully exited their higher risk, unregulated activities (i.e. marketing and trading of electricity, merchant generation of electricity) that were responsible for all of the disastrous headlines of yore (fraud, massive losses, liquidity pressure, etc.), they've issued equity where needed, refinanced debt at historically low rates, and – most recently – the Federal Energy Regulatory Commission issued the first of several highly anticipated rulings tied to claims arising from the California "energy crisis" that provides resolution of issues that have prevented several companies from selling/monetizing assets and refinancing debt. Furthermore, balance sheets are as strong as

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As we mentioned in our last quarterly report, the dreaded *El Niño* winter never materialized for most of the nation, with a normal/cold winter boosting demand for electricity and natural gas to heat homes throughout the densely populated regions of the country (Northeast, Mid-Atlantic, and Rust Belt). Among the principal beneficiaries of increased demand for basic utility services are the local distribution companies – those conservative, plain-vanilla utilities – who make their money on the volume of services provided at a regulated rate of return. While states west of the Rockies were treated to a non-winter, the rest of us were shivering. With only a modest number of natural gas rigs dispatched in anticipation of an *El Niño* (warm) winter, and a hesitancy on the part of exploration companies to risk additional capital to increase production knowing the weather pattern could reverse at any moment (remember they were severely burned in 2001/02 by sharply falling commodity prices), little additional natural gas production was added during the quarter. As a consequence of the low natural gas storage level beginning the season, an unexpectedly cold winter, and reluctance to spend money on additional natural gas production – the 2002/03 winter season is about to end with domestic natural gas storage levels at an all-time low (680 Bcf as of 3/28/03 ... versus a previous low of 697 Bcf in April 1996). While local distribution companies benefited from providing increased volumes of services, those companies with exposure to rising commodity prices through natural gas production found themselves sitting in the catbird's seat. Indeed, natural gas prices averaged approximately \$6.45/mmbtu for the quarter, relative to last year's \$2.45/mmbtu – a dramatic rise in price



in light of the *further* anticipated tightening supply/demand balance in North America from new natural gas-fired plants coming online this summer, diminishing production levels from older wells already in production, and infrastructure constraints that still make it difficult to move gas from where it's plentiful (Rockies) to where it's needed (East of the Rockies). That's not to say that we expect prices to stay in the stratosphere, but given the fundamentals of the industry we surely don't find it likely that gas prices will revisit the basement (<\$3.00/mmbtu). Indeed the dynamics suggest that North America has reached the "tipping point" for natural gas production/demand, where domestic production will never again be able to satisfy domestic demand. One can draw compelling parallels with the oil industry in the 1970s, when production plateaued, then began a steady decline, while domestic demand increased significantly over time, resulting in ever increasing dependence on imports to close the gap. To further appreciate this country's commitment to a natural gas-fueled future, 95% of newly constructed power plants are being fueled by natural gas, while 80% of new homes will be heated with natural gas. So, we're starting to feel like the clock's been turned back to the 1890s ... when flipping a light switch meant burning some natural gas!

Quarter Composite Net of Fees*

BTB/Util (Preliminary)	(6.13)%
DJUA (total return)	(2.14)%
LBGC	1.65%
Avg Util Fund	(3.89)%

12 Month Composite Net of Fees*

BTB/Util (Preliminary)	(31.88)%
DJUA (total return)	(28.68)%
LBGC	13.40%
Avg Util Fund	(25.63)%

10 Year Composite Net of Fees*

BTB/Util (Preliminary)	3.99%
DJUA (total return)	3.38%
LBGC	7.30%
Avg Util Fund	4.29%

*See Performance Disclosure on page 12.

PORTFOLIO HIGHLIGHTS

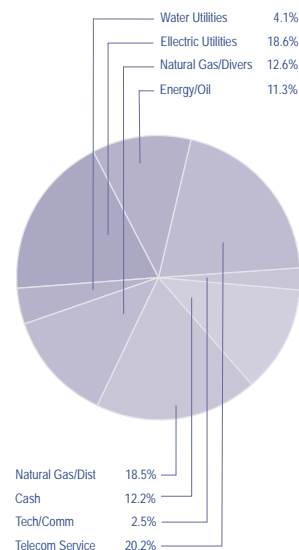
While our gas and electric holdings are likely to announce strong earnings and cash flow from traditional core operations due to the favorable weather this quarter, the portfolio's best performers were those utilities that also engage in the unregulated production of natural gas and oil, including: MDU Resources of North Dakota (+9%), Equitable Resources of Pittsburgh (+6%), and Questar Corp of Utah (+5.5%). Kinder Morgan Energy Partners, one of the country's largest petroleum pipeline companies – which benefits primarily from the volume of gas transported – continued to perform well (+5.5%), while boosting its quarterly distribution by 2.5%. More than a third of our positions raised their dividend payments this quarter, including: Cinergy, Energy East, Nicor, Peoples Energy, and Transcanada Pipelines. Even the much maligned Baby Bells SBC and BLS increased their dividends this quarter, as did Telephone & Data and rural telco CenturyTel.

We decided to “step aside” from Teco Energy until questions are answered regarding the status of their new merchant electric plants located in New Mexico and Arkansas. With a glut of electric generation present and/or developing in much of the nation, we've expunged all companies with meaningful exposure to the wholesale electricity market. We stuck with Teco due to the strength of their regulated utility, Tampa Electric, and aggressive steps taken to reduce costs, sell non-core assets and increase liquidity. Their foot-dragging and postponement of an announcement of whether long-term contracts have been secured for these unregulated natural gas-fired plants raised a red flag for us, prompting us to step aside and wait until these issues are resolved. We may reenter this position if a scheduled April 11th conference call assures us that these plants

are fully contracted, and liquidity will be adequate given the terms.

The Baby Bells were a big disappointment this quarter, falling precipitously as the highly anticipated repeal of UNE-P (FCC regulation that permits competitive carriers to piggy-back on incumbent lines at a discount) was derailed by an act of political treason. Though the Bells face significant long-term challenges, the financial strength of these companies, strong cash flows, and historically high yields suggest there's still much room for recovery. Acknowledging that the market appears to be pricing the Bells as more traditional utilities rather than growth vehicles, we're inclined to trim these positions at an attractive moment in the near future.

Keeping with the theme that natural gas is fast becoming a surrogate for electricity, we added Burlington Resources, one of the largest independent, domestic natural gas exploration and production companies, offering a modest yield (1.2%) with an outstanding record of reserve replacement and highly efficient production. Shortly after we added this position, Fitch Ratings tapped BR with a credit outlook “positive,” due to BR's strong operating and financial performance, large reserves, low risk profile, and aggressive deleveraging of the balance sheet. Though companies tied to commodity price fluctuations are traditionally more volatile in their price performance than utilities, the new paradigm of natural gas dependence in the United States for a rapidly growing portion of core electricity generation strongly suggests a long-term opportunity for companies with cheap, domestic natural gas reserves. To that end, we are likely to add a basket of pure-play natural gas producers who stand to benefit from firm gas prices, and potential consolidation within the industry. Merger is often cheaper and less risky than finding new reserves.



UTILITIES PORTFOLIO CHARACTERISTICS

Beta*	.58
Dividend Payout	53.26%
Sharpe Ratio	0.19
Proj Dividend Growth	4.32%
Treynor Ratio*	-1.76%
Current Yield	4.4%
Annualized STD	13.49%
Market Cap (MDN)	\$2.3 Bil
Price/Book	2.35
Quality (Equity Rating)	B++
P/E Ratio (MDN)	12.95

*Relative to S&P500, 3/31/93 - 3/31/03

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“Diversification efforts of prior quarters resulted in a well-balanced mix of holdings that were able to hold up in recent difficult markets.”

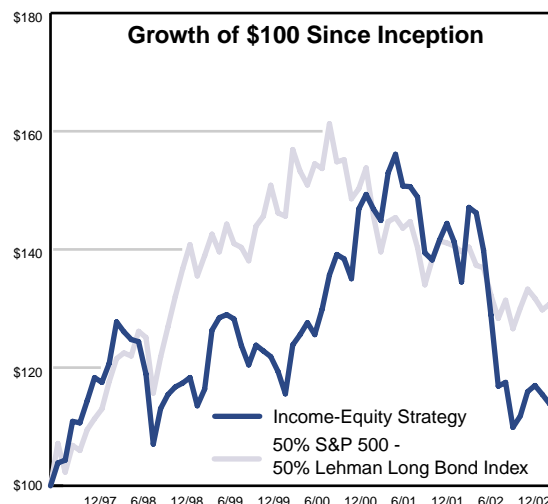
Our Income-Equity portfolio had a rather uneventful quarter—which is just how we like it—finishing down -2.8%, 30 basis points ahead of the broad market as measured by the S&P 500, and slightly below the Intermediate Bond, up 0.8% year-to-date.

Diversification efforts of prior quarters resulted in a well-balanced mix of holdings that were able to hold up in recent difficult markets. Master Limited Partnerships, representing a quarter of the portfolio, continued to generate strong relative and absolute performance closing the quarter on the positive note, with some, such as EPN up over 13% on a total return basis. We like the idea of being partners in some of the most stable businesses around in addition to low correlation with the rest of the equity markets and rising streams of tax-deferred distributions. Currently our MLP holdings are yielding over 8%, and all have increased distributions at least twice in the trailing 12-month period.

Our plain vanilla utility holdings performed quite well again. We trimmed Questar, our largest utility weight, as capital appreciation over 80% since our original purchase significantly reduced available dividend yield. We still love the business and the favorable fundamentals behind natural gas pricing and demand and will continue to own the stock at our typical weight of 3%.

PORTFOLIO HIGHLIGHTS

To add a bit of spice to our otherwise somber portfolio, in January we bought a convertible preferred issued by Motorola, the number one mobile-phone brand in China. Although the recovery here is undoubtedly dependent on the fundamental revival of the technology sector in



general, as well as a gradual improvement in the worldwide handset market, we believe that the shares are attractively valued at a current P/E of 14x '04 earnings. Taking a longer-term view, the high upside sensitivity of the security combined with a current yield of 11.5%, makes it an attractive holding for our income oriented portfolios.

Real estate investment trusts continued their strong relative performance as the group outperformed the S&P 500 by a substantial margin during the first quarter. Superior outperformance was primarily attributed to the strong showing delivered by mall REITs. CBL & Associates, since our addition last quarter, produced a 13% total return gain for our portfolio as the company’s tenant base and occupancy rates continued to remain healthy. In March we also added Rouse, a Maryland-based real estate trust with a diversified portfolio of high quality enclosed mall properties and office assets throughout the country. Rouse, after being on our watch list for several quarters, now seems to be taking all the right steps necessary to streamline its asset base and enhance the balance sheet through recently announced asset disposition

Quarter Composite Net of Fees*

Income-Equity (Prelim)	(2.83)%
50% SP500 - 50% LB Long	
Treasury Index	(0.87)%

12 Month Composite Net of Fees*

Income-Equity (Prelim)	(22.74)%
50% SP500 - 50% LB Long	
Treasury Index	(3.77)%

5 Year Composite Net of Fees*

Income-Equity (Prelim)	(2.31)%
50% SP500 - 50% LB Long	
Treasury Index	2.91%

*See Performance Disclosure on page 12.

to a retail REIT in Pennsylvania. In addition to a 4.8% dividend yield supported by one of the lowest payout ratios in the REIT universe, we like the competence of the management team as well as the recently confirmed guidance for the year. RSE continues to trade at an 8% discount to net assets while most companies in the sector are priced at a premium. Cousins Properties, an office REIT with properties concentrated in the Southern U.S., closed the quarter up 6.3% on a total return basis. Here the fundamentals remain quite strong as the rest of the office group continues to suffer from a weak economy, excess capacity and exposure to Silicon Valley.

At the end of the quarter we finished selling our position in United Dominion with a price gain of over 20% in addition to a 7% yield. While we are impressed with UDR's performance in the face of increased competitive pressures apartment REITs are facing from single-family home markets, its current valuation of 20% over the NAV compared to the average apartment REIT trading at a 3% discount, prompted the sale. We like the management and the structure of this business and would be happy to revisit the company at a more reasonable valuation.

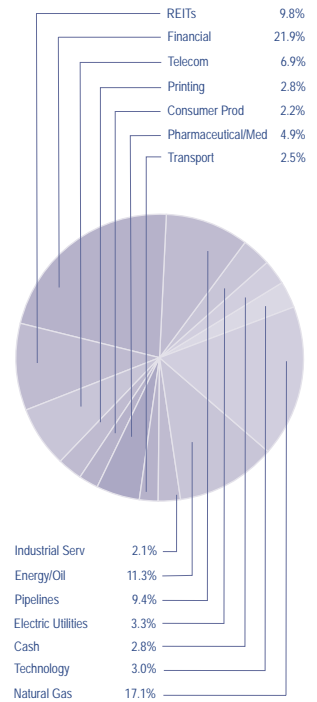
Other outstanding performers worth noting included Landaur (up 8% for the quarter), a classic value story in the radiation monitoring devices industry we added in the fourth quarter. Banks in general had a lackluster winter, closing unchanged or down slightly for the period. We trimmed AmSouth, up 4% year-to-date, after overweighting it last quarter on technicals.

Toys'R'Us brought several disappointments along the way, closing down -8% for the quarter. We entered the position fully aware of the risks inherent in trying to pick a bottom in

any deep value situation, but admit that we may have underestimated the current state of the retail environment and the severity of competition from retailing giants like Wal-Mart. We haven't made up our mind yet about exiting the position, but we will continue to monitor credit market spreads as well as any fundamental developments, and will exit if the situation proves to be hopeless or if a better candidate finds its way to the top of our watch list.

LOOKING FORWARD

Overall, we are content with the composition of our portfolio as our holdings continue to deliver strong fundamental results and pay out higher dividends. Tax Reform is on the table and while it's unlikely that the package will be passed in its entirety, we remain optimistic that our strategy is very well positioned to benefit from any reduction in dividend taxation. □



INCOME-EQUITY STRATEGY FUNDAMENTAL CHARACTERISTICS

Yield	6.6%
Proj Div Gro	5.28%
Payout Ratio	56.35%
Market Cap (MDN)	\$2.6 Bil
Price/Book	2.45
Beta*	0.51
STD	13.78%
P/E Ratio**(MDN)	12.04
Quality (Equity Rating)	B++

*Relative to S&P 500,
3/31/98 - 3/31/03

**REITs use P/FFO ratio

“...the ‘guaranteed’ allowed rates of return on equity in regulated utility operations of 10-12% (depending on the jurisdiction) suddenly doesn’t look too shabby in view of the investment returns available elsewhere.”

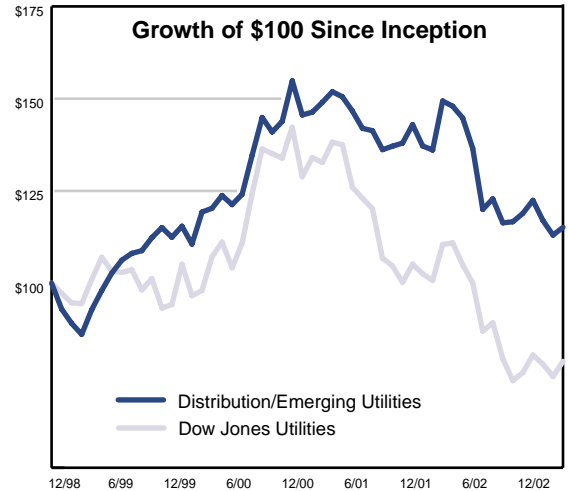
There was pressure from the overall market this quarter, and specific pressure from a retrenching utility sector generally, and in the absence of takeovers the portfolio performed commensurately. Last quarter’s strength faded, though there were definitely positive standout stocks that need only to be joined by the rest.

On the legislative front the new energy bill is in mark-up in the Senate Committee on Energy and Natural Resources as we write. While Republicans and Democrats have some issues to work out, so far the only deal-killer from the past—drilling in ANWR—is not in the bill. There is a single-sentence repeal of the Public Utility Holding Company Act, a repeal which has become our Godot ever since earlier legislation was scuttled in the wake of 911. There are disagreements in both the House and Senate on matters dealing with state powers and the Federal Energy Regulatory Commission’s Standard Market Design, but these are more technical in nature, as opposed to the exploiters vs. conservationist dichotomy that the ANWR drilling issue produced (and our fingers are crossed that it is not brought back into a reconciled bill, having been already defeated this year as a budget tack-on).

Meanwhile, as a straight and conservative utility portfolio offering a fine current yield and growth of yield, the strategy is doing fine. These are regulated utilities, you should remember, and will receive their allowed rates of return whether the economy booms or busts after the war in Iraq is “over.” Some have a little extra going for them on the side, and in most cases that has helped.

PORTFOLIO HIGHLIGHTS

Certainly that’s the situation with Questar, which hit a new 52-week high during the quarter



even as most stocks in the broad market were doing all they could to keep away from 52-week lows. The answer here is of course natural gas, which we’ve been talking about for more than a year and which we’ll keep talking about, no doubt, until you...explode. Normal weather has revealed a shortage of gas in the country and the exploration and production community does not exactly seem to be running to fill the void. STR has been doing a great job of building both sales and reserves (most companies seem able to do just one or the other), and has overcome a mild handicap, since there is little pipeline infrastructure serving eastern demand, causing Rocky Mountain gas to sell for substantially less than gas in other locations. That’s beginning to change, though, which may explain STR’s persistent and relatively ebullient pricing. Other positive stocks for the quarter included Energen, WGL (Washington Gas Light), Sempra, New Jersey Resources – gas stocks all, plus California Water.

We stood aside in two issues, Teco and XEL. Teco’s basic utility business couldn’t be more attractive and more financially sound, but at the holding company level they have problems due to a pair of large power plants coming on

Quarter Composite Net of Fees*	
Distribution (Prelim)	(6.21)%
DJUA (total return)	(2.14)%

12 Month Composite Net of Fees*	
Distribution (Prelim)	(23.11)%
DJUA (total return)	(28.68)%

3 Year Composite Net of Fees*	
Distribution (Prelim)	(1.25)%
DJUA (total return)	(7.02)%

*See Performance Disclosure on page 12.

line this year which are located in an area of oversupply and whose output they will be fortunate to sell at cost. The company is on the hook for the financing of these plants, and though they have expressed commitment to the dividend, we doubt it will hold. That would not necessarily be a dispositive issue for this particular portfolio, but we decided we could exit the stock in anticipation of its March 28th update to investors—which has been postponed another two weeks at least. We'd love to see long-term contracts for the output from these plants and we'd love to feel comfortable getting back in to TE, since we continue to feel it has value as a takeover candidate—but that value is clouded by its current financial stress. We also sold XEL at the same price we bought it when doubts arose regarding the company's ability to avoid liability for the bankruptcy of subsidiary NRG. Just days ago the company reached an accord with NRG's creditors, and with that issue out of the way we see the company as recovering its status as a premier utility in a fine service area with excellent merger prospects, so back into the portfolio it will likely soon come.

LOOKING FORWARD

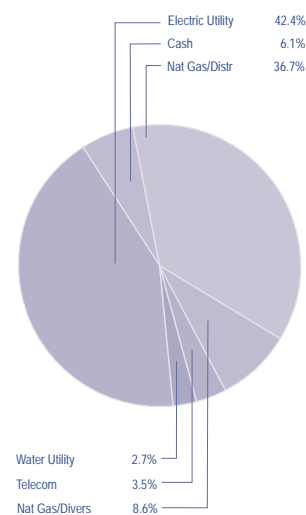
As you know, we crave repeal of PUHCA. We believe we hold many stocks that could be the object of acquirers without repeal, but the absence of the act will open up the gates to a busy world of deals. And there are plenty of buyers out there ready to act. After all, the "guaranteed" allowed rates of return on equity in regulated utility operations of 10-12% (depending on the jurisdiction) suddenly doesn't look too shabby in view of the investment returns available elsewhere. We believe we've said

something to indicate our willingness to ingest our hats if there aren't a huge number of deals when PUHCA is repealed. Things look good at the moment, though you never know how politics will go (as witnessed by the FCC's strange machinations this winter). Even if we're delayed, though, the portfolio is solid and the stocks remain, at this point, unimpeded by the kinds of issues that have plagued other utility stocks over the past couple of years. □

BTB/Utilities continued from page 5

LOOKING FORWARD

The seeds of improved investor sentiment toward the sector are surely about to sprout. With utilities' "back to basics" programs largely complete and bearing fruit in the form of solid earnings from traditional operations, weather patterns returning to normal, commodity prices out of the basement, California political claims finally wending their way toward decision by FERC, and the negative news flow being replaced with news of resolution of overhanging issues...the near-term outlook for utilities finally, truly looks bright. And all of this in a weak economic environment. Should the economy pick-up, thereby increasing demand for electricity (*née* natural gas), one can look forward to a dramatic turn in market sentiment toward all utilities and, in particular, producers of natural gas. Importantly, even without a significant economic turnaround, for consumers of natural gas, it appears that the squeeze is on. □



FUNDAMENTAL CHARACTERISTICS

Yield	4.5%
Proj Div Gro	2.06%
Payout Ratio	62.04%
Market Cap (MDN)	\$1.3 Bil
Price/Book	1.76
P/E Ratio (MDN)	11.88
Quality (Equity Rating)	B++
Beta*	0.32
STD	15.08%

*Relative to S&P 500, 3/31/00-3/31/03

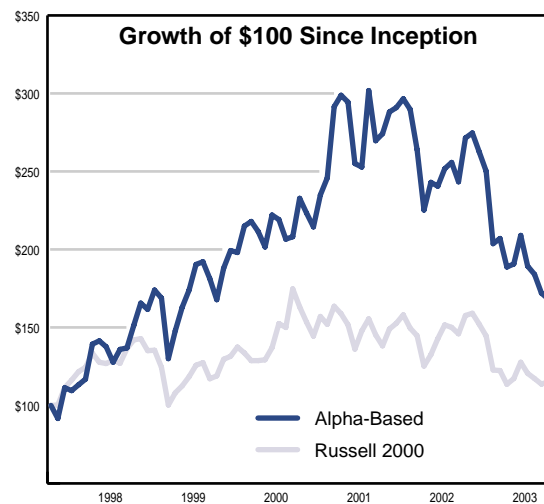
"Our focus now is to preserve the benefits of the positive moves we've made in the portfolio, and make greater efforts to avoid the negative surprise stocks in an uncertain world."

It was a tough quarter for all investors this winter, with hardly any stocks in any sectors showing positive returns for the period. War concerns combined with a steady flow of melancholy economic news combined to shrink investor certainty about the capital markets' backdrop. In addition, poor corporate revenue and earnings performance dampened the appetite of investors for stocks in any capitalization size. With the exception of selected resource stocks, there was really no way to generate absolute positive returns from a long portfolio during the winter.

For most of the quarter we were performing as well or better than the Russell 2000 small-cap index—which finished with a negative return of -4.49%. Near the end of the quarter, however, our portfolio was dragged down by several “torpedoes” in which companies reported negative surprises and the stocks were sold off sharply. These sneak attacks have become quite frustrating to us, especially in view of the fact that we’ve been able to buy and keep a number of the better performing stocks in the small-cap world during a period of great uncertainty and difficulty.

PORTFOLIO HIGHLIGHTS

We were rewarded this quarter by stocks that, in general, have little to do with the overall economy, or which have special stories enabling them to swim against the tide. We’ve been following Closure Medical for years, and higher than expected revenues from their surgical glue product prompted us to go bottom fishing, resulting in a 20% gain. Orbital Sciences performed similarly, and Mikhon Gaming, which we’ve held for many months, finally began a recovery. Helen of Troy, which makes the kinds



of consumer nondurables that are always in demand, finally saw spirited buying after many quarters of fine fundamental performance. Electronics Boutique, which almost singlehandedly degraded our returns last quarter, bounced back with a good gain, as did Friedman’s Jewelers. ELBO has been buffeted by investor sentiment regarding the video game industry, but we think both the industry and the company are solid values, and we’re holding on for now. Though we’re not thrilled with retail at the moment, we bought and sold Urban Outfitters for a roughly 20% gain in three weeks time (taking profits as they appeared).

On the downside, we saw that neither insider buying nor immunization from the economy through operating in an economically insensitive field, such as health, are any guarantee that you won’t find land mines in your path. We finally gave up the ghost on Lumenis after a dreadful revenue report which cast doubt on the veracity of earlier company pronouncements, in our view. Disposable medical products maker Medical Action delivered earnings that were not too bad from an absolute point of view, but were below expectations, so we exited quickly. Orthodontic Centers of America made us want to call a

Quarter Composite Net of Fees*

Alpha-Based (Prelim) (11.21)%

Russell 2000 (4.49)%

12 Month Composite Net of Fees*

Alpha-Based (Prelim)(38.07)%

Russell 2000 (26.96)%

5 Year Composite Net of Fees*

Alpha-Based (Prelim) 2.10%

Russell 2000 (4.12)%

*See Disclosure on page 12

lawyer, as earnings came in 40% below expectations and the company finally revealed massive problems with payments from its far-flung orthodontic practices, many of which were newly purchased in a merger. We also finally gave up on Charming Shoppes, which had a great idea taking on the Lane Bryant division of The Limited to become the largest player in plus sizes, an area which is growing in this world if anything is. But they have been totally inept at execution.

LOOKING FORWARD

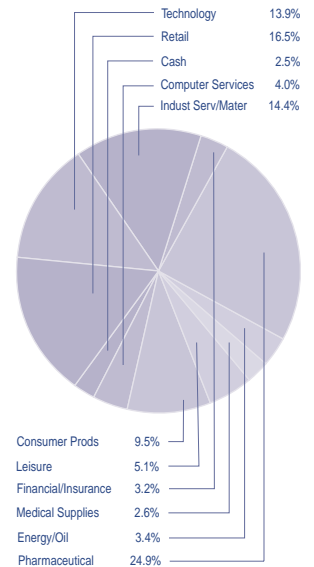
Our focus now is to preserve the benefits of the positive moves we've made in the portfolio, and make greater efforts to avoid the negative surprise stocks in an uncertain world. While we've increased our focus on stocks with strong insider buying in the past year, this is clearly not a foolproof factor to avoid negative fundamental surprises, though generally it is quite effective. We're now adding positive news flow to this factor, and opening positions when good news (such as earnings surprise or upside guidance) is announced, even if we have to pay up a bit. To avoid being caught in stocks whose volume has dried up during our holding period, we're going to raise our liquidity standards a bit.

In a fidgety world, we'll take profits more quickly than we might have in the past, relying more on technicals for help in this area. We can also avoid disappointment risk by selling or lightening positions before important announcements (such as earnings releases). Our experience has shown that prices change more and faster in response to bad news than to good news, and positive news releases typically presage more of the same going

forward. This of course ties in with the notion of buying on good news as a way of reducing the chances of disappointment.

There are fewer really prime situations now, since we don't necessarily expect the market to provide a big tailwind and we're viewing the retail area (a common haunt of our portfolio) with considerable caution. That means our more important positions will become a larger factor (and weight) in the portfolio. Our strategy used to often hold several very large weight stocks (10% or more) and this proved effective at enhancing returns in the past. And we'll be a lot more proactive in trimming down quickly if things are not progressing as we envisioned.

Finally, the feedback we have received from investors as well as from our own hearts and minds is to be much less married to a fully invested posture and more concerned with absolute returns (rather than bow to the financial industry obsession with returns relative to a benchmark). Last year, for example, there were long periods when no new candidates came up on our screens, and in astute hindsight we see that cash was the best choice. If we don't love our stocks, in effect, we want to avoid holding them as slots in a portfolio, and keep cash instead. All this means we may or may not outperform the benchmark in rallies, but we're likely to do much better in declines—which is more important. □



FUNDAMENTAL CHARACTERISTICS

Forward P/E Ratio	12.47
Market Cap (MDN)	\$249 Mil
Price/Book	2.05
LT Growth Rate	21.26
Beta*	1.08
R-SQR*	0.51
Annualized STD	29.66%
Annualized Alpha*	9.03%

*Relative to S&P500,
3/31/98 - 3/31/03

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 100 basis points from gross of fees performance. A complete list of all the firm's composites is available. Returns are total returns and dividends are assumed to be reinvested. 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.

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 3/31/03 was 230, which represents 94% of total assets managed in this strategy with a measure of dispersion of 0.30. Inception of the BTB/Utilities composite was September of 1991.

Income-Equity Strategy: 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 3/31/03 was 151, which represents 81% of total assets managed in this strategy with a measure of dispersion of 0.59. Inception of the Income-Equity Strategy composite was May of 1997.

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 3/31/03 was 31, which represents 86% of total assets managed in this strategy with a measure of dispersion of 30. Inception of the Distribution composite was December of 1998.

Alpha-Based Strategy: Net of fees performance is based on actual results after the deduction of management fees (weighted average fee of 200 basis points). Included in the results are all Alpha-Based portfolios that are unrestricted, including one non-fee paying portfolio, and that have been managed for at least one full quarter. In addition, in order to be included in the composite, a new account has to be at least 80% invested and it should hold not more than 5% cash exceeding the maximum cash held by any portfolio already in the composite, as of the end of the preceding quarter. The number of accounts in the composite as of 3/31/03 was 46, which represents 94% of total assets managed in this strategy with a measure of dispersion of 0.50. Miller/Howard Investments has prepared all performance results. Inception of the Alpha-Based composite was March of 1997. Some accounts were in a modified version of the strategy; they became part of the composite October 2001. Portfolio was managed by William T. Chidester from inception through November 2000. Team managed since December 2000.

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