

## MARKET OVERVIEW

### THE STRATEGIES

#### BETTER THAN BONDS / UTILITIES

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

#### BETTER THAN BONDS / INCOME

A fixed income alternative which utilizes reliable companies from across the broad market. Stocks are conservative, high quality, high yield, and are projected to have a rising stream of income.

#### THE SBI PORTFOLIO

A mid-cap strategy combining value with moderate growth that utilizes stable, moderate growth stocks from all sectors and emphasizes companies with strong dividend growth as well as unique fundamental characteristics. Based on the strategy detailed in Lowell Miller's book, *"The Single Best Investment."*

#### DISTRIBUTION / EMERGING UTILITIES

An opportunistic strategy 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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Last quarter we proposed hints of a return to a more balanced market. While one would be hard pressed to identify a clear trend confirming those musings in the quarter just ended, it is a fact that among fund categories the only positive returns for the quarter came from value funds in the various capitalization sizes. As we survey various indicators, the picture remains mixed, yet stocks with good fundamentals are consistently finding buyers now—a condition not seen for many quarters.

April and May were the cruel months for technology investors, wiping out any gains they may have retained by the end of the first quarter. Though thousands are now "investing on-line" (as well as bidding on E-Bay) we simply don't believe that there are many investors who can tolerate equity market volatility of up to 30% per quarter, especially investors who may be new to the arena or who have strayed over from their traditionally more docile attitudes. Given that the average annualized gain from equities over very long time frames is in the 11-12% range, that level of volatility makes no sense. Worse, any player on the NASDAQ now knows that intra-day volatility of 10% and more for individual issues is commonplace. It's bound to chew up investors and prompt at least some allocation to more restful merchandise. It would be foolish to think that the technology market or the momentum game is suddenly going to go away, but the gradual movement toward a more balanced market which we suggested might ensue last quarter does seem further on the road toward its prospect.

Look at the best performers for the year to date: drug retailers, hotels, airlines, food stocks in various sub-categories, tobacco, oil and gas producers, drillers, pipelines, securities brokers, diversified financial services, REITs, S&L's, every category of drugs and health, industrial equipment, computers, semiconductors, electric and gas utilities. To view that list you'd think we were back in the 1980's. The winners are in real, analyzable businesses, with assets, book values, market shares, and above all, the latest new new thing: "black ink."

Investors in both growth and value camps have been licking their wounds: growth investors recovering from the mirage of nirvana that was tantalizingly presented and then rudely smashed this year, value investors from a period of underperformance lasting longer and of greater magnitude than ever before in the records of value versus growth.

Perhaps we might better understand the emotional state of participants now from looking at these two situations as generalized *loss*, for most investors

*“The investor mopes, detaches himself, even turns off CNBC... Resignation sets in, the resignation of having to work for a living.”*

are now feeling either relative or absolute loss. Some years ago Elizabeth Kubler-Ross popularized a model for understanding loss. In her case she was analyzing feelings surrounding death—the ultimate bear market—but we think there might be insight for investors in looking at her “real world” observations.

In stage one, those experiencing loss retreat into **denial**. Or, as she quotes from the Indian writer Tagore, “Man barricades against himself.” In the denial stage ‘patients’ do not believe, and they shop among many doctors for a different opinion, for answers. Investors, having sold themselves on the case for an investment, reject the fact of its error. They stop looking at their monthly statements, whereas before they couldn’t wait to dial up their Schwab on-line portfolio each night.

Stage two is **anger**. Again she quotes Tagore: “ We read the world wrong and say that it deceives us.” There is the gang of specialists and market-makers to blame, the reporter who wrote that article, those lying thieves who run the company and managed to hide earnings troubles for so many quarters. Anger, resentment and envy is displaced in all directions and projected on the environment. Fire that broker!! Switch that fund to something better performing!

Stage three finds the loser **bargaining**: maybe the investor can succeed in entering some sort of agreement that may postpone the inevitable happening. If only I can get out even, I won’t ask for more. If I recover my discipline and walk the straight and narrow, then things may work out better. There’s a slim chance I may be rewarded for good behavior and have a special wish granted.

The fourth stage is **depression**. No longer does the investor generate fire to blame others or even himself, no longer does he or she

promise to be better and do better. Now “The world rushes over the strings of the lingering heart making the music of sadness.” Not only is that SUV now too expensive, it’s no longer a treasured object. The investor mopes, detaches himself, even turns off CNBC. The thrill is gone, and there’s no thrill to take its place. Resignation sets in, the resignation of having to work for a living.

In the fifth stage the investor discovers a kind of **acceptance** of his or her plight. I’m not the genius I thought I was. The game is hard. The hype is ubiquitous. Events are not so predictable. There is actual risk. There are some stocks that won’t come back and I’m no more than a speck of dust on a vast and incomprehensible earth. I should have settled for a decent average annualized return, with a low chance of long-term loss. “My house is small and what once has gone from it can never be regained.”

Then, just when it seems there is no choice for the investor but to trudge down to the bank and take out a CD, there is a renewal of the self, of essential optimism, of vision, of improvement, of the final stage – **hope**. As Tagore puts it, “Oh, dip my emptied life into that ocean, plunge it into the deepest fullness. Let me for once feel that lost sweet touch in the allness of the universe.”

The investor copes with loss through varieties of emotion, working through the destruction of his or her ego, until there is some kind of passing away of the defeat and the shame that attends it. The organic juices, the animal spirits, begin to flow once again. The organism is still alive, after all.

At about that time the Fed stops raising interest rates...and...hey...we’re off to the races! ☐

#### SELECTED INDICES

	2 <sup>nd</sup> Qtr’00	12 Mo
S&P 500	-2.66	7.24
Equity Inc	-1.08	-6.63
Util Fund	-4.27	9.11
DJUA	6.25	0.85
LB Treas	0.98	6.68
LBGC	1.45	4.32
S&P 400	-3.30	16.97
Val Line	-4.85	-12.43
Rus 2000	-3.78	14.29
Rus 2000 Val	1.95	-0.94

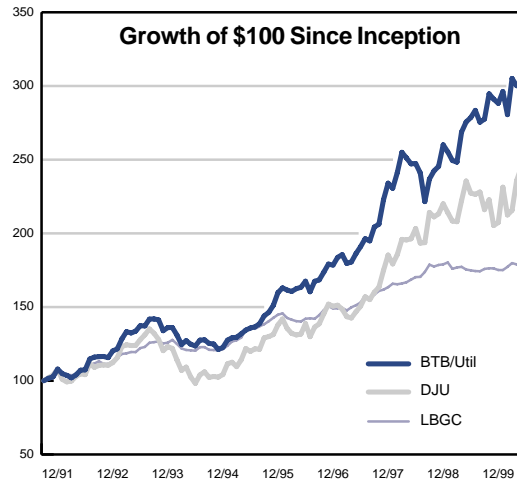
S&P 500 = Standard & Poor’s Index  
Equity Inc = Ave Equity Income Fund (Lipper)

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

June 30<sup>th</sup> was something of an unlucky data point and not really reflective of our performance during the quarter, since we were solidly up until the last few days of the period, just tipping into a less than one percent decline on strange doings during the final day—the final few hours, really—when institutional portfolio adjustment crosscurrents in the market produced a volatility among our stocks which is rarely ever seen. The tenor of the Dow Jones Utilities no doubt contributed, as it declined over -5% in the final week. (In our portfolio, for example, Azurix opened at 8 during the final day, traded at 9, and closed at 7—this is a stock with no news that normally trades in a fraction of a point for the day’s range. Low-beta Peoples Energy, to take a more conventional issue, declined 6% on June 30<sup>th</sup>). Indeed, in a shortened July 3 session we recovered all of the June 30 losses, so there were clearly secular trading influences in what were literally the final minutes of the quarter that impacted on our quarterly returns.

Nevertheless, apart from some puncture wounds from the telecommunications sector (which itself was touched by turmoil in technology), we’re pleased with the performance of our stocks during a difficult time, and our year-to-date and twelve-month performance exceeds both our relevant and irrelevant benchmarks.

In general, the tone for electric and gas companies was good this quarter, with the Dow Jones Utilities, a measure of large-cap electrics plus Enron and Williams, lighting up what was basically a night sky in the broad market with a 6.25% return. By contrast, utility mutual funds, which are typically telecom funds in disguise, declined by -4.27%. We’re rather concerned that the good electric performance reflects the



*“As the years go by our “Better Than Bonds” thesis becomes increasingly reinforced.”*

sort of “parking” in safer equities that was seen in 1998, though fundamentals have improved across the board for these companies, so perhaps these price increases will stick this time.

As the years go by our “Better Than Bonds” thesis becomes increasingly reinforced. Our one year net of fees composite at 8.49% compares to the Lehman Government/Credit (formally the Lehman Government/Corporate) at 4.32%, and the average general long bond fund at 4.4%. For three years, the BTB composite stands at 16.53% versus 6.03% for the LBGC and 6.38% for the average long bond fund, and for five years BTB has returned 17.35% compared to 6.10% for the LBGC and 5.75% for the average long bond fund. We’ve also outperformed the Value Line Index for all three time frames, and posted a remarkable 5-year return of 17.35% versus 5.57% for the Value Line (a broad unweighted measure) with about 25% less volatility than the Value Line. For the twelve months and year to date BTB is even well ahead of the S&P 500. There’s no telling how long our competitive position will be so positive in comparison to more volatile equity classes, but our contention that BTB/Utilities is a “good investment”—even though

**Quarter Composite Net of Fees\***

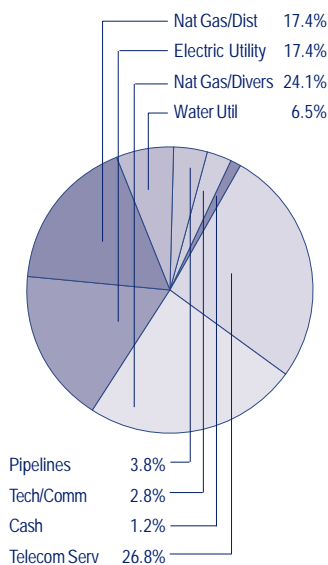
BTB/Util (Preliminary)	-0.98%
DJUA (total return)*	6.25%
LBGC*	1.45%
Ave Util Fund*	-4.27%

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

BTB/Util (Preliminary)	8.49%
DJUA (total return)*	0.85%
LBGC*	4.32%
Ave Util Fund*	9.11%

*\*Index returns are stated gross of fees, although it is not possible for an investor to purchase the index without incurring fees.*

it has no slice in an asset allocation pie chart, seems supported by the data. We also continue to rank well above the utility fund universe average, though, as noted, that group has increasingly become a crowd of covert telecom funds.



## PORTFOLIO HIGHLIGHTS

The portfolio was led by just the kinds of stocks whose virtues we've been extolling in the past few quarters: traditional utilities with a growth strategy, takeover candidates, and stocks with a connection to the energy markets. In a time of turmoil we can't think of a more comfortable place than companies which provide a necessary service and have proven themselves capable of doing so with a moderate, consistent, and replicable level of growth. Earlier winners like Enron backed off, as we'd suggested it might in our last report, but some favorites—which includes most of our highest-weighted issues, came on as leadership replacements.

El Paso Energy has been a consistently good performer—having doubled since purchase in February of 1999—and led the list again this quarter. The company has done an excellent job of consolidating a number of under-performing properties in the pipeline industry, and Wall Street greeted its modestly-priced takeover of Coastal with steady applause, especially as energy prices continued to run higher (Coastal gives EPG direct energy exposure as well as substantial additional pipeline mileage).

Keyspan has finally caught the attention of investors. The company has been doing all the right things for an evolving utility for quite some time, but with few fans. Now it's efforts in developing electricity projects, extending its services to its new Long Island territory, and adding telecom to its brand have resulted in sharp earnings gains—the perfume that draws the Wall Street crowd. Too, the company made a timely decision to keep its Houston

Exploration interest, giving it participation in the vibrant energy markets. We're high-weighted here, with no thought of trimming the stock, which is, not unimportantly, still priced well as a potential takeover target. Other helpful stocks included US West (now acquired by Qwest, whose light we probably will not ride at current prices), NiSource, American Water Works, Questar, Peoples Energy, and Columbia Gas.

But phones held back our returns. Century Tel continued to suffer from investor fears regarding roaming fees, and a weak earnings report did not help matters. But the company remains fundamentally sound, and weaker stock prices inspire thoughts of buying more, not selling. Bellsouth, on the contrary, reported fine earnings and continues to make progress in accomplishing the kinds of growth in wireless and data that are imperative for a phone company today. Yet it appears investors are concerned that BLS isn't big enough as a standalone company, and has as well shown some reluctance to be acquired, though it is definitely of marriageable age and beauty. Global Crossing was our biggest disappointment. Here we were touched by the decimation of NASDAQ stocks. Global attracts a much broader constituency than the average utility investor—which is a testament to its growth prospects—and it must therefore suffer concomitant volatility. Some additional financing activities didn't help the issue, either. But the company continues to possess and add to one of the most unique sets of telecommunications assets on the planet, and we have no difficulty envisioning much higher prices from here, the OTC market notwithstanding. Takeover prospects remain excellent, and management depth has only increased in recent quarters. This stock is a bit spicy for our portfolio, but we always like to have a bit of seasoning in our soup.

In the same vein, we were knocked about by a new telecom addition this quarter. After

### UTILITIES PORTFOLIO CHARACTERISTICS

Beta*	0.50
Dividend Payout	48.69%
Sharpe Ratio	1.06
Projected Dividend Growth	5.09%
Treynor Ratio*	24.26
Current Yield	3.36%
Annualized STD	11.43
Market Cap (MDN)	\$4.2 Bil
Price/Book	2.54
Quality	B+
P/E Ratio (MDN)	17.49

\*Relative to DJUA, 6/30/95-6/30/00

AT&T offered a grossly disappointing earnings report we decided to cancel our position and revisit Ma Bell later on. We replaced T with a “new” kind of telecom company, Covad. Covad has rapidly grown to become the number one DSL supplier in the country (DSL, or Digital Subscriber Line, is the current offering for affordable broadband internet access in the telecom industry). As a CLEC, Covad bundles DSL services for resale by local service providers: if you have DSL service chances are good that it’s a Covad package, even if not identified as such. And DSL has a big wind behind it. Companies like SBC Communications are looking to add 1 million subscribers this year, up from less than 100,000. Covad revenues have been more than doubling, and it’s anticipated that revenues will continue to grow in the 50-100% annual range for the next five years—we’re acutely reminded of AirTouch in its early years, a stock that was one of our big winners of the 1990’s. Meanwhile, the stock sells at just a bit more than 3 times book value. Unfortunately, it was more expensive when we bought it as a replacement for AT&T (which has also declined since we sold it). Only weeks after our purchase the company announced that it was going into retail service in tier II and III cities, potentially competing with some of its existing customers (while still remaining a wholesale provider in the largest cities). Though the plan is revenue neutral this year and should add to revenues in the future, investors reacted to this change of business plan and new element of uncertainty by selling the stock off. However, we’re willing to give the benefit of the doubt to a management that has been on the leading edge of broadband for the masses. That the stock is cheaper now than when we bought it stings a bit, especially because it is a “spice” item, but we’re content to retain our position, perhaps adding to it if, as, and when the new retail plan shows signs of success.

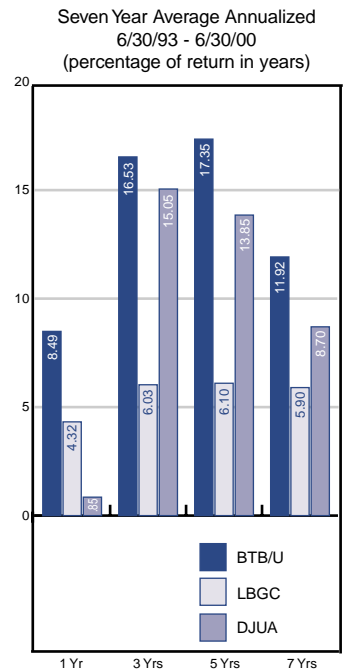
## LOOKING FORWARD

Our strongly positive view remains unchanged. In times of economic uncertainty investors will gravitate to the secure, the familiar, the necessary. Our conventional utilities have much further to go to reach even historically normal valuations. The takeover trend in the utility sector is likely to re-ignite at any time, and we own many of the most attractive candidates. Soft telecom pricing would appear to have created limited downside for our communications industry representation, and more normal valuations would put most in this group 20-30% higher. In all, we’re comfortable buying almost any of our holdings at current prices.

There is shortage potential for the quarter. Gas is at its highest price levels since the Arab oil embargoes, and inadequate amounts are being put into storage for the winter. Supply considerations may have been omitted when various participants made plans to build new gas-fired generation (nearly all new generation is gas-fired), and there is definitely a current crunch. Free market electricity prices are buoyant enough to absorb these extra costs now, and increased drilling levels can probably bring supply into balance down the road, but at the moment there’s not enough natural gas, and, as a consequence, potentially not enough electricity.

Weather will play a role, as will the “mysterious hand” that tends to balance supply and demand, but the environment is definitely more interesting than it has been in many years, and bears watching by utility investors for its profit possibilities. However, we need look no further than current undervaluation in all sectors for optimism. The earnings outlook has rarely been brighter, and yet the relative P/E’s of utility stocks at 40% of the S&P 500 P/E could double and still be within a normal “fair value” range by historical standards. □

*“In times of economic uncertainty investors will gravitate to the secure, the familiar, the necessary.”*



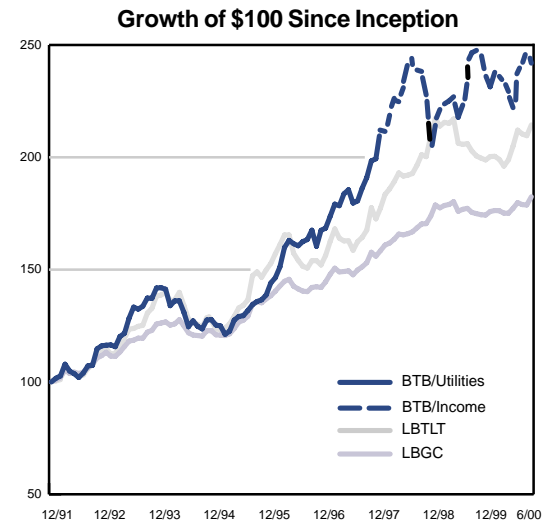
*“Our zone of opportunity has broadened in recent quarters, so the prospects for this portfolio look solid even if the interest rate scene proves uncongenial.”*

Last quarter we suggested that “a measure of reality has re-entered the market,” and that old economy issues would regain some constituency that had been temporarily lost to the OTC fantasyland excursion. While one could hardly assert that investors elected value and dividend-paying stocks in a landslide vote, there’s been enough change for us to completely sidestep the negative signs that have preceded most returns for the quarter and year to date. We outperformed most fixed-income funds as well as most equity approaches with our high-yielding turtles, as investors slowly and inexorably turned in our direction.

**PORTFOLIO HIGHLIGHTS**

If a company was connected in any way to gas, it helped our portfolio this quarter. Transporters were transporting more as a consequence of the increasing amount of gas used in electricity production. Those with exploration and production subsidiaries or midstream processing were helped by higher pricing. Our small remaining position in El Paso Energy led the list, up 26%. It was joined by a similar gain in El Paso Energy Partners (formerly Leviathan), a stock for whom we’ve needed great patience in the past couple of years, to say the least. But rising revenues have brought rising distributions and enthusiastic Wall Street analysts, so it appears this patient is healed. Peoples Energy was a double-digit contributor, as was Lakehead Pipelines, Keyspan, and Equitable Resources. Questar rose, but surprisingly modestly, considering its growing exposure to gas prices and rising reserves.

US West rose nearly 20% as its deal to be acquired by Qwest was completed. We’ll



be moving out of Qwest, since it doesn’t fit this portfolio and we already have one “new age” telecom acquired through a takeover. But we’ll move just a little slowly, just in case Deutsche Telecom cares to come back for the combined company with interest they already expressed in the first quarter. REITs are back to some extent, and Colonial Properties helped us this quarter. Timken has been all over the place as investors wax and wane in their feelings about the company’s recovery, but this quarter it was a helper. Though the banking sector was mixed, Washington Mutual and AmSouth (a new purchase this quarter) both helped our cause.

On the negative side, we were hurt, as was the utility portfolio, by a downdraft in Global Crossing (that’s our “new age” legacy from owning Frontier) and a somewhat meaningless decline in MCN as the completion of the latter company’s merger with DTE is delayed by an FTC examination. We consider the examination and the delay lacking in import—except to defer the transaction’s timing. In the interim, DTE stock has risen, giving us a much better chance

Quarter Composite Net of Fees*	
BTB/Income(Preliminary)	1.48%
LBGC	1.45%
LB Long Treasury Index	0.98%

12 Mo Composite Net of Fees*	
BTB/Income	-2.40%
LBGC	4.32%
LB Long Treasury Index	6.68%

\*See Performance Disclosure on page 12.

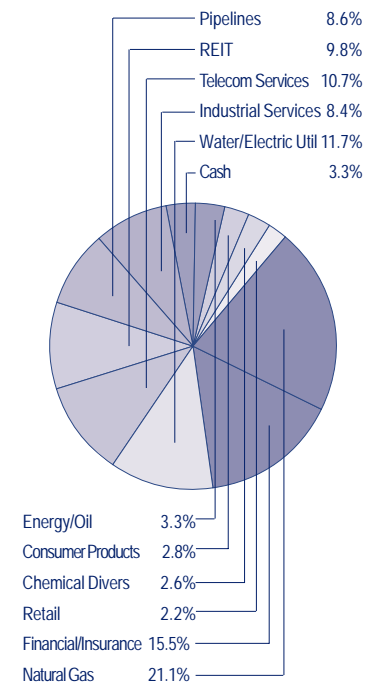
at the full value of the deal. Indeed, MCN is a strong buy right here, with a remarkably wide arbitrage opportunity. Dana was sent to the doghouse on soft earnings and investor fears regarding a slowdown in the auto industry. These fears may be well grounded, in our view, and it's quite possible that DCN will become a source of cash on a rally, though the company is a perpetual favorite of ours and a great name. The cycle may be too much against it right now, however. Crown Pacific lost some ground, even though management has clearly expressed its interest in increasing shareholder value by whatever means, including a sale of the company. This high-yielding item is one of the most likely to succeed in our portfolio, so we favor it even more on weakness.

Our newer preferred stocks gave a mixed performance. Lincoln National finished flat even though the common stock rose, perhaps adjusted for an overly positive move last time. AES preferred helped the portfolio, though the stock was more volatile than we'd like as it bounced hither and yon depending on developments in its takeover of a Venezuelan electric company (the company finally succeeded). New holding PSInet preferred met with some of the selling that characterized the NASDAQ market during the quarter, moving from a solid profit position to a small loss by the final session. This company occupies territory in the data services area that is similar to Verio, for which Nippon Telephone has recently offered a 60% premium. PSI's valuation is only about a quarter of NTT's offer for Verio, so chances are good for a consolidation of this company which, like Verio, essentially offers value-added services that a telephone company would be offering if it was sufficiently competent to have

started the business in the first place. It is easier for a telco to buy the service provider, at this point. Meanwhile, our yield on the preferreds is better than a bond.

### LOOKING FORWARD

Our zone of opportunity has broadened in recent quarters, so the prospects for this portfolio look solid even if the interest rate scene proves uncongenial. Not only are utilities in good shape, but MLP's and REITs have once again found buyers. Banks, an area where we think we'll find new and promising investments, have a great deal of upside if interest rates are supportive. We've been able to add a small measure of aggressiveness through the use of convertible preferred securities, and a clear bottoming in technology and telecommunications stocks would prompt us to fish a bit more in these waters. On the fundamental side our stocks have been in great shape for the past two years—at this point the growing values have finally met with some recognition from equity buyers. Now that many owners of hot stocks are carrying their heads in one arm, the tried and true has much more appeal, and we believe this will prove to be the case for the remainder of the year. We've been able to scratch out a "better than bonds" return with this portfolio in recent quarters, but we haven't forgotten earlier times, when annual returns in the 20-30% range were not uncommon. The potential is there, and all that's needed is a bit more market breadth—more likely now than it has been in many quarters. As the traders have been saying, "black ink is back in style." Current yield on the portfolio is approximately 6%.



#### FUNDAMENTAL CHARACTERISTICS

<b>Yield</b>	6.31%
<b>Proj Div Gro</b>	5.75%
<b>Payout Ratio</b>	70.20%
<b>Market Cap (MDN)</b>	\$2.98 Bil
<b>Price/Book</b>	2.31
<b>Beta*</b>	0.30
<b>P/E Ratio**(MDN)</b>	15.54
<b>Quality</b>	B+

\*Relative to LBGC, 6/30/98-6/30/00  
 \*\*Reit's use P/FFO ratio rather than P/E Ratio

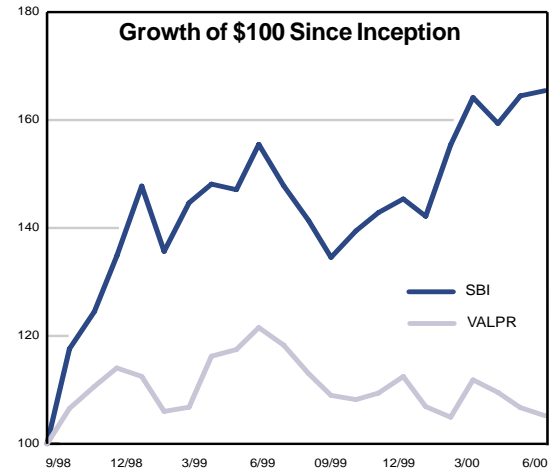
*"Stocks of many different colors performed well for us this quarter."*

In a generally down time for the broad market our portfolio emerged unscathed. The right balance between portfolio composition, industry diversification and issue selection proved once more that the ability to buy and hold real companies, industry leaders with solid fundamentals, competent management, and bright prospects for the future are the key factors for outperforming the market on a consistent basis. It is important to note that our SBI portfolio was again able to generate excellent results with low average downside volatility. Our conservative value issues in the financial, pharmaceutical and industrial sectors did as well as the more aggressive technology-oriented stocks (which represent about 25% of the portfolio, less than the tech weight in the S&P 500), and our tech stocks didn't get crunched in the April/May comeuppance.

## PORTFOLIO HIGHLIGHTS

Stocks of many different colors performed well for us this quarter. Tremendous values offered by pharmaceuticals were finally an enticement to investors, and we were able to realize gains on our long-time holdings like Alza, up 60% for the quarter, Watson Pharmaceuticals up 35%, as well as Baxter International, up 15% for the quarter. As you might remember, we increased our position in Alza in December of last year, when the stock collapsed on the news that the deal with Abbott Labs wouldn't go through due to the difficulties Abbott had getting the Federal Trade Commission approval. We viewed this momentary lapse as a superior opportunity to add more of this takeover candidate with improving finances and a strong drug pipeline. At the moment, we're contemplating

taking profits after a 70% year-to-date run and moving into other pharmaceutical opportunities. Also in the Health sector, Medtronic lagged this quarter due to general market volatility. The stock is a category killer and great dividend-growth issue. It's one of the most consistent growth stocks in the world and recent clinical trials—of heart-implanted wireless devices for patient monitoring—make us unable to resist referring to our own accelerated heartbeat when evaluating this company.



We suggested last time that Alcatel was quite undervalued compared to the telecom equipment average stock, and that their pursuit of DSL technology was likely to boost growth way beyond previous expectations. Wall Street stopped anchoring to the past this quarter, as good news on sales and earnings brought in the buyers and generated a 40% quarterly gain. In addition, the chances are high for Alcatel to spin off its optical components unit, which should enhance shareholder value in the upcoming months.

Venturing further into both non-domestic and technology representation we added Philips Electronics, the third largest consumer

### Quarter Composite Net of Fees\*

SBI	0.77%
Value Line Index	-4.85%

### 12 Month Composite Net of Fees\*

SBI	6.37%
Value Line Index	-12.43%

### YTD Composite Net of Fees\*

SBI	13.76%
Value Line Index	-5.38%

\*See Performance Disclosure on page 12

electronics firm in the world. Over the last few years, management has been speeding up capital expenditures, cutting out the deadweight, and selling non-core businesses in order to remain competitive. One of the favorable events that helped boost Philips' price was the announcement of the takeover of Seagram, one of its holdings, by Vivendi. In addition to trading at a very favorable valuation, Philips is rapidly becoming more of a high-tech company than just a consumer outfit, through aggressive acquisitions and strategic partnerships with giants like Sun Micro and Sony. It appears to have gained traction in positioning itself as a European leader in the semiconductor, telecom and consumer electronics sectors, and remains inexpensive.

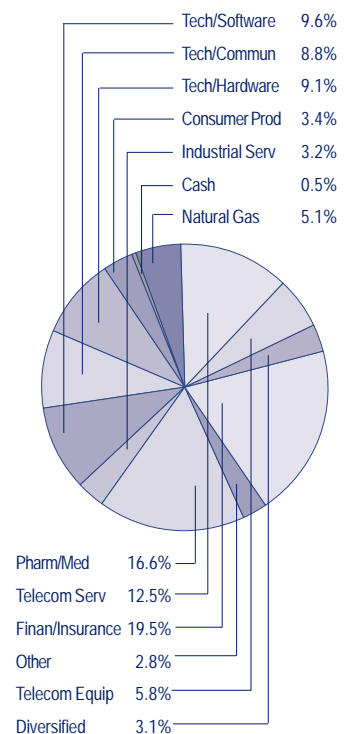
Another recent acquisition, EMC Corp, also offers tremendous value and growth in the data storage sector. We established the position in EMC right around the time of the famous tech sell-off and watched the stock recover and hit all time highs in early June. The demand for data storage remains enormous and will grow with time at an accelerating rate. Where is all that data for wireless web applications going to be stored? On EMC disk arrays, that's where. Where do the 100 million global websites live? That's right.

On the more docile side, we've added an insurer, American General Corp, and Donnelley & Sons, a commercial printing and information services company. We watched AGC quarter after quarter as it previously declined. Finally the argument that uncertainties were priced in—in this case interest rate risk and a pending lawsuit which was on the verge of settlement—became overwhelmingly compelling. AGC gives us a yield of around 3% with a five-year dividend growth rate of almost 7% together with long-term earn-

ings growth in the neighborhood of 12%. Donnelley is also incredibly cheap trading at a P/E of 9 with the current yield of almost 4% and a dividend growth of 7%. The stock fits perfectly our criteria of financial strength and value, and should provide a good balance and enhanced stability to modulate our aggressive stocks. Also among the beaten-down, Toys R Us continues to progress as a turnaround play and continues to register in the profit column for us.

As of our last report a deal for Shared Medical Systems had collapsed, but we remained comfortable holding the stock. As is often the case, another suitor came a-calling and we sold our position in the market at a price near a new offer from Siemens. We traded Pitney Bowes for Lucent Technologies (exchanging one depressive for a cripple with a healing leg), and sold Computer Associates just in time to avoid a sorry earnings picture which drove the stock down to about half our sale price. We added General Motors H (Hughes Electronics), the dominant player in the satellite communications space with a prosperous present and an outstanding long-term future in two-way broadband data. Perhaps we're biased: satellite is our best opportunity for broadband up here in the mountains, as it is for some 25% of the nation.

It was a satisfying quarter, but hardly perfect. This has been a market of land mines, and we stepped on a couple. Mercifully, our positions in these were small and the overall effect on the portfolio not so damaging. Electronics For Imaging, a reasonably-priced tech stock dominating the market for printer engines warned of a revenue shortfall shortly



#### FUNDAMENTAL CHARACTERISTICS

<b>Yield</b>	0.82%
<b>Proj Div Gro</b>	10.31%
<b>Payout Ratio</b>	24.93%
<b>Market Cap (MDN)</b>	\$19.5 Bil
<b>Price/Book</b>	4.61
<b>P/E Ratio(MDN)</b>	25.51
<b>Quality</b>	B++
<b>Beta*</b>	0.76
<b>STD</b>	14.98
<b>Sharpe Ratio</b>	0.07
<b>Treynor Ratio*</b>	1.39

\*Relative to Value Line Index (6/30/99-6/30/00)

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SBI Quarter Review continued from previous page

*“One key element under discussion is the abolition of the Public Utility Holding Company Act. If accomplished, this would open wide the floodgates...”*

after we had bought it. We still believe that it’s a fabulous company trading now at a P/E of 13 with a 25% projected growth rate, but pending evidence of a revenue recovery we decided to vote for another candidate. We’ll probably own the stock at some point in the future when our confidence level is higher. Unfortunately, our new candidate turned out to be Citrix, which seemed to catch the whole world by surprise (it had one of the highest Wall Street ratings of any stock) with an earnings shortfall attributed to a business model transition from unit sales to enterprise level sales. In retrospect, we don’t see any clues as to how we might have sidestepped this one, and it remains, in the words of one key analyst, “essentially without competition.” There are a number of technology companies that might find Citrix an attractive acquisition at current prices, and the stock will rally sharply on evidence that its transitional phase is over. So we’re sticking with the program here.

## LOOKING FORWARD

Over the past year we think we’ve successfully added a measure of aggression to the SBI portfolio without really changing its character or adding volatility that would make the stocks or the portfolio difficult to hold when the environment is stressful. We’ll continue our “barbell” strategy of seeking the best dividend growth/value stocks, moderate growth stocks, turnarounds, and selections from our utility strategy, while still keeping an adequate representation in technology and the kinds of companies that will lead the ongoing evolution of the domestic and global economy. □

The final two hours of trading on June 30 took what would have been an outstanding second quarter and turned it into merely a good one. We were astonished to see our portfolio decline by -3.5% on the final afternoon, especially since the normal fluctuation in this portfolio is in fractions of a percent. All the more irksome was its recovery on Monday, July 3, healing nearly the entire bruise. We’re at a loss to explain this odd movement—it certainly was not inspired by news of any kind—except to point to similar doings in the large-cap electric market. But that movement, while closer to normal for indices like the Dow Jones Utilities, was itself inexplicable.

In any event, notwithstanding a couple of raucous days, this portfolio has been a great place to be this year. With a year to date return of 7.99%, there are few strategies that have been able to even come close. And when volatility is viewed with just a bit more perspective, the returns are even more attractive: In the past twelve months, only three have been negative, with a worst month of -3.7% and a best month of 7.8%. It’s been easy to be a holder, and we hope the future contains more of the same.

The good returns, however, are coming from a gradual revaluation of an undervalued group of stocks, rather than from the takeover transactions which this portfolio targets. For the year to date has seen a drought of new deals. With the exception of National Power’s takeover of LGE, the Nova Scotia electric company’s recent offer for Bangor Hydro, and ATG Resources small deal for Virginia Gas, the action has suddenly been dry.

There are some possible explanations for this circumstance, which we’re quite sure is a

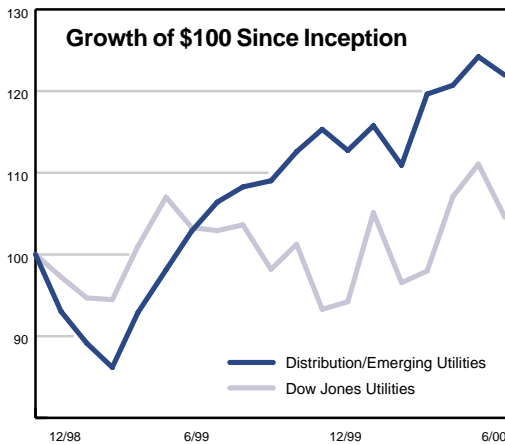
### Quarter Composite Net of Fees\*

Distribution	1.75%
DJUA (total return)*	6.25%

### 12 Month Composite Net of Fees\*

Distribution	18.36%
DJUA (total return)*	0.85%

*\*Index returns are stated gross of fees, although it is not possible for an investor to purchase the index without incurring fees.*

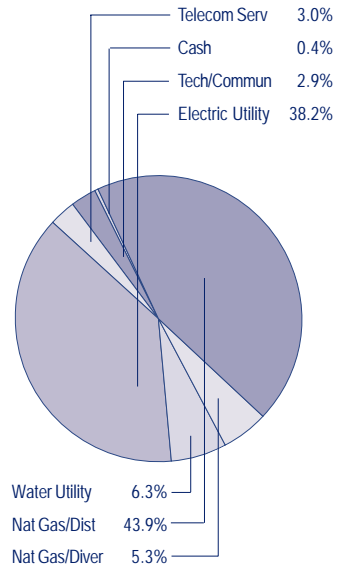


temporary condition. Rising short term rates have created both greater difficulty and more uncertainty in terms of the financing of deals. Regulators on a state by state basis have not been as quick to implement deregulation measures as has been anticipated (though that should come as no surprise), so acquirers have not been as certain of their outcomes. At the Federal level there has been much noise and maneuvering with regard to a national deregulation bill for electrics, a movement which may pick up steam in the event of summer brownouts or shortages. One key element under discussion is the abolition of the Public Utility Holding Company Act. If accomplished, this would open wide the floodgates for an entire class of deep-pockets acquirers who are now limited in what they can do. In general, it appears that those who have already done deals are digesting their meals, others are watching to see the results of the many deals already done, still others are waiting for legislative action on both the state and federal levels. And an easing of interest rates would certainly help grease the wheels.

But this may also be the dark calm before the tornado. No one in the utility industry

seriously believes that small investor-owned companies will survive independently, and there are plenty of sharks cruising. Both National Grid and National Power from Britain have already said they will be making new acquisitions by the end of the year (we're hoping to be asked for a dance). Domestics like Peco/Unicom are on the prowl for generation, perhaps generation they could split off from distribution. In the water area California has recently made clear its acceptance of consolidation in that industry (exposing two or three additional companies to clear sailing for acquirers), and every utility with less than 2 million customers is sizing up its chances to get bigger or get bought. We recently heard from an important investment bank: "we're working on four deals right now."

So we expect the second half will be more fun than the first, though if we can merely repeat our first half returns we'll be content indeed. We recently sold some stocks which were close to their deal prices and added Empire District, a little one with a tremendous arbitrage spread on an announced deal; Niagara Mohawk, an undervalued company nearly done with its exit from generation; California Water, a bite-sized water company with one potential acquirer already holding a sizeable stake, and Western Resources, fallen to unbearably low prices in the years since its failed merger with Kansas Power and Light. These and our other holdings may receive "the telegram" at any moment, in the meantime they are cheap, good yielding, and in a defensive area of the market. □



**FUNDAMENTAL CHARACTERISTICS**

<b>Yield</b>	4.68%
<b>Proj Div Gro</b>	3.42%
<b>Payout Ratio</b>	64.56%
<b>Market Cap (MDN)</b>	\$1.4 Bil
<b>Price/Book</b>	1.63
<b>P/E Ratio(MDN)</b>	14.35
<b>Quality</b>	B++
<b>Beta*</b>	0.20

\*Relative to Dow Jones Utilities Index (6/30/99-6/30/00)

**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.

**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. The number of accounts in the composite as of 6/30/00 was 149, which represents 40% of total assets managed in this strategy with a measure of dispersion of 0.38. Inception of the composite was 9/30/91. (Note: The composite represents only 40% of assets managed in this strategy because two large clients, a mutual fund and a pooled fund, are not included due to excessive and non-regular cash flows.)

**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 6/30/00 was 16, which represents 78% of total assets managed in this strategy with a measure of dispersion of 0.95. The cumulative chart contains a combination of Better Than Bonds/Utilities performance from 9/30/91 through 9/30/97 and Better Than Bonds/Income performance from 9/30/97 through 6/30/00. Better Than Bonds/Income as a stand alone strategy started in May of 1997. BTB/Income is a strategy that evolved from BTB/Utilities sharing the same philosophy and process and many of the same stocks. The essential difference between the two is that a portion of BTB/Utilities invests in telecom stocks and a comparable portion of BTB/Income invests across the broad market.

**SBI:** 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 6/30/00 was 5, which represents 75% of total assets managed in this strategy with a measure of dispersion of 1.00. Inception of the SBI composite was 9/30/98.

**Distribution:** 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 6/30/00 was 19, which represents 25% of total assets managed in this strategy with a measure of dispersion of 1.16. (Note: The composite represents only 25% of assets managed in this strategy because 2 large accounts opened during the quarter and are not yet part of the composite.) Inception of the Distribution composite was 12/31/98.

**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