

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.

We continue to exist in a kind of no-man's land economically, with an economy that really hasn't been experienced before by investors who are active today. We've said before that 1% interest rates are no cause for rejoicing. Indeed, if anything they are cause for one to jump at the sight of one's own shadow. What does it say about the world that 1% interest rates cannot stimulate investment or spending? And so, because the environment is somewhat unrecognizable, strong stands can't really be taken. In short, no one really knows this terrain, and those who claim to are just...marketing. Bulls are betting on successful stimulus. They may prove right, but so far, the pulse is faint indeed.

Last year at this time we started looking at ten factors we thought were important to understanding where the economy and stocks might be headed. They're still relevant, and so we'll review them once again. To preview, little has actually changed save the prices of merchandise in the market, and a number of measures have become even more troubling.

- 1) *The Fed is loose.* Short term rates have zero within sight. The fed has indicated that if short rate reductions don't work they will buy treasuries, at, as Greenspan put it, "minimal cost." Minimal cost means (for those who've momentarily forgotten that everything a governmental official or corporate executive says is actually code for something else) that the Fed will simply print the money to do this buying. That should take care of any lingering worries about deflation.
- 2) *Investor confidence in corporate governance is at the lowest point since the 1930s.* Just when the headlines about corporate accounting shenanigans seemed to be fading, it turns out that Freddie Mac was cooking the books, right under the noses of a 140-person governmental agency whose only job is to monitor Freddie Mac and Fannie Mae. Before you know it, it may even turn out that the government itself is cooking its books! Perhaps this factor is fading as a real pricing element, but we also doubt that all the skeletons are out of the closet, even now.
- 3) *Sentiment measures are inadequate to support an intermediate-term rally.* In hindsight, "inadequate" may have been an inadequate term, for the market obviously traveled higher and farther than such measures would have implied. Let's just say that if every indicator worked 100% of the time, we'd have all

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the money. Nevertheless, we remain adamant that the sentiment measures do not carry a positive message about upcoming pricing. Investment newsletters have not been so bullish since winter of 2000. The Association of Individual Investors survey has not been so bullish since summer of 1987. Of course anything can happen in the markets, but these are not generally the kinds of signposts we would want to see to help us find a near-term optimistic path.

- 4) *Short-term options activity has improved to neutral but stocks are not currently oversold.* While put/call volume doesn't have much of a message in it, our index-option-open-interest figures have become, in contradistinction to the figures in #3, quite bullish. Improvement that began in the first quarter continued robustly through the second. These factors suggest that there is enough skepticism about the rally to keep it going. If only this were the sole factor!
- 5) *Valuations support upward price adjustments in some sectors but not all.* There's not much of a valuation case here anymore. Surprisingly, the valuations are most attractive in the most interesting area of the market—stocks with high dividends.
- 6) *The dollar has weakened and may well have reversed its long-term uptrend.* We can delete the “may well” now, and suggest that the dollar is probably due for years of weakness, though it is currently bouncing near-term. Would we like to pay back foreign lenders, who hold about half the national debt (nearly a trillion dollars), in cheaper dollars? We would. And we will.
- 7) *The macro-environment has changed from peaceful prosperity to a kind of nervous struggle.* Just now world events seem to be receding from center ring, and that's a big positive for investor confidence, as well as giving politicians and

administrators more room to focus on economic issues. But we must continue to squelch domestic terrorist actions, for Twin Tower memories are not so deeply buried.

- 8) *Earnings comparisons are easier... investors may be free once again to extrapolate limitless growth.* That companies are now lean and mean augurs well for future earnings when revenues return, but so far revenues have not returned. Unfortunately, cost savings can only take you so far, and investor hopes for better earnings are due for betrayal if revenues do not develop pronto.
- 9) *The old highs reflected a vastly different economic and sentimental framework.* This is a done deal, no matter that low-quality stocks did have a nice bounce last quarter. The retire-early-on-stock-market-jackpot-gains mentality is gone, and a renewal of the eternal verities about business and investment has replaced it. This should support our own approach to investment with a new and more sober constituency.
- 10) *Corporate insiders have not been buyers...a negative factor for the six-month outlook.* On the insider front, things are getting ridiculous. The insider sell ratio (selling/buying) is about four times normal. In technology, 16,000 shares are being sold for every share being bought. No one is perfect in his or her market timing, not even insiders, but the current moment is off the charts. This factor has gotten worse, if anything, as many insiders took the 2nd quarter rally as an opportunity to unload yet more shares.

In all, as we've seen in the second quarter, the market may sometimes go up even when it “shouldn't.” Sometimes it goes up when negatives have been excessively discounted,

SELECTED INDICES

	2 nd Qtr'03	12 Mo
S&P 500	15.40	0.23
Equity Inc	14.82	(1.30)
Util Fund	16.70	1.56
DJUA	21.86	(3.99)
LB Treas	5.07	19.37
LBGC	3.52	13.15
S&P 400	17.64	(0.71)
Value Line	22.36	(7.79)
Rus 2000	23.42	(1.64)

S&P 500 = Standard & Poor's Index
 Equity Inc = Avg Equity Income Fund (Lipper)
 Util Fund = Avg Utility Fund (Morning Star)
 DJUA = Dow Jones Utilities Avg
 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

sometimes when shorts are busy covering, sometimes when activity is light and small money can have an inordinate impact on prices, sometimes on enthusiastic discounting of future prospects based on a present change (such as the tax cut and rate cuts). These are all conditions in which stock prices can rise surprisingly strongly, and we believe that each of these factors played some role in the second quarter's good results.

But we're also having trouble changing our cautious position based on the economic and secular market factors which we think are important. When newsletters and individuals are markedly bullish and insiders are not, there's a hole in the picture no matter what more conventional economic views may indicate, arguing for caution in general terms—though we believe that the sweet spot, stocks with dividend appeal, may prove immune to developing crosscurrents. □

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 6/30/03 was 225, which represents 93% of total assets managed in this strategy with a measure of dispersion of 0.20. Inception of the BTB/Utilities composite was September of 1991. One institutional client, which makes up 45% of the composite, held a 2% position not held by other investors in the composite.

The news was good this quarter. Our portfolio registered nearly a 15.5% gain for the quarter driven largely by a bounce back from the Baby Bells, solid first quarter earnings for electric and gas utilities, and an expanded pool of constituent investors attracted by high dividend income taxable at the newly reduced tax rate of 15%. The Baby Bells and our rural telecom holdings provided the strongest performance for the quarter, followed by several gas utilities – some with exposure to natural gas production, others spurred by progress in resolving lingering doubts about their former unregulated businesses, and credit issues. Too, we further diversified our portfolio this quarter by adding more pure-play natural gas producers who provide the essential raw material for the generation of electricity in 95% of all new power plants being built in the United States.

It appears the beneficial change in dividend taxation has tipped market sentiment back in favor of this high yielding, traditionally conservative sector. Our mid-cap utilities didn't receive as much of a pop following the President's signing of the Tax Bill as did the large-cap, familiar names of the DJU Index. Nevertheless, the mid-cap utilities that comprise our portfolio are poised to continue their steady-eddy earnings recovery accompanied by regular dividend increases – *and* are likely to receive additional favorable attention with the repeal of legislation that has been an obstacle to M&A activity since 1935 – the Public Utility Holding Company Act. With the repeal of PUHCA seemingly imminent, and an increase in merger activity almost sure to follow, we are looking for transaction announcements to raise valuation benchmarks to their historic norms across the mid-cap utilities universe, and quite possibly to inspire a modest premium to historic norms for

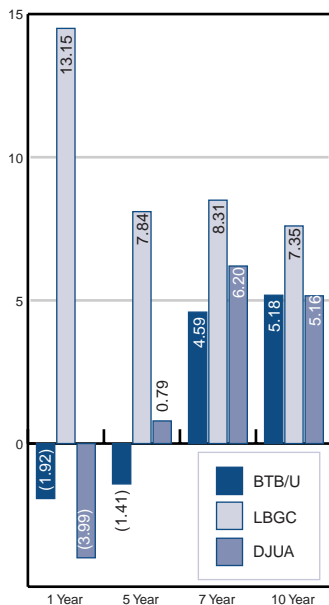
"With the repeal of PUHCA seemingly imminent...we are looking for transaction announcements to raise valuation benchmarks to their historic norms across the mid-cap utilities universe..."

those utilities that exhibit particular attractiveness as takeover candidates. While this strategy is not managed with takeovers specifically in mind (See our Distribution/ Emerging Utilities discussion) and we expect market sentiment alone will lift valuations to historic norms in time, we do include companies in our portfolio that should benefit from renewed M&A activity, with several highly likely to become acquisition targets.

PORTFOLIO HIGHLIGHTS

The Baby Bells turned in star performances this quarter in response to better-than-expected quarterly results, low valuations and historically high, secure dividend yields, such that SBC, BellSouth and Verizon were up 27.4%, 22.9%, and 11.6% respectively. Indeed, early pessimistic assumptions about the FCC's decision to uphold UNE-P (continued, discounted piggy-backing rights for competing long-distance carriers) seem to have been overblown, and overlooked the possibility that states would offer the Bells the rate relief that the FCC was unwilling to grant. Further, the rural wireline and wireless companies CenturyTel (+26.3), Telephone & Data Systems (+21.5%), and ALLTEL (+7.8%) also found favor this quarter following earnings reports indicating stronger wireless growth and increased operational revenues (TDS), and increased revenue and income from high-speed internet services and credit affirmations (CTL and AT). Seeing this rally as an opportunity to trim our weight in the sector, and mindful of the structural uncertainty and challenges that remain for the urban-centric telecom majors, we reduced our weight in the Baby Bells, and further diversified the portfolio by adding three small positions of pure-play natural gas producers that are highly leveraged to natural gas prices.

Building on last quarter's new gas position of Burlington Resources (+13.3%), we decided to take small positions in EOG Resources, Devon Energy, and Anadarko Petroleum.



Quarter Composite Net of Fees*

BTB/Util (Preliminary)	15.40%
DJUA (total return)	21.86%
LBGC	3.52%
Avg Util Fund	16.70%

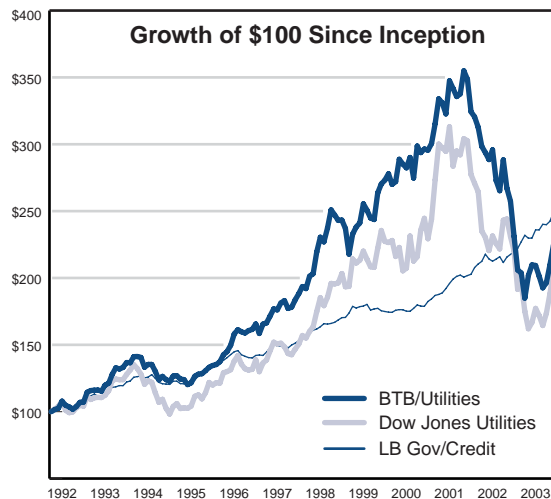
12 Month Composite Net of Fees*

BTB/Util (Preliminary)	(1.92)%
DJUA (total return)	(3.99)%
LBGC	13.15%
Avg Util Fund	1.56%

10 Year Composite Net of Fees*

BTB/Util (Preliminary)	5.18%
DJUA (total return)	5.16%
LBGC	7.35%
Avg Util Fund	5.87%

*See Performance Disclosure on page 3.



These companies' reserves and production are heavily weighted toward natural gas, are geographically strategic (domestic, North America), with lots of acreage for organic production increases, reserve replacement, and reserve additions. "Blue-bloods" in the industry, EOG Resources and Devon Energy, are among the most conservative vehicles for playing the emerging natural gas paradigm shift (read: tightening supply/demand balance) due to each company's very strong balance sheet, efficient, low cost production, and managements who have proven themselves to be some of the shrewdest in the industry. Anadarko Petroleum, on the other hand, has the largest reserves of any American independent E&P company, yet its CEO was out of sync with cycles in the E&P industry and unresponsive to investors' management priorities – and so the CEO was recently replaced with the company's former CEO, who is well regarded within the industry for his highly effective, prior stewardship of the company. We view Anadarko as something of a value play with modest downside risk in the near term, yet great long-term potential due principally to the size and geography of its reserves. Given the utility sector's growing dependence on gas producers for their regulated as well as unregulated activities, these E&P companies should help the portfolio's performance during periods when traditional utility earnings could come under

pressure, and further diversifies the strategy within the utility chain of business.

In an opportunistic purchase of our own, we nearly doubled the weight of veteran gas distributor Nicor (GAS) which had been trading at distressed prices due to the overhang of government investigations related to its Illinois performance-based-rate calculations and a tiny partnership with Dynegy that had accounting irregularities and has since been dissolved. GAS happens to be one of the premier natural gas distribution companies, with an extremely conservative business model, and among the strongest balance sheets in North America. Yet, it was trading as though these investigations could conclude in some manner that would propel the company into a liquidity crisis and lead to dividend cuts, etc. Upon Standard & Poor’s affirmation of GAS’ AA credit rating, we increased our weight of GAS by almost 40%, capturing a 6.3% yield in the process. The position is up 35.9% for the quarter, and up 24% since we added weight.

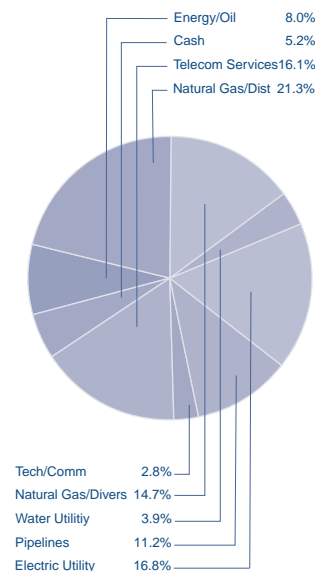
We also added weight to portfolio newcomer Equitable Resources (+8.6%) due to the company’s attractive mix of conservative gas distribution businesses along with exposure to natural gas prices through low-cost production in one of the most profitable gas markets in the country – the Northeast corridor. Too, EQT has a very strong balance sheet, and is likely to boost its dividend in the near term. Speaking of the Midwest, a neighbor of EQT, NiSource Inc.(+4.4%) got some very good news recently when S&P affirmed NiSource’s credit rating and raised its outlook from Negative to Stable. NiSource, a multistate natural gas distributor, got into trouble with credit agencies and investors from overleveraging its balance sheet to purchase a large interstate gas pipeline in Spring 2000, just before market sentiment turned viciously bearish towards leveraged utility and energy companies. Now, having stripped itself of virtually all unregulated businesses, this conservative giant is working

on further paying down debt, improving its credit ratings, and sticking with the basics. With a current yield of nearly 6%, fantastic gas assets reaching from the Gulf coast to the Northeast, and trading at book value, NiSource remains one of our favorite long-term positions.

Other positions of note include DPL Inc (+27.9%), the Dayton, Ohio utility which is midway through its “back to basics” transformation and cleaning up its balance sheet; MDU Resources (+19.95%), an electric and gas distributor in North Dakota with a thriving E&P business bringing exposure to rising oil and natural gas prices; Peoples Energy Corp (+19.9%), a Chicago-based natural gas distributor and power generator that reported strong earnings and remains a possible takeover candidate due to its prime service territory; and Atmos Energy (+16.7%), a Texas-based network of local gas distributors spanning 12 Southeastern states continues to chug along while offering a 4.8% yield.

LOOKING FORWARD

While first quarter earnings were driven by extreme weather that drove higher than average usage of gas and electricity, the second quarter was characterized by very temperate conditions that will likely weigh on utilities core earnings this quarter. With constant rain and cool temps in the Northeast, Midwest, and Southeast, the number of air conditioners humming is surely below normal for this time of year. Despite this disappointing weather and lackluster demand for services from the industrial sector, utilities’ operating environment continues to stabilize, tax reform has rendered their equity more attractive to a larger pool of investors, major regulatory reform in the shape of PUHCA’s repeal is at hand, and companies are funneling resources back into core traditional businesses. Now we’re just waiting for some renewed economic activity... thankful there’s no reason to lose sleep while we wait. □



UTILITIES PORTFOLIO CHARACTERISTICS

Beta*	-0.10
Dividend Payout	50.84%
Sharpe Ratio	0.25
Proj Dividend Growth	3.96%
Treynor Ratio*	-50.12%
Current Yield	3.8%
Annualized STD	20.88%
Market Cap (MDN)	\$4.9 Bil
Price/Book	2.06
Quality (Equity Rating)	B++
P/E Ratio (MDN)	14.70

*Relative to S&P500, 6/30/93 - 6/30/03

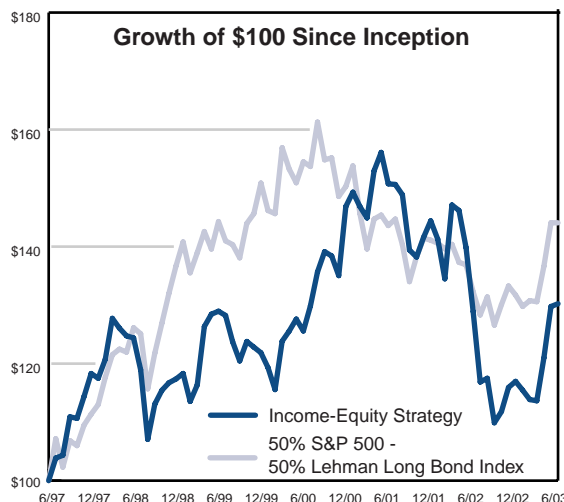
“The recent positive momentum exhibited by our stocks...combined with the intrinsic quality of our positions, augurs well for a continuation of positive returns in all but the most dire future scenarios.”

What a difference three months make! Defensive behavior of our stocks during the first quarter of the year was transformed into an enthusiastic rally resulting in double-digit gains in our portfolio. Our Income-Equity strategy finished the quarter up 14.97% and 12.09% year-to-date, running neck and neck with the more aggressive S&P 500, Treasury benchmarks and most income equity mutual funds (up 9.72% year-to-date and 14.8% for 3 months) as reported by MorningStar.

PORTFOLIO HIGHLIGHTS

The diversified nature of our portfolio, built on a time tested classical value approach to investing, helped us benefit from sector rotation within our universe. MLPs, leaders of the first quarter, were replaced by a mix of issues from a variety of industries, including consumer services/staples, financials, REITs and selected gas distributors. Our best performer for the quarter was, somewhat surprisingly, Donnelly, a pure value play on a commercial services sector recovery. At the right moment, even very conservative stocks can provide excellent returns—like Donnelly’s 43% for the quarter.

Our heavy representation in financial sector holdings proved rewarding yet again, supported by fundamental attractiveness of the regional banking sector, stability of cash flows and renewed takeover activity. US Bancorp, Community Bank Systems, and Union Planters all finished the quarter in the 20% range, bringing valuations closer to intrinsic norms from deeply oversold levels. During the quarter we used the financial sector rally to trim our weight in KeyCorp as it became overextended on technical grounds. Still a takeover candidate, and in need of additional management improvement, KEY is exhibiting modest bottom line enhancement while providing our portfolio with a 4.8% dividend yield.



Insurers were in the spotlight as well. Progress toward resolution of asbestos litigation propelled several names in the sector including St. Paul Companies’ convertible preferred, up 12% for the quarter in addition to its 6.5% annual yield. We are especially intrigued by the convertible’s high sensitivity to the upside pricing in the common, while maintaining notably less sensitivity to the downside. Without getting too technical, we still find St. Paul attractive at a 10% conversion premium and will consider raising portfolio weight should the preferred (or the broad market) pull back from current levels. Early in the quarter we added 7% 11/16/05 Chubb convertible preferred, currently yielding 6.7%. The timing couldn’t have been better as shortly after our purchase, Chubb, up 12% for the quarter, reported an earnings surprise of 24% over the Street estimates. The industry appears to have bottomed out with the worst seemingly behind it, and our holdings should be capable of showing gradual fundamental improvement as well as strong cash flows in the quarters to come.

Our utility holdings enjoyed a quarter of strong performance as well. We trimmed Questar (up 108 % since original purchase) once again in order to make room for new names. Industry fundamentals remain

Quarter Composite Net of Fees*

Income-Equity (Prelim)	14.61%
50% SP500 - 50% LB Long	
Treasury Index	10.19%

12 Month Composite Net of Fees*

Income-Equity (Prelim)	1.07%
50% SP500 - 50% LB Long	
Treasury Index	10.42%

5 Year Composite Net of Fees*

Income-Equity (Prelim)	0.93%
50% SP500 - 50% LB Long	
Treasury Index	4.10%

*See Performance Disclosure on page 12.

exceptionally strong and even at our reduced weight of 2%, Questar can continue adding alpha to portfolio returns without a noticeable yield sacrifice. To replenish our utility exposure, we added Nicor Inc. (GAS), up 18% since early May, a financially strong gas distributor in the process of overcoming a few minor stumbles in the operational area. GAS has a current yield of 5%, solid financial investment grade financial ratings, and takeover appeal. We also added a position in DQE, a reformed plain-vanilla electric utility with dividend yield of over 6%. While DQE is undergoing a makeover, drastically reducing debt and cleaning up past attempted-growth ventures, it should continue to generate above market income for our portfolio even in the absence of deals.

In an effort to complement high income and safety represented by our new utility positions, we added Campbell Soup to our mix. Campbell, yielding 2.5%, recently raised guidance for next year, and should enjoy extended growth momentum going forward. In addition, its current valuation at the low range of historical norms makes it an attractive takeover target for potential acquirers in the food sector.

Our REIT holdings performed quite well, with Rouse and Cousins closing the quarter up 10.3% and 8% respectively. In May we gradually reduced and exited our position in CBL & Associates, realizing a gain of over 15%, not counting dividends. We're now taking a cautious stance toward the group generally, and mall REITs in particular, as sector valuations across the board appear to be stretched. We appreciate the appeal of historically uncorrelated real estate as a portfolio diversifier, but at current levels we're concerned that the widely accepted diversification feature may be temporarily losing its attractiveness. We're not ready to completely eliminate our exposure to the group, as we

realize that high dividend flows offered by REITs (albeit not tax favored) may prove to be enticing to bond investors desperately seeking income in the face of impoverished interest rates. Nevertheless, we're satisfied with our selective exposure to publicly traded real estate (6%) and will certainly participate in the sector should we come across a sufficiently liquid and undervalued name.

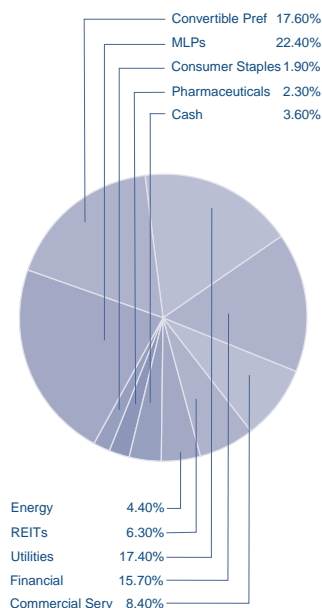
On the sell side, we finally exited our position in Toys'R'Us after the convertible preferred appreciated over 36% for the quarter. We're satisfied with the yield we collected along the way and feel that the run was a bit too vigorous for our taste in a turnaround play, especially in the face of heavy "Walmartization" of the toy industry.

Master Limited Partnerships, leaders of the first quarter, finished up 6% on average. Increased short-term volatility was primarily caused by the asset rotation out of MLPs shortly after the passage of the Tax Bill. As we pointed out in previous reports, MLPs pay distributions from pre-tax cash flow and thus are not eligible for dividend tax reduction. Still, one will be hard pressed to find equivalent quality recurring-revenue businesses with solid cash flows and moderate growth in any other sector. Too, for the taxable investor these stocks are even more advantaged than straight dividends on a current-tax basis.

LOOKING FORWARD

The world is laden with bearish economic and sentiment indicators hardly supportive of the recent run up in the broad market, yet we can still grant that the market has often been a better predictor of the future than pundits and economists. The recent positive momentum exhibited by our stocks—both fundamentally

continued on page 12...



INCOME-EQUITY STRATEGY FUNDAMENTAL CHARACTERISTICS

Yield	6.0%
Proj Div Gro	3.9%
Payout Ratio	50.0%
Market Cap (MDN)	\$7.6 Bil
Price/Book	2.3
Beta*	0.59
STD	15.99%
P/E Ratio**(MDN)	14.7%
Quality (Equity Rating)	B++

*Relative to S&P 500,
6/30/98 - 6/30/03

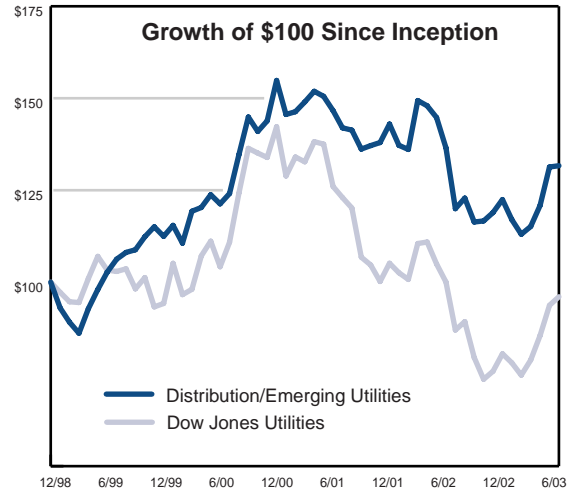
**REITs use P/FFO ratio

“Indeed the risk in an equity strategy couldn’t be much lower than for this portfolio of moderate growth, regulated monopoly local distribution companies.”

While we were waiting for the Energy Bill to work its way through Congress, we had a very nice quarter on the back of a strong market for utilities generally, and renewed interest in dividend-paying stocks now that the top tax rate on common dividends is only 15%.

Slowly, slowly, slowly, energy legislation—which includes repeal of the Public Utility Holding Company Act as a more or less undisputed given in both House and Senate versions—is working its way toward a final vote. The status (remember that we expect a repeal of PUHCA to inspire a renewed surge of M&A activity in the utilities sector) of this all-important legislation is as follows:

The House of Representatives passed their Energy Omnibus Bill, HR.6, on April 11, 2003, including a provision repealing PUHCA, which now awaits passage of a corresponding Senate energy bill for reconciliation later this summer in conference committee. Senator Pete Domenici (R-NM), Chairman of the Energy and Natural Resources Committee has been working closely with his fellow New Mexican, Energy and Natural Resources Committee ranking member Senator Jeff Bingaman (D-NM) to winnow the number of largely Democratic-proposed amendments to the Senate Energy Bill (S. 14) in an effort to vote out a bill before the Senate summer recess begins August 2nd. The Republican leadership’s goal is to debate this bill for approximately 10 days in late July, pass the bill before August 2nd, and have a reconciled energy bill on the President’s desk for signature this Fall. Senator Domenici has even threatened holding the Senate in session beyond August 2nd (cutting into Senators’ vacation/politicking time) should Senators who oppose the measure attempt to sabotage its passage through spurious



amendment proposals. As of this writing, there are approximately 391 amendments proposed (mostly by Democratic Senators and maverick/Northeastern Republicans) representing a myriad of issues. By all accounts, most of these amendments will be dropped by their sponsors, or harmlessly incorporated in the final bill, with only a few substantial issues remaining for debate, including: Standard Market Design (FERC’s proposed overhaul of electric grid rules and transmission ownership), CAFE standards (Corporate Average Fuel Economy), Climate Change, Renewable Portfolio Standard (mandating % government consumption of electricity from renewable sources), and whether to grant FERC additional authority to oversee increased M&A activity spurred by the repeal of PUHCA.

PORTFOLIO HIGHLIGHTS

Back in the real world of operating companies and quarterly profits, our companies have been impeccable. Nearly every one reported an increase in earnings over last year, and all have maintained or increased their dividends since we purchased them (we do have a few dividend reducers, but we bought them after

Quarter Composite Net of Fees*

Distribution (Prelim)	14.63%
DJUA (total return)	21.86%

12 Month Composite Net of Fees*

Distribution (Prelim)	(3.76)%
DJUA (total return)	(3.99)%

3 Year Composite Net of Fees*

Distribution (Prelim)	2.70%
DJUA (total return)	(2.67)%

*See Performance Disclosure on page 12.

the cuts). These are fine results for any group of stocks, especially in a broader world of flat or declining revenues, and display one of the features we really like about the portfolio—even in the absence of takeovers it's still a good quality, high yield, tax-favored, low-volatility equity portfolio that most investors would be happy to own. The added feature that all of our stocks are clear acquisition candidates adds the second “win” to a win-win strategy. We're looking for high alpha to return to this portfolio, but if it doesn't we're not undertaking what is normally the dark side of high alpha: high risk. Indeed the risk in an equity strategy couldn't be much lower than for this portfolio of moderate growth, regulated monopoly local distribution companies.

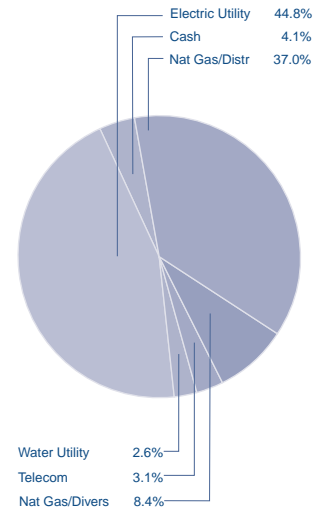
Each and every stock rose in price, a most unusual circumstance. The best performers last quarter were those with minor issues on the way to resolution. We've spoken before about Nicor (GAS), a financially very strong company that had a few operational problems and a brush with Dynegy in a small joint venture in the past couple of years. In fact, though, this is one of the strongest utilities in North America from a business standpoint, with a fine service territory in addition to generally conservative management. This quarter investors became satisfied that the past is the past, and stepped up to buy, carrying the stock up over 30%. Nevertheless, we think GAS could bring 30-50% more in a transaction. Constellation Energy Group rose with the larger-cap electric sector and a renewal of investor confidence. PPL, a prime merger candidate, rose over 20%. Peoples Energy, in a contiguous territory to GAS, rose 20% on the heels of a solid earnings report. Southwest Gas, in a way the most obvious takeover candidate since there have

already been two offers for the company at prices some 50% higher than current quotes, brought up the rear of the portfolio, with a 3.6% gain.

We added Xcel Energy, a company we had dropped early in the first quarter when its liability for former subsidiary NRG Energy had become unclear. As soon as that risk disappeared from the picture we re-entered the stock in time for a double-digit gain. The company still sells at near book value, however, and with a strategically valuable territory, should be among the first post-PUHCA romantic objects. We also added Southern Union at the end of the quarter, after they had completed buying the pipeline operations and LNG terminals of CMS Energy, at what we thought was a great price. SUG is a bit more aggressive and acquisitive than most companies we own, but we think pipelines are going to be in demand by large buyers going forward. At 1.6 times book, its pipelines and local distribution companies are intriguingly cheap assets with high cash flow.

LOOKING FORWARD

We've grown old waiting for the repeal of PUHCA, weary, with white beards and stooped backs. But one day we'll be dancing, with arms high and skin glistening, as the businesses we own become free, free in that most American of freedoms, free to sell themselves to the highest bidder. Increasingly it looks like that day will come soon, if not this quarter then by the middle of the fourth quarter. We continue to make weight and name adjustments in our portfolio as the stocks rise and fall, hoping to push as perfect a group as possible into the starting gate. □



FUNDAMENTAL CHARACTERISTICS

Yield	4.1%
Proj Div Gro	1.1%
Payout Ratio	51.0%
Market Cap (MDN)	\$1.8 Bil
Price/Book	1.6
P/E Ratio (MDN)	13.7
Quality (Equity Rating)	B++
Beta*	0.38
STD	15.85%

*Relative to S&P 500, 6/30/00-6/30/03

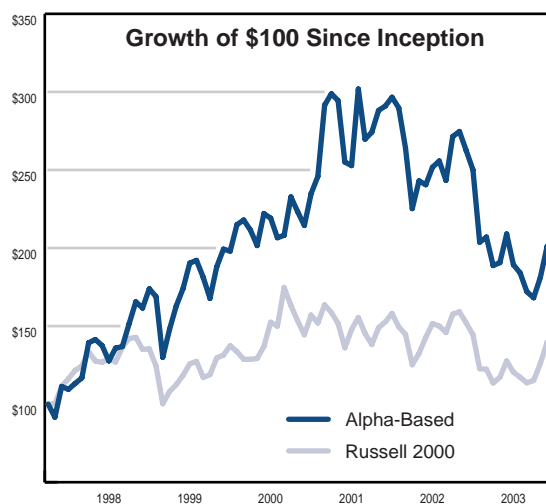
“The result has been a more concentrated and more controllable portfolio, one that can keep up with a historic rally even when less than fully invested.”

Nervous as we were going into the second quarter, we continued to implement our discipline and its evolution as we discussed last time, and we were able to perform in line with one of the best quarters ever for the Russell 2000, as well as outperforming the blended small-cap mutual fund average. We were able to accomplish this with substantial cash - at times as much as 20% - since we kept busy during the quarter taking profits as they appeared. Our approach has been that the world is dicey now, but there are always good absolute and relative values to be uncovered, and this has been the right attitude.

Importantly for a small-cap portfolio, we’ve avoided the “torpedoes” that have sometimes dented otherwise good portfolio periods by 1) focusing on stocks with insider buying, 2) taking profits when they appear, 3) limiting losses using technical tools, 4) substantially overweighting our best ideas for temporary periods and, 5) emphasizing recent good news in new purchases. The result has been a more concentrated and more controllable portfolio, one that can keep up with a historic rally even when less than fully invested. So we’re pleased not only with our returns this quarter (though acknowledging that a considerable portion are due to the whims of Mr. Market), but also with the development of our process. While the market is doubtless characterized by a set of eternal verities, it is also always changing and unfolding—successful portfolio management needs to harmonize with this changing and unfolding aspect of things.

PORTFOLIO HIGHLIGHTS

As always, this portfolio was busy. We took a heavy weight in SurModics in anticipation of the approval of Johnson and Johnson’s new drug-eluting stent for which SRDX makes the



coating material. In fact the approval drove the stock about 25% higher, where we sold half of our position, and shortly thereafter sold the remainder. We added Serono, one of the few undervalued biotech stocks in the world. They have a stable business in the fertility area, and a rapidly growing presence in Multiple Sclerosis. We bought on news of better than expected growth in their MS drug as well as superior performance in head-to-head trials against competitor Biogen. SRA has also filed for EU approval of Raptiva, the Genentech/Xoma biologic drug for severe psoriasis, a biotech story we have followed closely for many years. When our holding Curative Health sold off without reason (in our view) in May, we doubled our position ahead of a roughly 30% move up. We sold Closure Medical, which we’d bought in February on good news and insider activity, at twice the price of our purchase, within a half point of the all-time high—which has not been seen since. We bought CryoLife, a major player in human tissue supply that had run into operational (but not financial) difficulties in 2002 on signs of a return to business as usual—which in this case means high growth and dominant market share in a rapidly growing arena. We added more as

Quarter Composite Net of Fees*

Alpha-Based (Prelim)	21.18%
Russell 2000	23.42%

12 Month Composite Net of Fees*

Alpha-Based (Prelim)	(18.54)%
Russell 2000	(1.64)%

5 Year Composite Net of Fees*

Alpha-Based (Prelim)	3.20%
Russell 2000	0.97%

*See Disclosure on page 11

the quarter progressed, netting an unrealized gain of about 30% in what is now one of our heavy weights.

Also heavily weighted is portfolio addition Chesapeake. This is one of the more leveraged plays on natural gas in the market, and it has seen more insider buying than any stock we have ever followed. If it doesn't work out, at least we know the suits will be going down with us! We also added Zoran, maker of semiconductors and software for the DVD market, at an unusual moment of modest valuation (most tech stocks are beyond our value parameters).

A number of our existing holdings had the kind of mighty growth that comes only during a broad-based speculative market rally. Merge Technologies—whose weight we just recently reduced in a profit-taking move—nearly doubled. Their digital image sharing and storage systems for medical records have met with surprisingly strong demand. Mikohn Gaming rose 80% after some months of investor apathy regarding new management initiatives. Lightly weighted Hologic, with a new generation digital mammography system, rose on renewed optimism after a wretched first quarter. We've had to tolerate considerable controversy over Take-Two Interactive, but after a 27% quarter the stock now sits at nearly triple our first purchase in 2001.

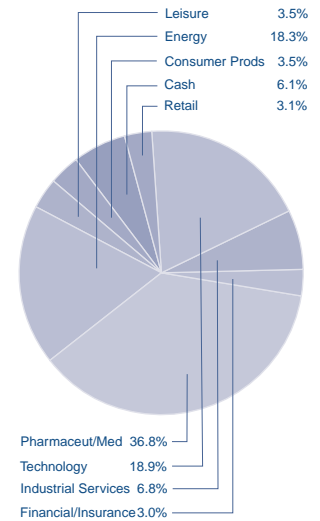
There wasn't much downside this time, though Prime Medical fell 36% after a poor earnings report. We added to our position in Headwaters after a sell-off related to a delay in IRS certification of Synfuel credits pursuant to Section 29 of the code. Shortly thereafter, it became clear that the IRS had launched a broader investigation into whether some companies may not be following the guidelines for credits. We don't believe that HDWR is in

the problem camp, but we may reduce our weight pending the outcome. We finally came to believe that no matter how badly Playtex desired to sell itself—and announce that fact publicly—there were no interested buyers out there. Meanwhile the basic business was not doing well, so we sold it at a loss. We also sold Electronics Boutique at a loss, as investors began selling the stock out of concern that the monster's shadow belongs to Wal-Mart.

LOOKING FORWARD

Looking forward, we're keeping the same approach. Because we're nervous about the overall environment, emphasizing a relatively limited number of high-weights forces us into our most impeccable selections. We think we can still find enough interesting stocks in this environment, but we are on guard against a relapse in the economy or the equity markets. Longer-term, there are some terrific small stocks that will rise greatly if their earnings projections become reality, if their stories come true, as it were. Shorter term, there are natural profit-taking risks in the market as well as macro-issues (discussed in the Overview) which may moderate progress in the next few months. □

Disclosure: 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 6/30/03 was 40, which represents 92% 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.



FUNDAMENTAL CHARACTERISTICS

Forward P/E Ratio (MDN)	12.75
Market Cap (MDN)	\$413 Mil
Price/Book	2.8
LT Growth Rate	20.98
Beta*	1.07
R-SQR*	0.52
Annualized STD	29.67%
Annualized Alpha*	7.56%

*Relative to S&P500,
6/30/98 - 6/30/03

continued from page 7

and technically—combined with the intrinsic quality of our positions, augurs well for a continuation of positive returns in all but the most dire future scenarios. Income-Equity is uniquely positioned to deliver consistent returns in most environments, since most of the companies are recurring-revenue type businesses with little or no pricing pressures. Should the economy soften, rates will remain low or lower, and our yields should prove extremely compelling to a broad constituency of investors. It is often said that money goes where it is treated best, and we think a 15% top tax rate sends an audible message to both investor-owned corporations and the investors who own them. □

Disclosure:

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 6/30/03 was 155, which represents 85% of total assets managed in this strategy with a measure of dispersion of 0.86. 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 6/30/03 was 39, which represents 90% of total assets managed in this strategy with a measure of dispersion of .30. Inception of the Distribution composite was December of 1998.

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