

MARKET OVERVIEW

THE STRATEGIES

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.

BETTER THAN BONDS / UTILITIES

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

DISTRIBUTION / EMERGING UTILITIES

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

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.

Momentum from the second quarter carried through the summer and into mid-September, though the major indices finished with only modest gains. Small stocks were superior, but the quality here left much to be desired. Indeed, over the past twelve months stock returns have been exactly inverse to both size and quality. There were some awesome performers in the third quarter—if you favor stocks with high short positions and stocks with no earnings. This does not strike us as ideal from the standpoint of a long-term investor, and, despite the renewed march of the bullish Wall Street publicity machine, various gaps we've noted in the underlying background continue to argue for a cautious stance in the face of generally positive price action.

One percent interest rates rise up in our minds like an ominous wagging finger. Many commentators have pointed to low interest rates as a positive in the picture, but when short rates are lower than has been seen by any investor alive, it's time to wonder why. Clearly the Fed is protecting the banking system, and doing its best to encourage some inflation (hasn't it been the Fed's job to fight against inflation these many generations?), and attempting to make investment irresistibly attractive compared to earning interest (a rally certainly did follow). But the simple economic statement here is that when something is cheap there are more sellers than buyers. Demand for money must be weak, if lenders are forced to receive so little for its rental. No matter what the numbers say about "growth" and "recovery," the economy can't be seen as "strong" at least up to this point.

Maybe low rates will work. When money's not needed in the real economy it turns to assets; so far it's clear that low rates and a liquidity fountain have had their intended effect in creating equity asset inflation—acknowledgement of low rates as a supportive market factor is in order. But do we really want another asset bubble without a real economy underneath it?

The ten key points we've been covering since spring of 2002 still have traction, we think, and we review them as follows:

- 1) *The Fed*: No one is talking about deflation any more (except the Fed itself). Actually, we don't know why anyone who drives a car, pays real estate taxes, gets a haircut, has kids in private school or college, buys a book, shops in a supermarket, or eats in a restaurant, would ever talk about deflation.
- 2) *Investor confidence in corporate governance*: Just when it looked like Fannie Mae and Freddie Mac were going to mark the end of the scandals, up rises The New York Stock Exchange and the newly revealed Hedge Fund/Mutual Fund Connection. But this factor doesn't appear to stop buyers

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“Indeed, where economists are predicting 6% growth for the fourth quarter, CEO surveys suggest more like 2% growth. Who you gonna’ believe, economists or CEOs who aren’t buying their own stocks?”

SELECTED INDICES		
	3 rd Qtr’03	12 Mo
S&P 500	2.64	24.39
Equity Inc	2.15	20.35
Util Fund	(0.99)	21.54
DJUA	0.84	21.81
LB Treas	(2.68)	3.66
LBGC	(0.50)	6.51
S&P 400	6.59	26.83
Value Line	6.55	30.26
Rus 2000	9.08	36.50

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

- anymore. Presumably, the new view is that corruption just comes with the territory.
- 3) *Sentiment measures*: Newsletter and poll sentiment indicators simply have not worked in 2003. Taking a position contrary to newsletters and individuals is time-honored and not, we think, an approach to abandon lightly. As we noted last time, if an indicator was always right we’d have all the money. Right now, these are still suggesting a down market, though they’ve been wrong for months.
 - 4) *Short-term options activity*: We noted last time that our proprietary put/call open interest indicator had become quite bullish, and that these figures suggested there was enough skepticism to keep the rally going (as it turns out, the pros were talking bullish but hedging with options). As we write, open interest figures for the large-cap indices have deteriorated noticeably (S&P 500 and 100, Dow Jones Industrials), while small cap and Nasdaq 100 open interest remains as bullish as it was. We suspect that the latter will follow the larger segments down, but an objective snapshot as of this minute suggests continued outperformance by small cap and technology stocks.
 - 5) *Valuations*: You have to believe in a long-term trouble-free recovery to be comfortable with today’s valuations. Energy stocks appear undervalued to us, as do utilities on the assumption of incipient catalysts in the near future. Otherwise, even the biggest improvers of the breed max out at “fair value” nowadays. In an asset bubble, which the fed seems willing to create in the absence of having any impact on the real economy, of course, valuation doesn’t mean anything—for several quarters.
 - 6) *The dollar*: We’ve suggested a weak dollar for 6 quarters now, and any further slippage would probably be a negative for stocks. It hasn’t stymied foreign investment so far, but at some point foreign lenders may tire of losing more in currency translation than they earn on their bonds, thus forcing interest rates higher.
 - 7) *The macro-environment*: The longer we go without a terrorist attack, the more investors will believe that things are back to “normal,” though the last attack was nothing if not a surprise. Now confidence in the Bush administration is fading. Generally, low confidence in the Administration translates into difficult markets.
 - 8) *Earnings*: Most earnings gains are still the result of cost cutting. Revenue gains are far scarcer. While it’s true that corporations have become extremely lean, auguring well for sharp gains should revenues increase, revenues are still static at best.
 - 9) *The old highs*: Can the bubble return? Last time we said no. But on-line investing seems to be having a revival, with trash stocks being bid up mightily by momentum types goaded on no doubt by visions of bubble-style pricing. Margin debt has suddenly climbed to near record levels. Perhaps this toothpaste is permanently out of the tube.
 - 10) *Corporate insiders have not been buyers*. By now there has been much commentary on this issue, but it has certainly not gotten any better. Indeed, where economists are predicting 6% growth for the fourth quarter, CEO surveys suggest more like 2% growth. Who you gonna’ believe, economists or CEOs who aren’t buying their own stocks?

The overall case for a strong recovery remains dicey, yet we’ve already seen buyers ignore it. They could be right about recovery, but we’ll demur as long as extraordinarily low interest rates and their implication of low demand for money in the real economy remain with us. That said, we will certainly grant there has been enough improvement to suggest that long-term lows in a broad trading range environment were likely made last spring. □

Our Income-Equity portfolio was able to withstand recent market volatility finishing the quarter up 3.12% and 15.45% year-to-date (gross of fees), while delivering returns consistently stronger than the average income equity fund (up 12.00% year-to-date) and the broad market as measured by the S&P 500 index (up 14.72% including dividends). No fixed income benchmark was even close.

People are always asking us “what happens to your strategy when interest rates go up?” The data shows that there is no more correlation to interest rates for our strategy than for any other equity approach. Indeed, in times of sharply rising interest rates it is the growth sector that’s likely to decline more. But in our experience most investors are moved not by data, but by anecdotes. For them, we can say “look at the third quarter of 2003!”

PORTFOLIO HIGHLIGHTS

Diversification played a major role in our success as sector rotation led by a variety of names drove performance. The best performing position this quarter turned out to be our only pure technology play, Motorola 7% 11/16/04 convertible preferred, gaining over 16% in addition to a current annual yield of over 9%. Motorola, propelled by recent reaffirmation of forecasts along with the shift toward a more streamlined business model implemented by new management, is finally finding support in the face of improving trends in handset sales, spending and overall recovery in the semiconductor market fundamentals. We like the fact that we can have the best of all possible worlds: a technology stock when techs are in favor, a large-cap turnaround, and very high reliable

income—all in a single package that diversifies our overall portfolio.

Financials performed quite well, with Community Bank Systems leading the quarter with a 15% gain. While we believe that the valuation continues to be very attractive (still significantly below private market value for a bank) we harvested some of our gains, bringing the position back to original weight mostly due to reduced current yield (a result of appreciation). In July we exited our position in AmSouth with over 30% in capital appreciation alone, since a recently slowing mortgage market represents a substantial portion of its overall pre-tax income. We replaced it with the more promising turn-around UnumProvident 8.25% 5/15/06 convertible preferred. Unum, in our opinion, is an undervalued and attractive recovery story in the process of cleaning house and focusing on profitability.

Our remaining insurance holdings performed as hoped, with Chubb gaining over 6% on stronger than expected earnings and significant margin improvements across multiple segments. St. Paul Companies, our long-time favorite in the property/casualty group, finally started to receive acknowledgement from analysts and press as a grossly undervalued quality name. Impressive income generated by the preferred as well as its close price sensitivity to the underlying common make this holding a model of a perfect income-equity candidate, as the financially strong company begins to put its problems behind it.

Utility holdings had a relatively quiet quarter, most finishing either flat or slightly negative while continuing to generate a solid

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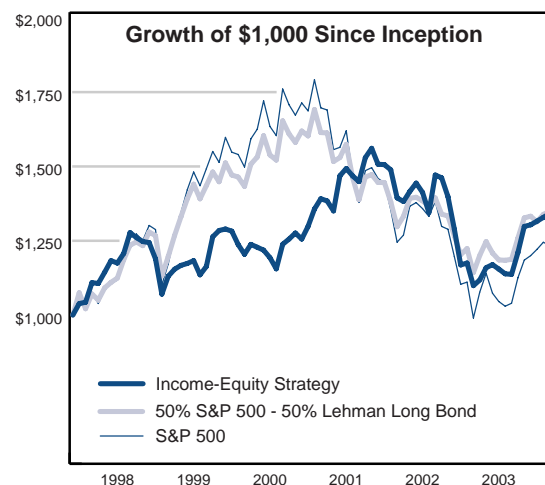
“Intuitively we should be looking for a pause, and yet there are large pockets of our portfolio that remain highly unexploited and have excellent potential in the coming months.”

income stream during the busy dividend months of the summer. Over the course of the quarter, we finally replaced our position in Questar (low current yield due to price appreciation), collecting close to 100% in realized gains, with a higher yielding gas distributor, Oneok 8.5% convertible preferred. Oneok is a solid name in the gas distribution space that continues to be priced at 11x earnings and 1.25x book value and is an obvious acquisition choice in our view. As always, we’ll be happy to hold this one even if no deal arises.

Master Limited Partnerships (MLP) and other energy related issues performed satisfactorily as well, with Enerplus closing the quarter up over 12% (current income yield is 9.8%). The defensive characteristics of pipelines plus strong energy prices and secure rising dividends were a buffer during volatile moments in the markets. In fact 60% of our MLP holdings increased dividends during the last quarter, and high yield stocks that increase their dividends typically show strength on the announcement and beyond. It’s the simple truth of the dividend discount model of stock pricing in action.

Late in the quarter we added British Petroleum to our energy mix. Best in its class, BP provides our portfolio high current income of 4.15% in addition to increasing exposure to pure oil integrated markets with operations in over 100 countries and a recent strategic move to create Russia’s third-largest oil company. Commodity price dependent stocks are inherently more volatile, but BP is vertically integrated and has an emphasis on natural gas.

Several new names this quarter came from the “value” side of the market. We decided to put Worthington Industries back in our portfolio (down 12% since addition) after owning it back in 2002. We originally exited our position in WOR on a suspicious jump in their corporate credit spread—which we



believe can be a powerful indicator of the company’s financial strength/or weakness in the eyes of the credit owners. While the sale was timely and at much higher prices, we continued to monitor developments in the industry (as well as the spreads) and bought the stock back as the spreads narrowed to similarly rated corporate bonds. Since it is a cyclical issue influenced by a number of global factors such as the recovery of the US manufacturing sector, as well as macro-economic conditions affecting world steel supply and pricing, we view WOR more as a long-term play on the eventual comeback of the industry. Granted, recent earnings proved that industrial weakness is still with us, but we think that with time our position will prove to be a strategic diversifier supported by a safe dividend yield of 5% and potential for recovery.

REITs continued their steady rise in spite of seemingly overblown valuations. Rouse, which we trimmed at the end of July, returned over 9%, not counting dividends. We continue to exercise caution when it comes to our real estate holdings since we find it difficult to justify owning any asset priced at far more than its tangible value to a private market buyer. Cousins, our only other REIT holding, finished flat for the quarter but pleasantly surprised us with an extra dividend of \$2.07 per share as

Quarter Composite Net of Fees*

Income-Equity (Prelim)	2.88%
50/50 SP500 & Long Treas	1.26%

12 Month Composite Net of Fees*

Income-Equity (Prelim)	22.02%
50/50 SP500 & Long Treas	18.07%

5 Year Composite Net of Fees*

Income-Equity (Prelim)	3.47%
50/50 SP500 & Long Treas	2.43%

*See Performance Disclosure on page 12.

the result of taxable gains from the sale of four properties, bringing 12-month trailing yield to almost 12%. As we've mentioned in previous reports, we value the importance of real estate exposure in any diversified portfolio, but for the moment we'll continue to maintain our defensive position toward the industry until we're able to find companies that meet our valuation criteria, in addition to growing Net Asset Values and dividends. We make no judgment about current commercial and industrial real estate values in the actual world of buildings that are bought and sold, but the premium attached to REIT equity paper right now makes us want to stand aside.

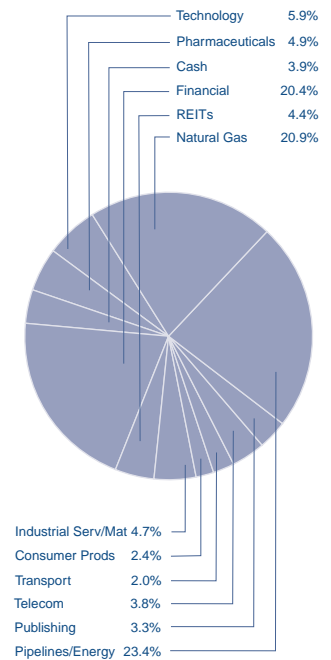
Schering Plough, one of the few losers this quarter (down 18%), proved to be the only disappointing position in the portfolio as the struggling company finally made the decision to drastically reduce its annual dividend. Our main interest in the position was Schering's takeover appeal, arguably still viable, but at this point we think Schering still has a long way to go in order to bring product pipeline back to life. More to the point, this portfolio holds stocks with high current yield, so SGP has become a source of cash for new purchases.

LOOKING FORWARD

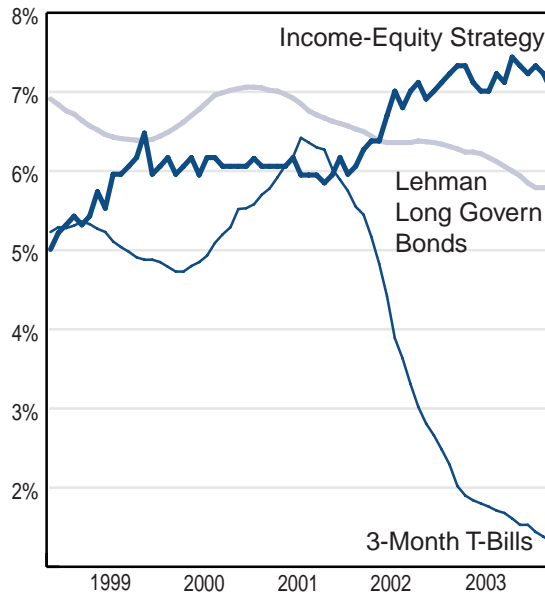
Considering the bearishness with which most pundits introduced 2003 ("single-digit returns as far as the eye can see"), and considering that long-term interest rates have recently risen markedly, and considering we had to run a high income equity portfolio essentially without REITs, the year has been a pleasant surprise so far (and the opening days of the quarter have added to our gains). This portfolio is designed to outperform a balanced strategy (mix of stocks and bonds), but so far we've outperformed a rather strong S&P 500 as well.

Intuitively we should be looking for a pause, and yet there are large pockets of our portfolio that remain highly unexploited and have excellent potential in the coming months. While the financials may have a rougher going if long-term interest rates continue to rise, the energy side of our portfolio—including utilities, pipelines, MLP's, and energy producers, have been much more modest performers. Yet a potentially improving economy and merely a normal winter are all these stocks will need to benefit from increased volumes and increased prices. Too, the passage of an Energy Bill in Congress is likely to open up substantial consolidation among utilities, and we've used private market value (takeover) criteria as a strong factor in the utilities we've included.

So, going forward, we'll continue to make the changes necessary to protect the portfolio from any potential sector weaknesses, and lean toward areas where there are continuing opportunities. □



12-Month Rolling Yield as of September 30, 2003



Income-Equity dividend income data taken from representative accounts.

INCOME-EQUITY STRATEGY FUNDAMENTAL CHARACTERISTICS

Yield	6%
Proj Div Gro	4%
Payout Ratio	59%
Market Cap (MDN)	\$3.7 Bil
Price/Book	2.3
Beta*	.5
STD	13.4%
P/E Ratio**(MDN)	14.7%
Quality (Equity Rating)	B++

**Relative to S&P 500, 9/30/98 - 9/30/03*

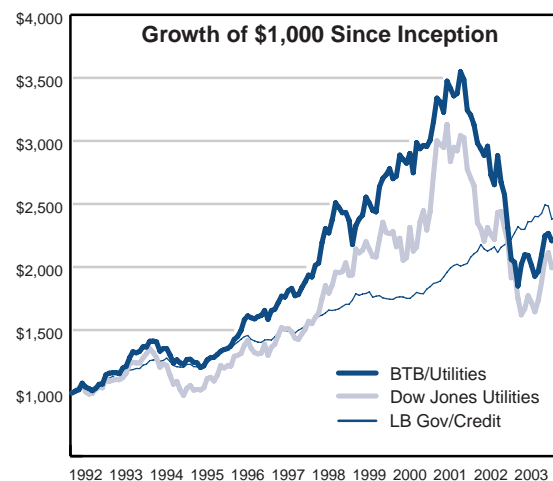
***REITs use P/FFO ratio*

“Unlike much of the market, our stocks are not even close to the high end of historical valuations.”

Investors “played” the hottest – often most troubled – tech names during the third quarter, while utilities and other conservative stocks drifted sideways for the most part, a little up and a little down. But a dull quarter wasn’t at all bad, considering the sharp rise in long-term interest rates. Within our portfolio, traditional gas and electric utilities fared best, along with pipelines and a few utilities well on their way toward achieving their “back to basics” goal. The Baby Bells were our only disappointment this quarter, though we had already reduced them before their recent pull-back to reallocate into new natural gas E&P positions. Thankfully, our new gas stocks fared better than the telecom weights they replaced.

PORTFOLIO HIGHLIGHTS

Record-breaking cold and wet weather in the Eastern half of the country (aka “the summer that wasn’t”) coupled with tepid economic activity resulted in lackluster demand for traditional utility services. Despite the abnormally mild weather, AGL Resources (Atlanta Light & Gas and Virginia Natural Gas) posted our highest returns for the quarter with a gain of 10.73%. AGL’s wholesale natural gas marketing arm (Southstar) and natural gas trading services (Sequent Energy) helped this Southern “wires and pipes” company achieve earnings growth while strengthening its balance sheet. Energy East, a super-regional gas and electric company with service territories sprinkled throughout the northeast, rallied 8.04% for the quarter in anticipation of further earnings improvements from cost savings related to recent acquisitions, resolution of a NY rate case, and the sale of generation assets picked up when it acquired Rochester Gas & Electric (a disposition mandated by NY state). Kinder Morgan Energy Partners, the nation’s largest



Master Limited Partnership operating pipelines that transport petroleum products, processing centers and storage facilities, raised its quarterly distribution again, and gained 8.3% for the period. Our “back to basics” utilities NiSource and DPL – which, in our estimation sit in the sweet-spot for future M&A activity among local distribution companies (see Distribution/Emerging Utilities for more discussion) – rose 5.16% and 7.59% respectively, while DPL’s credit rating was affirmed and NiSource’s outlook was raised to stable. While traditionally we’ve always viewed dividend cuts as warning signs of problems to come, times have changed in the utility world, such that, in our view, recent dividend reductions at NiSource and IdaCorp are positive signs that lingering credit and liquidity issues have finally been put to rest. Both companies have rallied off these trims.

Speaking of dividends this quarter, gas distributor and production company, Equitable Resources raised its dividend by 50%; Questar raised its dividend by 11%; MDU Resources raised its dividend by 6% and declared a 3-2 stock split; and Philadelphia Suburban raised its dividend payment 7% along with a 25% stock dividend.

Quarter Composite Net of Fees*

BTB/Util (Preliminary)	(0.91)%
DJUA (total return)	0.84%
LBGC	(0.50)%
Util Fund	(0.99)%

12 Month Composite Net of Fees*

BTB/Util (Preliminary)	21.5%
DJUA (total return)	21.8%
LBGC	6.5%
Util Fund	21.5%

10 Year Composite Net of Fees*

BTB/Util (Preliminary)	4.8%
DJUA (total return)	4.9%
LBGC	6.9%
Util Fund	4.7%

*See Performance Disclosure on page 12.

We trimmed several positions that had appreciated considerably (KMP, Questar, KeySpan) to make way for new candidates: Consolidated Edison (bought it on a dip for its high, secure dividend), Southern Union (a growing, multi-state natural gas pipeline company which recently acquired a premier LNG terminal and pipeline complex in Louisiana), and Oneok (a dominant mid-western gas distributor with the largest gas marketing operation out of the Rockies). We also added weight to two steady-eddy utilities (Vectren and Cinergy) that offer high yields, strong balance sheets, good earnings and dividend growth potential, and look like potential takeover targets should consolidation materialize in the mid-west. Further, we sold Telephone & Data Systems after it appreciated 36+% from where we doubled our weight in March 2003.

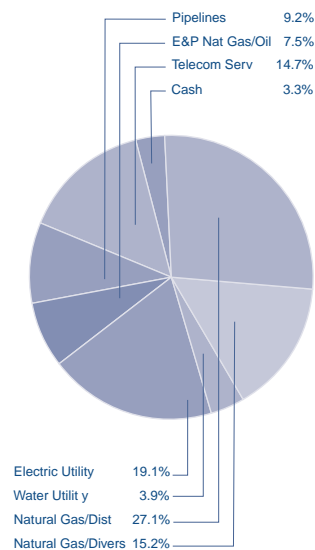
The quarter was notable for the continued strength of natural gas prices relative to historic norms – though prices have steadily declined from spring highs as mild summer weather allowed for rapid replenishment of winter gas supplies. Interestingly, even with significant demand destruction among industrial consumers unwilling (or unable) to pay high prices, near record pace setting drilling, and extremely cooperative weather (including an active hurricane season that hasn't significantly interrupted production in the Gulf of Mexico), winter gas storage levels are only projected to hit the 5-year average before the traditional withdrawal season commences. Still, with a gas "crisis" out of the headlines, and the short-term supply picture less threatening than earlier projected, our pure play E&P gas stocks have fluttered downward with the volatile commodity outlook. Nevertheless, with a colder-than-normal winter forecast and additional natural gas powered electricity plants coming on line, our view of an ever tightening supply/demand

balance for natural gas remains firm. Too, these companies are printing money even at present prices, while the universe of gas production companies are being valued at future cash flow multiples using projected "normalized" gas prices significantly below current levels (\$3.50-\$3.70 vs. \$4.40-\$5.00) ... levels that we believe will represent the potential lows of the future trading range, not the norm.

The Baby Bells again produced disappointing results, though with less of an impact on the portfolio since we significantly lowered our exposure here. Despite the pressure they're feeling from weak demand for traditional local service and rising employee costs, the dividends are well covered and continue to rise – indeed, SBC continued its practice this year of offering a "special dividend" of \$0.10 in addition to a declared dividend of \$0.2825. Also, with recently announced price cuts to DSL services, we're optimistic that the Bells can grow their broadband internet business at the expense of cable.

LOOKING FORWARD

With the winter season upon us and credible forecasts for colder than normal temperatures ahead, our utilities are poised to benefit from selling their traditional services (gas and electric for heat). Additionally, those utilities with gas production operations should benefit from firm(er) commodity prices flowing from increased demand. Furthermore, should the economy begin to finally pick up, or an Energy Bill pass that includes the repeal of the Public Utility Holding Company Act of 1935 (see our Distribution discussion), we believe a rise in earnings as well as an expansion of valuation multiples will follow. Unlike much of the market, our stocks are not even close to the high end of historical valuations. □



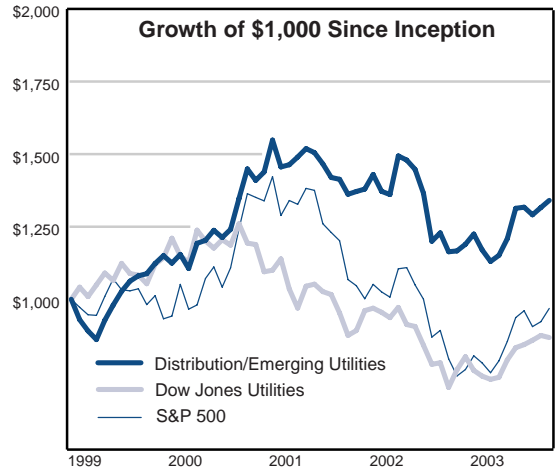
UTILITIES PORTFOLIO CHARACTERISTICS

Beta*	.6
Dividend Payout	51%
Proj Dividend Growth	4.4%
Current Yield	4%
Annualized STD	13.73%
Market Cap (MDN)	\$4.8 Bil
Price/Book	1.9
Quality (Equity Rating)	B++
P/E Ratio (MDN)	13.9

*Relative to S&P500, 9/30/93 - 9/30/03

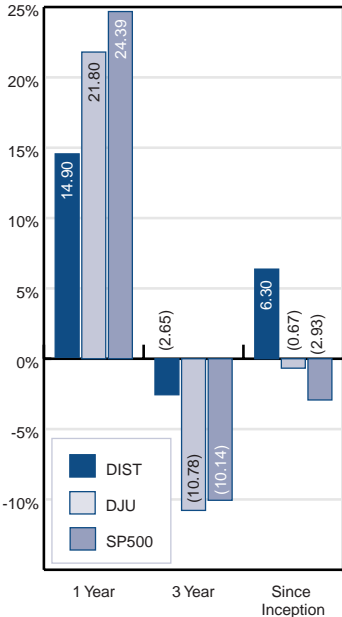
Our quiet and conservative Distribution strategy stocks outperformed the utility indices this quarter, adding to a nice year of steady returns. Unusually cold, wet weather east of the Mississippi put a damper on demand for utility services generally this quarter, further compounded by the Blackout of 2003 and Hurricane Isabel, so it wasn't as though conditions were booming. Conversely the heat has been rising in Washington, D.C., as legislators wrestle over contentious provisions of a soon-to-be finalized Energy Bill conference report, with the goal of getting a final bill to the President's desk by Thanksgiving. We're pleased to report that the long awaited repeal of the Public Utility Holding Company Act of 1935 (PUHCA) appears likely to be part of any final legislation. Too, with the majority of our portfolio holdings trading at substantial discounts to historical valuations and even deeper discounts to the private takeover valuations we've observed over the years, this portfolio remains ripe for transactions.

The Blackout of 2003 reminded everyone that utilities provide a service we'd rather not do without. What was also highlighted is that it has become quite difficult for utilities to build and invest in new facilities (transmission and distribution lines in particular), which has arguably resulted in an antiquated grid, vulnerable to failure: *First*, NIMBY ... nobody wants these electro-magnetic radiating facilities in their backyard; *Second*, siting new facilities is extremely difficult due to no single agency having multi-jurisdictional and eminent domain authority; *Third*, public utility commissions can "jerk around" utilities when it comes time to recover costs from infrastructure investments; *Fourth*, given the aforementioned hurdles, the allowed rate of return for transmission investment has been inadequate to attract



capital; and *Fifth*, the path of least resistance – PR and financial – lies elsewhere. The Blackout also prompted a call from nearly 50 million Americans for improvements in the reliability of our electricity grid. Conveniently, an Energy Bill was already pending in Congress.

The Energy Bill, which became the lead story once power was restored, is in conference committee as of this writing – which means the leadership of the House and Senate (both Republicans) are drafting a compromise “report” representing the varied components of the energy bills that were passed earlier by the House and Senate. The process, however, has been widely criticized by Republicans as well as Democrats for being conducted in a secretive, non-participatory manner, and is suspected of leaving out provisions that contributed to its passage in the Senate (such as a requirement that 10% of the nation’s power come from non-hydro renewable power sources by 2020 – known as the “Renewable Portfolio Standard”), while including the most controversial elements introduced through the House (drilling for oil in the Arctic National Wildlife Refuge – ANWR). Congressman Billy Tauzin (R-Louisiana), representing the House, and Senator Pete Domenici (R-New Mexico) representing the



Quarter Composite Net of Fees*

Distribution (Prelim)	1.77%
DJUA (total return)	0.84%
S&P 500	2.64%

12 Month Composite Net of Fees*

Distribution (Prelim)	14.90%
DJUA (total return)	21.80%
S&P 500	24.39%

Since Inception (Jan 1999)*

Distribution (Prelim)	6.30%
DJUA (total return)	(0.67)%
S&P 500	(2.93)%

*See Performance Disclosure on page 12.

Senate, anticipate concluding the conference report in the third week of October.

The repeal of PUHCA, which is contained in both versions of the energy bills that went to conference committee, will probably be part of the electricity title of the conference report. The electricity title is going to be contentious because many hot button issues that affect the reliability of the electrical grid naturally fall within this title, including: imposition of mandatory reliability standards, organization of the regional grids into larger Regional Transmission Organizations [RTOs], federalization of siting authority along with the power of eminent domain, and incentives for infrastructure investment.

Ultimately, we believe PUHCA's repeal (which already enjoys broad bi-partisan support) will spur consolidation among local distribution companies because: (1) utilities will be able to buy one another, spanning non-contiguous geographic regions and/or state boundaries, with fewer restrictions, (2) restrictions on non-utility activities by utility companies will be reduced, (3) mandated holding company corporate structures will be relaxed, and (4) a less strictly-regulated utility industry will attract more non-utility capital for investment.

PORTFOLIO HIGHLIGHTS

Given the dramatic events impacting the utility landscape this quarter and with several catalysts still brewing (i.e. Blackout 2003, Hurricane Isabel, Energy Bill, likely PUHCA repeal), our portfolio was rather well-mannered.

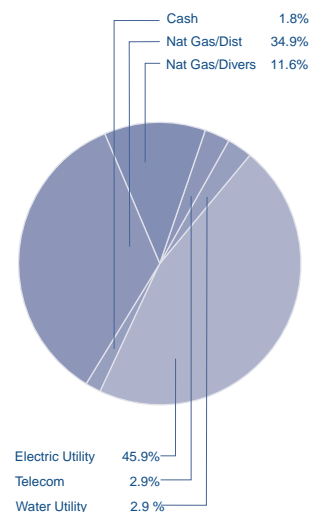
Our best performer this quarter, Alliant Energy, a gas and electric distribution company serving Iowa, Illinois, Minnesota and Wisconsin, gained 15.61% following the issuance of additional equity, the sale of several non-core

assets, and an interim rate increase at one of its subsidiaries ... all of which positions Alliant for a credit upgrade. As a group, our distribution companies with natural gas production and marketing did very well due to high commodity prices, as did companies operating in the soaring temperatures of the Southwest: Energen (+8.65%), Southwest Gas (+7.18%), Sempra (+2.91%), Oneok (+2.75).

We added several new positions that are trading at excellent valuations vis-à-vis our proprietary private market value model, and are located in what we believe to be geographically strategic areas: Westar, an electricity distributor in Kansas; UIL Holdings, an electricity distributor in Connecticut; Wisconsin Electric, an integrated gas and electric utility serving Wisconsin and part of Michigan; and SCANA, the holding company for electric and gas utilities serving South Carolina, North Carolina and Georgia.

LOOKING FORWARD

With valuations in the broad market – tech stocks in particular – having risen to levels where pundits openly wonder if future earnings growth can justify these lofty prices, we're pleased to hold a portfolio of stocks that still trade at low historical valuations and offers a 4% yield with rising income to boot. Indeed, the conservative character of this portfolio offers a nice hedge on the uncertainty that characterizes our economy today, while still positioned for gains. And so, whether it's economic expansion that drives increased earnings, takeover activity following PUHCA's repeal that ignites a revaluation of these mid-cap utilities, or both ... this conservative portfolio seems well-positioned for appreciation in the upcoming quarters. □



FUNDAMENTAL CHARACTERISTICS

Yield	4%
Proj Div Gro	3%
Payout Ratio	61%
Market Cap (MDN)	\$1.8 Bil
Price/Book	1.6
P/E Ratio (MDN)	14
Quality (Equity Rating)	B++
Beta*	0.3
STD	15.3%

*Relative to S&P 500, 1/31/99-9/30/03

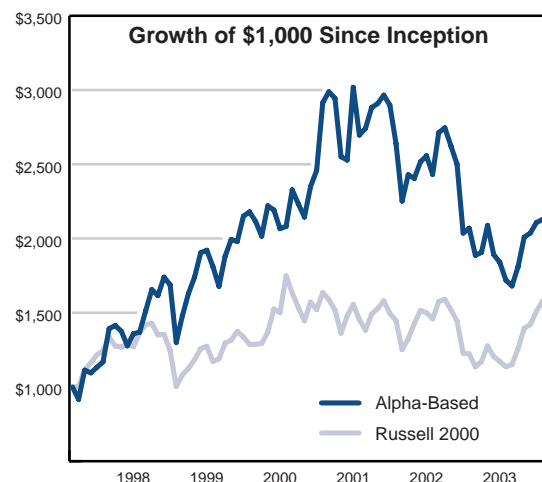
"While outperforming an index in any rally is important to us, we believe that the ability to stay with a discipline in moments of dubious investor fascination with former high flyers of the market will better serve investors in the long run."

Our Alpha-based portfolio finished the quarter up 6.31% and 16.51% year-to-date (gross of fees). It was tough to match the Russell 2000 this quarter as former bubble stocks rallied relentlessly. As in the bubble, investors seemed unconcerned that the companies have current losses and, for the most part, no improvement in revenues. We remain content with the overall composition of our portfolio as well as the consistency of our returns. Our discipline, having undergone fine tuning during the last several quarters, continues to generate satisfactory returns with holdings that maintain the classic reasonably-priced growth profile we seek.

PORTFOLIO HIGHLIGHTS

The monstrous (in both sense of the word) rally in speculative names, primarily in technology "ideas" led the small cap universe upward. While crowd fascination with the former stars of the market is puzzling to us, we had a few standouts of our own, but in our case fully supported by outstanding fundamentals in addition to good price momentum.

Top performers this quarter came from various industry groups and sectors, as we witnessed substantial appreciation in issues as conservative as Sovereign Bancorp, in the portfolio for its ever appealing takeover profile, up over 18%, to Orbital Sciences up 27%, a manufacturer of small space systems for commercial and defense purposes. Subsequently, our best performing stock turned out to be Helen of Troy, designer and manufacturer of beauty supplies. Up over 60% since the end of last quarter, HELE was propelled by excellent earnings, increased guidance and strategic acquisitions liable to



broaden already significant market presence. After gradually trimming our position, since we believe at the current level the stock has limited upside potential, we sold completely at the very end of the quarter—just in time to avoid an abrupt interim price drop.

Our retailers performed well, with Mothers Work, a specialty maternity retailer, finishing the quarter up 11%. One of the cheapest retailers in the small cap universe at the time of our purchase, MWRK is a standout in the group still valued at 11x earnings with projected growth in the double digits. Early in the quarter, we added to our selective retail exposure a small weight in Mossimo (up 30%), a Target licensed designer and manufacturer of quality brand casual wear, trading at a PE only half its growth rate, a ratio rarely seen in the group.

Cardiac Science, one of our largest weights as well as a long-term holding, finally received well-deserved recognition (up 58% for the quarter) after signing a multi-year partnership agreement for distribution and development of external defibrillators with GE Medical, in addition to receiving numerous contracts from various organizations around

Quarter Composite Net of Fees*

Alpha-Based (Prelim)	5.78%
Russell 2000	9.08%

12 Month Composite Net of Fees*

Alpha-Based (Prelim)	14.18%
Russell 2000	36.50%

5 Year Composite Net of Fees*

Alpha-Based (Prelim)	7.81%
Russell 2000	7.46%

*See Disclosure on page 11

the country. DFIB, still very much a GARP stock in our opinion, has all the necessary characteristics that would make it an appealing acquisition candidate to larger, better known names specializing in emergency cardiac arrest equipment...like GE Medical.

Merge Technologies, following reduction in weight in the second quarter, continued higher, this time rising an additional 30% in three months as their digital image products found increased demand while generating strong earnings growth. Also in the medical imaging theme, we recently added a position in CTI Molecular Imaging, a supplier of products and services for positron emission tomography (PET) used for detection and treatment of cancer, cardiac disease and neurological disorders. While currently pressured by sluggish hospital spending, CTMI is the leader in its field and in our view a likely turnaround story supported by valuation, recent insider activity, and likely qualification for Medicare reimbursement of PET scans.

CryoLife, a heavily weighted position we discussed last quarter, disappointed—the return to normal operating business environment we'd envisioned is going to take longer than we expected. While, we believe that CRY continues to dominate the human tissue market for cardiovascular and orthopedic transplants, weak gross margins followed by lower than expected revenues in practically all business segments prompted us to stand aside for now.

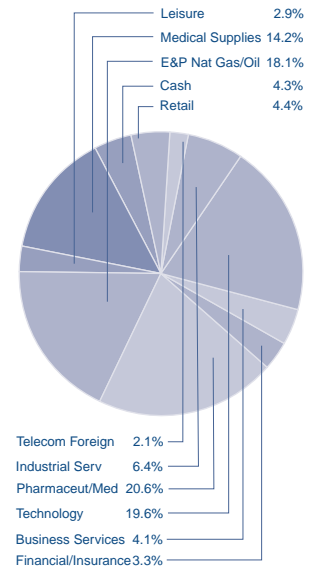
Of our heavyweights, Chesapeake Energy, our play on natural gas pricing, finished the quarter up over 6%, despite a continual softening of prices through the period. There is relentless insider buying in this stock, though, and our confidence level for rising gas prices this heating season is very high. Other

highlights included Rambus, patiently awaiting resolution from the Supreme Court in its quest to collect as much as \$840 million in patent royalties from rival semiconductor makers - which rose 35% on a favorable decision October 6 - and Serono (up 12.5% for the quarter) benefiting from a likely approval by year end of Raptiva, a potential blockbuster drug developed by Xoma and Genentech for treatment of psoriasis.

LOOKING FORWARD

While outperforming an index in any rally is important to us, we believe that the ability to stay with a discipline in moments of dubious investor fascination with former high flyers of the market will better serve investors in the long run. Our selection process, which we believe we have significantly improved through fine-tuning several factors in recent quarters, should carry our unique portfolio through most environments. When stocks in the worst companies offer the best returns, however, as they did in early 2000, a grain of investor salt is needed. □

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 9/30/03 was 34, which represents 93% of total assets managed in this strategy with a measure of dispersion of 0.17. 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)	15.9
Market Cap (MDN)	\$437 Mil
Price/Book	26
LT Growth Rate	20%
Beta*	1.0
R-SQR*	.044
Annualized STD	27.0%
Annualized Alpha*	10.15%

*Relative to S&P500, 9/30/98 - 9/30/03

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.

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 9/30/03 was 163, which represents 80% of total assets managed in this strategy with a measure of dispersion of 0.34. 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 9/30/03 was 39, which represents 84% of total assets managed in this strategy with a measure of dispersion of .21. Inception of the Distribution composite was December of 1998.

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 9/30/03 was 216, which represents 95% of total assets managed in this strategy with a measure of dispersion of 0.27. 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.

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