Miller/Howard INVESTMENTS, INC

MARKET OVERVIEW

Although demons still lurk for the economy and the broad equity markets, the unfolding of events in Washington leaves no strategies better positioned than our dividend-oriented portfolios. After a grueling year, we definitely have reason for optimism on both a relative and an absolute basis, as a cacophony of woe has almost magically transformed into a harmonic convergence.

We never thought we'd see the day that investors in general would finally look favorably on dividends again; but to find in that same day an executive and legislative branch seemingly in complete agreement that dividends have been unfairly taxed—a circumstance which as of this writing appears almost certain to be rectified— almost makes us blush. A reduction or elimination of the double tax on dividends will make our stocks more valuable with one stroke of the presidential pen.

Not only that, but a homogenously Republican government is highly likely to finally pass an energy bill which will include repeal of the Public Utility Holding Company Act, a repeal which we have asserted for some time will result in substantial merger activity in the utility industries and a general upward re-valuation in the sector. While this bill may have slightly longer odds than the tax reduction, it is on the minds of many in Congress and we think it will pass. Indeed, given the concern of many over the state of the energy industry, including pipelines and power production as well as the integrated companies which would be most sensitive to PUHCA repeal, there may be additional goodies in the final bill which benefit investors from the standpoint of stability, order, and profit support for the sector. Further, chances are good that the incumbent telecom companies will benefit from a review of the implementation of the Telecommunications Act, with relief from the burden of having to provide facilities to competitors at prices allegedly below cost.

As for the broad market and the economy, we once again do not see that much has changed, apart from things not getting any worse. We've been working with what we think of as ten key points of interest in this context, and a quick review is probably in order:

1) *The Fed is loose*. The Fed has cut rates once again, and has threatened to get even "looser," using unusual techniques to prime the pumps if necessary. As before, we are nervous that the long string of interest rate reductions has not had much bite and has not inspired higher valuations from investors.
2) *Investor confidence in corporate governance is at the lowest point since the 1930's.* The tide of revelations has ebbed, but we, and we suspect

THE STRATEGIES

BETTER THAN BONDS / UTILITIES

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

INCOME-EQUITY STRATEGY

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

DISTRIBUTION / EMERGING UTILITIES

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

ALPHA-BASED STRATEGY

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

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several generations of investors, have become permanently cynical. This is good for the markets, long term. Too, the various legal initiatives, from legislation to attorney general suits and criminal prosecutions, are a positive if disappointingly vigorous element.

3) *Sentiment measures are inadequate to support an intermediate-term rally*. Ever since these measures turned negative there have been nothing but short-term rallies (three weeks or less). Sure, everyone you know is moaning, but the quantitative measures, which are the only ones that count, still are not supportive. Some recent improvement has been seen, but it is minor, in our view. The advisors are still bullish.

4) *Short-term options activity supports a rally, and both the indices and individual stocks are severely oversold*. This may have been true at the end of the third quarter, but it is less true now. Stocks are off the bottom, and put/call volume measures have been erratic. On the other hand, advance/decline measures have shown enough improvement to speculate that the October lows may have demarcated a longer-term pricing low.

5) *Valuations support upward price adjustments in some sectors but not all.* Now that stocks are "off the bottom" there won't be much justification for upward re-valuation until the economy appears less questionable. Stocks with high dividends, on the other hand, should be marked up commensurate with a dividend tax reduction.

6) *The dollar has weakened and may well have reversed its long-term uptrend*. We've seen still more evidence of this over the past three months. Good for internationals and exporters, not so good for inflation and the overall financial system and borrowers such as, once again after a substantial hiatus, the U.S. government.

7) *The macro-environment has changed from peaceful prosperity to a kind of nervous struggle.* When the Berlin Wall came down, companies and investors could focus on growth in a world without real enemies. Now we have real enemies again. Surprise attacks are always possible, and this is bad for confidence among economic decision-makers as well as investors.

8) *Earnings comparisons are easier ...investors may be free to once again extrapolate limitless growth.* Ah, nobody was fooled. Revenues haven't risen, and earnings gains have come from cutting, which is exactly negative for the overall economy. The markets won't rise without revenue increases this time.

9) *The old highs reflected a vastly different economic and sentimental framework*. As businesspeople as well as investors continue to sober up, the old highs look more and more like innocence, or youth, or lost love, or some other unrecoverable thing.

10) *Corporate insiders have not been buyers...a negative factor for the six-month outlook.* This remains the case, and was somewhat exacerbated over the past quarter. Investors need to ask themselves how good the current prospects can be if insiders are not believers.

In sum, there's been little progress over the past few months in these factors. These elements *need* to improve for the economy and the markets to turn bullish again, although there is now a technical argument that the lows have been seen. We doubt there will be much movement prior to a resolution of the Iraq situation.

But there is a sea-change pending for dividend-paying stocks, what radicals might call a long wave, that may help restore confidence in companies and managements, and should logically re-rate the valuation boundaries for companies that offer to share some prosperity in real-time with their investing "partners." ❑

"But there is a sea-change pending for dividend-paying stocks...and should logically re-rate the valuation boundaries for companies that offer to share some prosperity in real-time with their investing partners."

SELECTED INDICES

	4TH Qtr'02	12 Mo
S&P 500	8.43	(22.10)
Equity Inc	7.38	(16.33)
Util Fund	9.07	(23.83)
DJUA	1.29	(23.40)
LB Treas	(0.01)	16.78
LBGC	1.73	11.04
S&P 400	5.83	(14.51)
Value Line	7.90	(28.57)
Rus 2000	6.16	(20.48)

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

The air calmed down, the headlines faded, and helped by a general improvement in the fundamental operating environment for regulated and gas-oriented utilities, we were able to post excellent gains this quarter, far outperforming the average utility fund and the Dow Jones Utilities Index. Much of this quarterly result can be traced to our portfolio's natural gas bias, improved performance from the Baby Bells and rural telecoms, and our avoidance of positions with exposure to speculative trading and the unregulated electricity market. While 2002 is likely to go down as one of the most challenging years in history for the utilities sector, several pistons in the proverbial "engine" of a broad-based utilities recovery are finally firing in unison – which we believe will translate into improved earnings from core operations and market valuations rising steadily toward historical norms for the sector.

Thankfully, several components of the utility sector's *Perfect Storm* – a period roughly defined as late Fall 2001 through Summer 2002 – dissipated over this last quarter. The *Perfect Storm* was a function of the California crisis, historically mild weather and weak economic activity, compounded by a glut of electric power plant construction and high storage levels of natural gas, which depressed commodity prices and cut into earnings for regulated and unregulated power and gas utilities alike. Investor and lender confidence was further eroded by revelations of fraud, excessive and often obscured debt, and threats of credit downgrades for failure to rapidly deleverage. The fourth quarter of 2002, however, was characterized by progress in cleaning up the corporate world, and a reversal of several fundamental factors that once undermined core earnings within the utility industry:

(1) very cold weather increased demand for natural gas to heat homes, as well as to generate electricity for homes in the South and West,
(2) natural gas drilling activity dropped and levels of natural gas in storage stagnated in response to depressed commodity prices experienced earlier in the year,
(3) weather forecasts calling for a warmer-than-normal winter (El Nino) were mistaken, and caught the natural gas industry by surprise,
(4) natural gas consumption vastly exceeded projections, even after "weather normalization," with the jury still out as to why, and gas storage levels fell below the 5-year average, which left the industry exposed to significantly higher gas prices on concern of a shortage should cold weather persist,
(5) investors began to distinguish between safe and risky industry participants,
(6) FCC actions began to bolster the telecom sector.

And so, we think it's safe to say, the *Perfect Storm* is over.

PORTFOLIO HIGHLIGHTS

For the quarter, we had some issues with fine bounce-backs. The Baby Bells (SBC, BellSouth, and Verizon) as well as our two rural telecoms (ALLTEL and CenturyTel) led the portfolio, posting impressive gains for the period, ranging from 27% to 41%. The Bells' recent performance can, in part, be attributed to their success in capturing long-distance marketshare in an ever expanding number of states, while their competitors continue to struggle to convert local subscribers. It's also

"And so, we think it's safe to say, the Perfect Storm is over."

Quarter Composite Net of Fees*	
BTB/Util (Preliminary)	13.21%
DJUA (total return)	1.29%
LBGC	1.73%
Avg Util Fund	9.07%

12 Month Composite Net of Fees*	
BTB/Util (Preliminary)	(29.24)%
DJUA (total return)	(23.40)%
LBGC	11.04%
Avg Util Fund	(23.83)%

10 Year Composite Net of Fees*	
BTB/Util (Preliminary)	5.74%
DJUA (total return)	4.67%
LBGC	7.61%
Avg Util Fund	5.39%

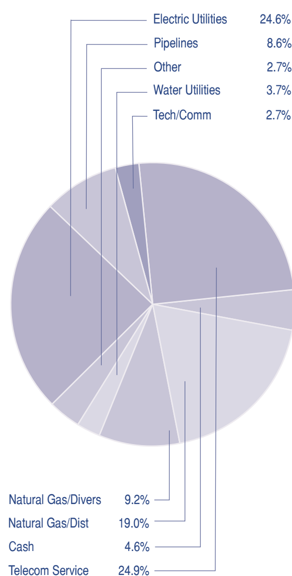
*See Performance Disclosure on page 12.

increasingly likely that the FCC is going to revise the rule requiring incumbent local phone companies to offer line access to competitors at deep discounts. With the phones currently representing approximately 25% of the portfolio, we're pleased the market has rediscovered the intrinsic value here, though a variety of issues still remain.

Questar, a natural gas exploration, production, and distribution company based in Utah, turned in another outstanding quarter of performance, gaining 22%, driven by strong earnings from increased production volumes. Similarly, natural gas distributors Peoples Energy, AGL Resources, Atmos Energy, and Keyspan Corp performed well on increased demand for gas, rising gas prices, and effective cost controls, with gains of 14.7%, 10%, 8.5%, and 5.2% respectively.

One of our heavier weights in the portfolio, Kinder Morgan Energy Partners, bounced a respectable 9.6% for the quarter. Nicor and NiSource both recovered from sell-offs earlier in the year, rising 20.6% and 16%, respectively. Nicor (Chicago-based gas distributor and transmission co) got into trouble by miscalculating its Performance Based Rate (PBR) when assessing customers, and still has the cloud of an SEC investigation hanging over it, but investors have been returning. NiSource continued to execute on its deleveraging program, issuing equity while selling off non-core assets, even as it posted increased profits from retained core operations.

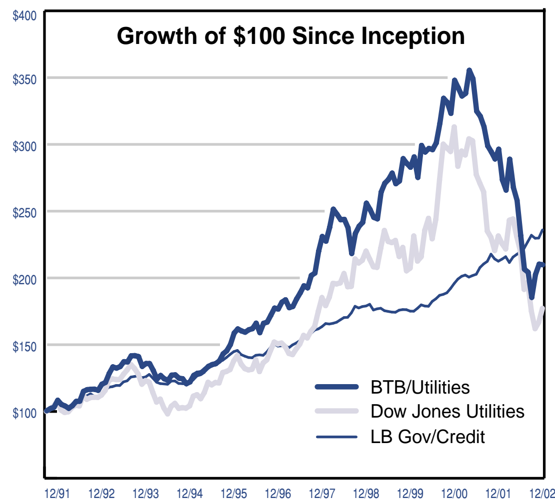
We added to our natural gas bias with Vectren, an Indiana gas and electric utility with a profitable unregulated gas marketing and trading subsidiary; TransCanada Pipelines, Canada's largest natural gas pipeline company, providing a vital interconnection between the United States and Canadian gas supplies; and Equitable Resources, natural gas distributor and producer with large proven reserves in the Appalachia and an outstanding track record of profitability.



UTILITIES PORTFOLIO CHARACTERISTICS

Beta*	0.57
Dividend Payout	58.13%
Sharpe Ratio	0.12
Proj Dividend Growth	3.79%
Treynor Ratio*	1.29%
Current Yield	4.4%
Annualized STD	13.47%
Market Cap (MDN)	$2.9 Bil
Price/Book	1.99
Quality (Equity Rating)	B++
P/E Ratio (MDN)	14.83

**Relative to S&P500, 12/31/92 - 12/31/02*



LOOKING FORWARD

In addition to an improving operating environment, highlighted at the outset of this review, initiatives from Washington are contributing to an optimistic outlook for utilities:

- The Public Utility Holding Company Act of 1935 is very likely to be repealed this year, perhaps in the first half of 2003. PUHCA was almost repealed last year as part of the comprehensive energy bill, but the entire bill died in conference at year-end. Simply put, PUHCA forbids the acquisition and merger of two regulated utilities, unless they are physically contiguous. The repeal of PUCHA would permit much more consolidation and increase the number of candidates for merger, as well as expanding the number of parties who would likely wish to become owners of US utilities.
- President Bush has announced he will make repeal of the federal tax on dividends a cornerstone of his administration's economic stimulus package. High yielding stocks, such as utilities, are viewed as likely beneficiaries of such a repeal. In our estimation, utilities are particularly attractive at the moment, since their yields are historically high,

continued on page 7...

As the year finally finished its torturous run, our portfolios closed the quarter gaining 6.68% in market value, similar to broad market indices and equity income funds. While the past 12 months were frustrating for investors everywhere, we're especially disturbed by the deceptiveness and dishonesty we had to face in the last year, and we're committed to avoiding a repeat performance. Nevertheless, we sense an increasing return to normalcy, and this return has manifested in all sectors of our portfolio, including the previously troublesome utilities. Overall, the strategy ended the quarter with only a couple of losers, all in the single digits – you'd never know from the last quarter that it was a year of struggle. And we've opened the new quarter with even stronger gains, reinforcing the possibility that this train is truly back on track.

PORTFOLIO HIGHLIGHTS

Questar, a major weight in the portfolio, produced a 22% gain for the quarter, supported by increased gas production and positive news flow surrounding the business. Differentiated by a stable business model with regulated assets in the neighborhood of 2/3 of earnings and a conservative balance sheet (debt/capitalization of 56%), STR recently affirmed its earnings forecast for the quarter and year. Everything seems to be on the right track, as the company continues to be well positioned to capitalize on stronger pricing this winter and year. North American gas production is weak while gas demand is strong, and a previous inventory surplus has been whittled away quickly. Having risen so much it's a candidate for trimming, but we still like the story.

Mid-quarter we trimmed Kinder Morgan after a significant rally. The company continues to deliver, and we love the steadily rising yield here, but its very strength had caused the stock to rise to 7% of the portfolio, so it became a "sell on rally" candidate. We replaced that reduction with another interesting MLP, Enterprise Products Partners. EPD is involved in processing and transportation of natural gas liquids, is attractive on all fronts, including its solid business model, strong management (Shell is their general partner), solid cash coverage and attractive yield spread relative to treasuries. With a dividend yield over 7% and historical distribution growth of over 14%, the stock should be capable of providing a conservative, rising income stream. Too, this is one of the few stocks on the NYSE in which insiders are consistently active buyers.

Telecoms posted a significant turnaround, resulting in a quarterly gain of 18% on our ALLTEL convertible preferred (still yielding over 7%), and over 44% in Vodafone convertible which we sold shortly after conversion in mid-November due to low yield on the common. At the moment, we have light exposure to the telecom sector and on a pullback may consider adding several convertible preferreds in the integrated phone space, as recent posturing by the FCC points toward increasing security for incumbent phone providers (though there are still competitive technology issues to be concerned about).

As a result of our increased attention to corporate debt and corporate spreads to treasuries, in mid- October we sold our position in Worthington (with an average gain of 12%), as the spread widened unexpectedly and stabilized several hundred basis points higher than comparably rated industrials. Although no disaster happened to the stock since then, it

Over the years investors have sometimes been confused about the difference between ***Better Than Bonds/ Utilities*** *and* ***Better Than Bonds/ Income****. Considering that confusion, and also our anticipation that a certain traditional income-equity "style" will see a re-awakening of interest, we are re-naming this portfolio* the **Income-Equity Strategy**.

Quarter Composite Net of Fees*	
Income-Equity (Prelim)	6.32%
LBGC	1.73%
LB Long Treasury Index	(0.01)%

12 Month Composite Net of Fees*	
Income-Equity (Prelim)	(19.09)%
LBGC	11.04%
LB Long Treasury Index	16.78%

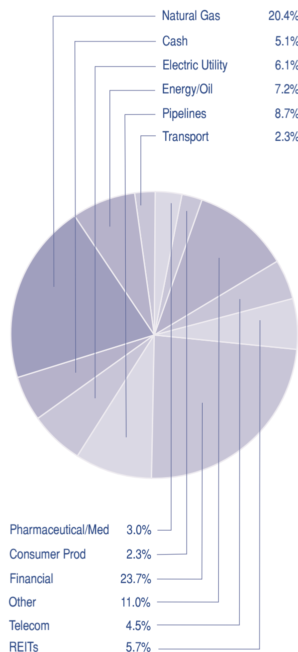
5 Year Composite Net of Fees*	
Income-Equity (Prelim)	(0.25)%
LBGC	7.62%
LB Long Treasury Index	8.68%

*See Performance Disclosure on page 12.

has declined substantially from our sale price and earnings did come in a bit soft with indications of possible future weakness. The real import of this story is that we can identify financial stress early, and will abide by those indications even in the face of potential opportunity cost.

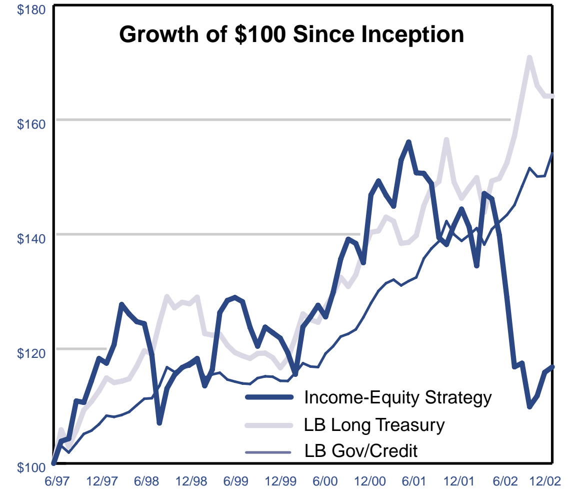
"The income-equity style of investing is liable to spark investor interest in the face of a more challenging environment for bonds and the much anticipated stimulus package."

In our REIT portion, we made a contrarian move by replacing First Industrial, a REIT that fell prey to weak economic conditions and speculation of a possible dividend cut, with CBL & Associates, a regional mall REIT with numerous properties scattered all over the US. We've stayed away from mall REITs for several years as the group valuations became severely inflated, but this Fall our internal research efforts led us to this unlikely name at a time of weak consumer spending and lackluster same-store sales projections for most retailers. CBL, at the time of purchase was the only publicly traded REIT priced at a discount to net assets and remarkably reported positive FFO and Net Operating income growth for most of its property groups. In addition to its attractive geographical diversification, solid management and financials, CBL boasts the lowest dividend payout in the sector (29% vs 50%+ average) and recently announced an 18% increase in dividends per share. The current yield is 6.6%, in addition to appreciation of over 7% since inclusion in our portfolio.



The rest of our REIT holdings performed very well relative to the broad market as well as comparable indices, as Cousins Properties and United Dominion finished the quarter up over 7% and 3% respectfully, compared to the Bloomberg REIT index down -1.6% . We're quite pleased with such disconnect as we believe that our proprietary research efforts in this area are bearing fruit even in uncertain times.

New names this quarter included a position in small-cap Landauer, Inc (LDR) and R.R. Donnelley (DNY). Landauer, which manufactures personal radiation monitoring devices, in our view, is a classic value stock with consistent earnings growth, over 4% yield and a forward P/E of 16x. Recently, the company reported a slight earnings surprise and yet again raised its dividend by 7%. Donnelley is the largest printer in the country, and has a similar dividend and financial profile: the position gives us exposure to the commercial services sector along with an attractive yield of 4.8%, 5% historical dividend growth, high financial strength and attractive fundamental valuation.



Our convertible preferreds performed quite well in the last three months. Early in the quarter, we increased our weight in Toys'R'Us, as the stock continued to suffer from negative pressures and a general lack of fans. We still believe the convertible preferred is the safest way to participate in a recovery of one of the cheapest names in the sector. While the troubles for US retailers are far from over, shortly after the addition, the company reported impressive quarterly results, including 4% comparable same-store sales growth and an optimistic outlook for the future. A brief rally followed the news and subsequently pulled back on profit taking. Still, trading at 10x next year's EPS, the preferred offers our portfolio the benefit of diversification along with a yield over 8% and high correlation to the underlying common.

During the quarter we raised weights in several financial services holdings. As a result we dollar-cost-averaged and increased our positions in Union Planters and AmSouth. Prospects for

the financial sector are pretty good at the moment, especially in terms of consolidation potential, and these two holdings continue to exhibit value characteristics along with takeover appeal, trading at about 12x earnings.

LOOKING FORWARD

Over the last year most of us learned that excessive volatility is easily predictable in hindsight. Outliers, meaningless in a statistician's world, do tend to happen and distort perfectly normal patterns of the past and our portfolios need to be prepared for the worst. In order to avoid moments like this in the future, we continue to utilize various risk protection measures to ensure that our holdings are more diversified and include a well-balanced blend of stocks representative of various industry sectors. Overall, the quarter turned out to be something more than just a relief, and we're looking forward to more. The income-equity style of investing is liable to spark investor interest in the face of a more challenging environment for bonds and the much anticipated stimulus package. As we noted in previous reports, most of our holdings raised dividends this year, and this quarter brought increases in several positions (ASO up 4.5%, CBU 7.4%, EPN 3.8%, ERF 5%, LDR 7.1%, STR 2.8%, EPD 2.9%). Our yield remains at 6.4%, compared to 4% on the intermediate Treasury. With the upcoming reduction or complete elimination of dividend taxes, our approach should be very attractive to investors across the board.

Over the years investors have sometimes been confused about the difference between "Better Than Bonds/Utilities" and "Better Than Bonds/Income." Frankly, they look somewhat alike on the page and sound alike to the ear, not to mention there is some overlap of stocks. Considering that confusion, and also our anticipation that a certain traditional income-equity "style" will see a re-awakening of interest, we are re-naming this portfolio *"The Income-Equity Strategy."* Track record, stocks, managers, and all else remains as it was. ❑

BTB/Utilities continued from page 4...

especially relative to bonds, while payout ratios have decreased markedly in recent years when many companies thought they would rather use their excess cash to chase a chimera of growth.

- The Federal Communications Commission (FCC) seems poised to revise the rules requiring that local phone companies (i.e. Baby Bells) offer their lines to competitors at deeply discounted rates. The Baby Bells have long argued that this right to "piggy-back" is anti-competitive, since the Bells alone are responsible for the expansion and maintenance of infrastructure, which directly benefits their competitors. Further, their competitors don't have any incentive to contribute to infrastructure improvements in a given territory, since they have subsidized access to another company's lines.

In all, though it seems difficult to mouth the words after the head-banging year of 2002, overall fundamental prospects for utilities are as bright as we've ever seen. Independent electric generation may still be in a trough and may be forever so, but regulated utilities are benefiting from a renewed respect among regulators and investors, gas fundamentals have snapped back into a positive glow, everything coming from Washington has been supportive, and valuations remain in the nether regions of historical precedent. A dicey economy may slow progress for companies of all types, but our industries can boast once again their traditional appeal (moderate growth with solid income) as well as new attractions (dividend tax repeal, PUHCA repeal) which will likely draw a new and larger constituency. ❑

"In all, though it seems difficult to mouth the words after the head-banging year of 2002, overall fundamental prospects for utilities are as bright as we've ever seen."

INCOME-EQUITY STRATEGY FUNDAMENTAL CHARACTERISTICS

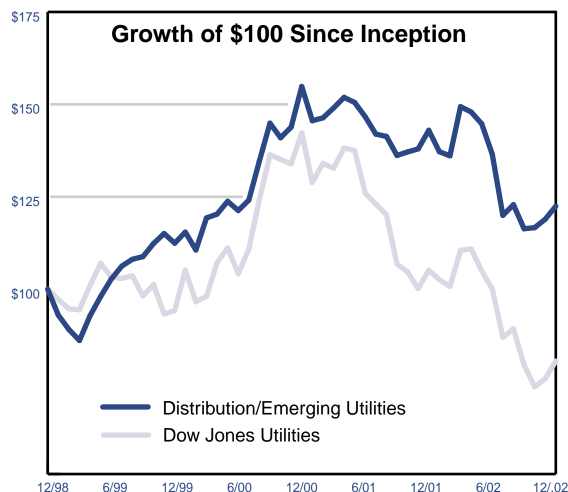
Yield	6.4%
Proj Div Gro	10.29%
Payout Ratio	57.38%
Market Cap (MDN)	$2.4 Bil
Price/Book	2.29
Beta*	.51
STD	14.06%
P/E Ratio(MDN)**	15.94
Quality (Equity Rating)	B++

**Relative to S&P 500, 12/31/97 - 12/31/02*
***REITs use P/FFO ratio rather than P/E Ratio*

"As we noted in the Overview, the prognosis could not be better for this portfolio...In all, the risks are low and the potential rewards are palpable."

Last quarter we suggested that the summer period was an anomaly for this portfolio, dragged down as it was by poor performance across the equity world and negative headlines in the utility industries, and that we were due for a return to the more "normal" positive results which have historically characterized the strategy. Despite a soggy quarter for the utility indices (hurt by early troubles in many large-caps, most notably TXU), our stocks delivered a solid performance with little intra-quarter volatility and were one of the better places to be in these uneasy times. We note also that this is one of the few equity portfolios to post positive returns over the past three years.

Investors should remember that these are "your father's utilities." These are intrinsically among the least risky of all equities. They are the local distribution monopoly companies, the "pipes and wires" that bring utility services to your home or business, locally regulated and without competition. They are most emphatically *not* the companies that have made headlines in the utility world over the past year and a half, though a few have been occasionally touched by troubles when they have diversified their businesses in order to provide an element of greater growth. But they don't need to provide much growth to be of interest to us; a nice yield that is safe and grows gradually over the years is adequate. This is especially true because all these companies are likely takeover candidates. The "Emerging" part of this equation is that these are the companies which will be consolidated to create fewer and much larger utilities, which we and many observers of the sector envision as the shape of the future. Here is where we have experienced capital appreciation in the past, and it is where we expect to experience capital appreciation in the relatively near future. In the meantime, we receive ample income—which appears soon to be no-tax income—stability of revenues and profits, and moderate growth derived from demographic increases and increases in the use of services. If anyone is using less electricity or gas or telephone service than they were five years ago, we want to meet them.



Quarter Composite Net of Fees*	
Distribution (Prelim)	5.23%
DJUA (total return)	1.29%

12 Month Composite Net of Fees*	
Distribution (Prelim)	(14.36)%
DJUA (total return)	(23.40)%

3 Year Composite Net of Fees*	
Distribution (Prelim)	2.88%
DJUA (total return)	(5.09)%

*See Performance Disclosure on page 12.

PORTFOLIO HIGHLIGHTS

Our roster of holdings produced mainly winners this quarter, as stocks bounced back from the general equity market pressures of the third quarter and typically provided a positive flow of fundamental news as well, with strong earnings and revenues—a rarity in this environment among the broad list of stocks.

CenturyTel posted sharply higher profit on 25% greater revenues, and proved, with a 30% gain for the quarter, that – as the song goes – the fundamental things still do apply as time goes by. At the close of the year, the company had more than doubled its earnings of five years ago, but the stock is up only about 50% from the highs of five years ago (S&P 500 is down for the five years, by

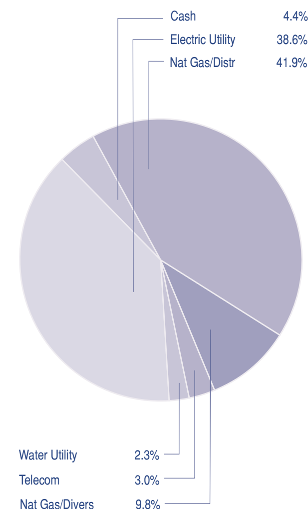
contrast), so there should still be more room on the upside. And with its relatively protected non-urban franchise, the company remains a candidate for acquisition.

We've long been interested in Questar on the theory that if an acquirer doesn't want its utility operations then perhaps it will want the company's excellent and rapidly growing gas reserves. The stock rose over 20% on increased gas production volumes and renewed interest in gas in the face of declining national inventories. It is this gas exposure that prompts us to be interested in owning the shares with or without a takeover. However, with the stock near an all-time high we may begin to reduce it's weight somewhat.

Other gainers covered all the industries in the portfolio, from integrated electric companies with some power production, to gas distributors, to "wires" only companies like NSTAR, to our heaviest weighting, Southwest Gas. You may recall that two years ago SWX was the object of a heated takeover competition between Oneok and Southern Union, a battle which finally became so messy that the regulator denied both hopefuls and sent them home. At that time both companies offered more than $30 per share for the Southwest. Since then its earnings, which were depressed at the time, have risen by some 50%, but at a current price of 23 it sells at a P/E of 14 times next year's estimates, where comparable distributors have normally sold for 20 times earnings or more. Is it any wonder that we keep a high weight here, when private market buyers have already told us the stock is worth far more than its public market price? Interestingly we also recently added Oneok (with a 15% profit in several months). Though we'd normally not want to own an acquirer, some 40% of OKE is owned by Westar, which is essentially being forced to sell its stake by its local regulators, making OKE fairly easy pickings. Our basket wasn't totally filled with prize winning apples. We also had two nightmare stocks, Aquila and Allegheny, which we cleared from the portfolio this quarter, having been soundly reamed by what we consider to be management misrepresentations and misleadings. We're looking forward now, and with a highly skeptical eye toward anything any management says if it pertains to unregulated growth.

LOOKING FORWARD

As we noted in the Overview, the prognosis could not be better for this portfolio. We start with modest valuations due to general industry turmoil, and reliable revenues in a world without reliable revenues. Add in a solid dividend yield at a time when investors are more interested in dividends than they have been for over twenty years, especially in view of low interest rates. Add to that the strong possibility that dividend income will be favored with a reduced or eliminated tax, elevating the rational valuations of stocks paying dividends. And finally, add in the stronger-than-ever possibility of repeal of PUCHA from a Republican congress, the watershed event we have been waiting for since before the events of 9/11 intervened and pushed it to the back burner. In all, the risks are low and the potential rewards are palpable. ❑

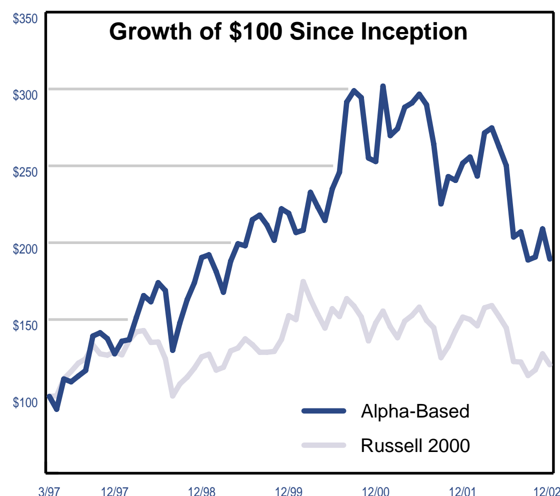


FUNDAMENTAL CHARACTERISTICS

Yield	4.4%
Proj Div Gro	1.13%
Payout Ratio	67.95%
Market Cap (MDN)	$1.7 Bil
Price/Book	1.62
P/E Ratio (MDN)	14.36
Quality (Equity Rating)	B++
Beta*	0.33
STD	15.84%

**Relative to S&P 500, 12/31/99-12/31/02*

Fourth quarter resulted in a mixed performance for the strategy, as excellent returns from many of our holdings weren't sufficient to offset negative pressures from a relative handful of disappointments. While we made good progress throughout the fall and early December, our exposure to several companies that delivered surprise negative fundamental news limited our gains to just +1.15% for the quarter and -23.09% for the year compared to the Russell 2000 index up +5.75% for the quarter, -21.58% for the year.



"And any economic improvement is likely to be felt first in these more flexible and more innovative businesses."

PORTFOLIO HIGHLIGHTS

The medical services/equipment sector helped us yet again, with Curative Health and Merge Technologies gaining in the 60 percent range for the period. During the quarter we re-weighted stocks quite a bit since the unreliability of market sentiment combined with slim pickings in terms of new names in our universe justified this strategy from technical and fundamental points of view. We raised Merge to over 5% on a technical breakout at the end of October, after the company reported excellent earnings and beat estimates by over 13%. The report was very strong and confirmed the resumption of vigorous revenue and profit growth for the company. MRGE's balance sheet is getting stronger, as the company now has virtually no debt and at 14x next year's earnings is expecting future growth rates to exceed 50%.

Similarly, we raised the weight in Hologic and finished the quarter up 25%, achieving most of our gains shortly after our addition in early October. We also continued to slowly unwind our illiquid Synovis after another spectacular run of over 20%, and took profits in PPDI on a technical breakout. Both companies became overextended on technical and fundamental grounds and no longer fit the GARP profile of the portfolio.

In the industrial services group, we raised Insituform (up 19%) again on a technical breakout. INSU is still a relatively low risk position as this steady earner continues to be priced at 13x EPS, and in today's world of dicey earnings should be capable of achieving a P/E of at least 20. Industrial services is not the most exciting area of the market, but one can't argue with fundamentals in this case, as well as the recent earnings surprise reported by the company.

Headwaters, up over 12%, was a trader for us during the quarter, as we successfully added weight in early October and then took profits in early November, reducing our weight to 2% from over 5%. Shortly thereafter HDWR retreated and we were able to raise our weight back up to 3% in late December as the stock began to bottom. HDWR still trades at a PEG ratio of 0.6, recently reported strong earnings, and reiterated 30%+ growth rates for 2003.

The consumer sector, including retailers and consumer products, produced mixed results. JAKKS Pacific's valuation drooped partially due to uncertainty surrounding the west coast dock lockout and the consequences for

Quarter Composite Net of Fees*	
Alpha-Based (Prelim)	0.31%
Russell 2000	6.16%
12 Month Composite Net of Fees*	
Alpha-Based (Prelim)	(24.80)%
Russell 2000	(20.48)%
5 Year Composite Net of Fees*	
Alpha-Based (Prelim)	8.18%
Russell 2000	(1.36)%

*See Disclosure on page 12

the retail industry. The combination of attractive fundamentals, including $4 of cash per share, no debt, projected P/E of 8, and good technicals warranted a relatively heavy weight allocation in our portfolio and we finished the quarter with a 13% gain.

Playtex rallied strongly off the lows, up 16% for the quarter, as the rumors of a sellout to boost shareholders value started to float to the surface yet again. Much speculation centered on the possibility of PYX attracting international buyers or perhaps even Proctor and Gamble, whose average sales have risen a meager 2.4% compared to PYX's 11% over the past 5 years. The stock is still inexpensive trading at half the valuation of PG and one of these days should get the recognition it deserves. Friedman's and Helen of Troy performed well also, appreciating 11% and 2% respectively.

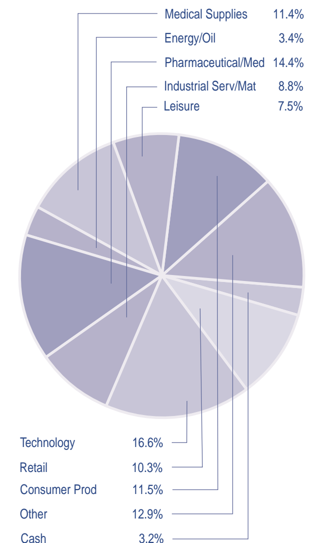
So we had lots of good stocks this quarter, but previously mentioned negative surprises dragged down results. Charming Shoppes (down -38%) suffered from disappointing comparables in almost every part of the business. We're disappointed with their execution, and now seeking a different vehicle to approach the growing market share of plus-sized apparel.

Monterey Pasta turned out to be a major disappointment this quarter (down -33% since purchase). We established our position in mid-October, believing we were investing in a company with projected earnings growth of over 30%, a recent earnings surprise, support from enthusiastic insiders and very reasonable valuation. Unfortunately, these factors were not sufficient to counterbalance the effects of a weak retail environment, which prompted PSTA to sharply reduce quarter and year guidance due to lower than expected sales at a number of distribution channels.

Take-Two (down -19%) suffered with the rest of game manufacturers and retailers (Electronics Boutique, down -42%) during a vicious sell off late in the quarter on fears that the shortened Christmas retail season, and tough year-over-year sales comps, would result in annual growth rates short of expectations. While preliminary sales numbers suggest that the videogame industry is not immune to weak consumer spending cycles, nevertheless, growth continues unabated. TTWO raised its guidance for the year, while ELBO continues to expand its used game business – which is higher margin than new games. Although we took profits and drastically reduced our Take-Two weight to 3.5% in November, our combined exposure to the gaming sector hurt the bottom line this time around.

LOOKING FORWARD

Looking forward, we also look backward. 2002 was a tough time to find good stocks, the most difficult we've seen. Revenues declined across the economy, and stocks that disappointed were lined up and shot mercilessly. We think many of these will prove to have been vastly oversold this year, and many will become the new leaders when the economy – which remains questionable at the moment – gradually finds its footing. But events may unfold in fits and starts, and this year, more than ever, we're prepared to act quickly on both the buy and the sell sides. Geopolitical stresses are bound to have an effect on the markets, but will likely have the least impact on our small, domestic companies. And any economic improvement is likely to be felt first in these more flexible and more innovative businesses. ❑



FUNDAMENTAL CHARACTERISTICS

Forward P/E Ratio	11.49
Market Cap (MDN)	$316 Mil
Price/Book	1.88
LT Growth Rate	21.68
Beta*	1.1
R-SQR*	0.48
Annualized STD	29.43%
Annualized Alpha*	11.50%

**Relative to S&P500, 12/31/97 - 12/31/02*

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 12/31/02 was 251, which represents 96% of total assets managed in this strategy with a measure of dispersion of 0.63. Inception of the BTB/Utilities composite was September of 1991.

Income-Equity Strategy: Included in the results are all portfolios that are unrestricted and that have been managed for at least one full quarter. The number of accounts in the composite as of 12/31/02 was 145, which represents 83% of total assets managed in this strategy with a measure of dispersion of 0.58. 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 12/31/02 was 31, which represents 67% of total assets managed in this strategy with a measure of dispersion of .10. Inception of the Distribution composite was December of 1998.

Alpha-Based Strategy: Net of fees performance is based on actual results after the deduction of management fees (weighted average fee of 200 basis points). Included in the results are all Alpha-Based portfolios that are unrestricted, including one non-fee paying portfolio, and that have been managed for at least one full quarter. In addition, in order to be included in the composite, a new account has to be at least 80% invested and it should hold not more than 5% cash exceeding the maximum cash held by any portfolio already in the composite, as of the end of the preceding quarter. The number of accounts in the composite as of 12/31/02 was 52, which represents 92% of total assets managed in this strategy with a measure of dispersion of 0.45. Miller/Howard Investments has prepared all performance results. Inception of the Alpha-Based composite was March of 1997. Some accounts were in a modified version of the strategy; they became part of the composite October 2001. Portfolio was managed by William T. Chidester from inception through November 2000. Team managed since December 2000.

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