Miller/Howard INVESTMENTS, INC

THE STRATEGIES

INCOME-EQUITY STRATEGY

A diversified dividend-growth strategy providing high current income, growth of income, and growth of underlying principal. Stocks are conservative, high quality, high yield, and are projected to have a rising stream of income.

RISING DIVIDEND PLUS

A porfolio of large and mid-cap companies in which dividend growth is the key variable, focusing on companies with proven long-term success or special current opportunities.

BETTER THAN BONDS / UTILITIES

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

DISTRIBUTION / MERGING UTILITIES

An opportunistic portfolio focusing on companies that are likely to be acquired during an era of utility consolidation and convergence.

TABLE OF CONTENTS — PAGE

Every Monday, it seems, is Merger Monday. The pace of takeovers and leveraged buyouts has become unprecedented, and the resultant number of shares available on the markets has been shrinking radically for two years. Indeed, domestic publicly traded shares have diminished by some 5% over the past eight quarters. Excluding new share issuance, about $1 trillion of equities disappeared from the market last year (several hundred million dollars of new shares were issued, but these are often not the type of companies of interest to investors who'd held the kinds of proven companies which were acquired). To provide some sense of scale, all US equity funds hold roughly $10 trillion of shares; a comparatively large percentage, then, has vanished. Further, according to Citigroup, in 2006 equity markets shrank in Europe, the UK, and the United States simultaneously for the first time in history. It's a trend.

And why not? Economists suggest that the cost of capital in issuing equity is about 9-10%, whereas high-credit debt can be had for 5%. That spread, which participants such as private equity investors can leverage to create substantially higher returns, is simply too large to resist. It's especially irresistible in what many have called a "single-digit" world—or at least that's what they were saying at the beginning of last year, before the equity markets surprised on the upside—where clients of the private equity funds are quite content to receive a moderate (high-single-digit or low double-digit) return which can reliably meet the actuarial assumptions of their pension and health fund obligations. When companies are doing well in terms of earnings and have relatively little debt it's easy enough for an entrepreneurial investor to demonstrate to a bank how comfortably the asset will make its loan payments, and banks or investment groups actually create the

Performance of Miller/Howard Investments strategies since their inception dates:
(See performance disclosures inside.)

	Annualized Return	Standard Deviation	Reward/Risk Ratio
Income-Equity Net of Fees (Incep. 7/97)	**8.2%**	**11.7%**	**0.70**
Russell 1000 Index	7.2%	15.5%	0.46
Russell 1000 Growth	3.8%	19.4%	0.19
Russell 1000 Value	9.7%	14.4%	0.68
50% Russell 1000 and 50% Lehman Long Treas	8.0%	8.0%	1.00
Dow Jones Industrial Average	5.2%	15.5%	0.34
Dow Jones Transports	5.6%	21.3%	0.26
MSCI EAFE (international equities)	6.9%	15.2%	0.46
Nasdaq 100 Index	6.6%	32.7%	0.20
Rising Dividend Plus Net of Fees (Incep. 12/04)	**21.1%**	12.9%	1.64
Russell 1000 Index	10.8%	7.1%	1.52
Russell 1000 Growth Index	7.2%	8.4%	0.85
Russell 1000 Value Index	14.4%	6.7%	2.15
BTB/Utilities Net of Fees (Incep. 9/91)	**9.6%**	**12.4%**	**0.78**
S&P Utility*	8.8%	15.7%	0.56
Russell 1000 Index	11.2%	13.8%	0.82
Distribution Utilities Net of Fees (Incep. 1/99)	**11.3%**	**13.2%**	**0.86**
S&P Utility	5.6%	18.6%	0.30
Russell 3000 Utilities	(0.8)%	16.0%	(0.05)
Russell 1000 Index	3.9%	14.3%	0.27

**Russell 3000 Utilities started in 5/95 so is not listed in this section.*

"The cap-shrink of the major mature markets will surely help stocks become more efficiently priced, as investors come to see that elements such as strategic positioning and the capacity for sustaining more debt are attributes of companies just as valuable as earnings or book value."

SELECTED INDICES

	4th Qtr06	12 Mo
S&P 500	6.7%	15.8%
Equity Inc	7.5	18.8
Util Fund	10.6	26.0
R3UTIL	9.0	29.4
LB Long	0.5	1.9
LBGC	1.0	3.8
R1000	7.0	15.5
Wilshire 5K	7.3	15.9

S&P 500 = Standard & Poor's Index
Equity Inc = Avg Equity Income Fund (Lipper)
Util Fund = Avg Utility Fund (Morning Star)
LB Long = Lehman Long Government
LBGC = Lehman Bros. Gov/Credit Bonds
R3UTIL = Russell 3000 Utilities
R1000 = Russell 1000
Wilshire 5K = Wilshire 5000 Market Index

capital needed to do the buyout. The McKinsey Global Institute has suggested that the current global financial total capital (equities and bonds) of $118 trillion could grow to $200 trillion in four years, and it is growing faster than global gross domestic product. This means that more money is being created than is being earned; it's the product of capital market machinations worldwide, and the machine is machinating faster and faster. Where does all this money go? It does what we should all do: it buys assets that can produce an increasing return on capital over a long horizon.

What can we learn from all the mergers and takeovers that have been steadily pouring forth from the glass towers? First of all, if there was ever any doubt that the academic understanding of investment pricing is seriously flawed, the current (and previous) M&A booms should clarify reality. No, Virginia, "the market" does not incorporate all information about a company and arrive at a perfect price that is a consensus of all market participants. That "efficient market" concept is simply proven wrong each time an investor or investor group offers an above-market price for an entire company. Indeed, one could see the entire merger and takeover trend as an arbitrage pitting participants with superior information and business abilities (acquiring companies and private equity) against the less sophisticated pricing "agreed" upon by passive investors in the everyday secondary markets. Given that the acquirers expect to make a profit on top of the premium they're paying for shares, the "dumb" money—all public equity participants, including us—must not know what they really have! Too, those with access to cheap money understand that a feature of undervaluation can be lack of debt. We prefer a margin of safety in our investments so we don't like debt, but more risk-oriented participants see the capacity to undertake more debt as an exploitable source of potential additional value.

Now one could counter that these big money buyers are wrong, and their deals will be left on the shore when the tide goes out. But that will only be known in the fullness of time. In the interim, the deals have been vetted inside and out by players who deserve some respect if for no other reason than they have, or have corralled, the money to do these deals. And we've been around long enough to see countless leveraged buyouts re-merge down the road as acquisitions by major companies or re-listed on the secondary markets when the time is ripe for private equity owners to make their exit. True, there have been many idiotic acquisitions made by company managements, but we'd say 'not so many' by those investing their own money or investing for a fee based on success.

To bring the issue down to earth, our position is this: if we own a XYZ at $30 a share and a private equity group comes along and offers $40 a share, we are willing to assume that $30 wasn't the right price. It wasn't "efficient."

The cap-shrink of the major mature markets will surely help stocks become more efficiently priced, as investors come to see that *elements such as strategic positioning and the capacity for sustaining more debt are attributes of companies just as valuable as earnings or book value.*

Share diminution should provide support for the market generally, since the same or more money will be chasing fewer available shares. The cap-shrink should likewise encourage investors to return to the well when the inevitable correction from 2006's second half occurs (any day now). We think the *very unusual* technical persistence and breadth of the market through the second half may be a kind of longer-term signpost or symbol of an awakening to the underlying effects of share reduction. At the very least, share reduction should inhibit the force of declines.

While we're cognizant of times in the past when cap-shrink did not result in a rising market—at least not immediately—those were not times when the world's capital stock was in the process of a quick doubling, nor had the emerging market economies truly emerged at all. There's lots wrong with the US and the world politically and economically right now, but there's a reasonable chance that in a low-rate environment the momentum of the various global wealth creators is sustainable, and that may have a far-reaching impact on nearly all shares.

ON ANOTHER NOTE...

We received a great deal of feedback about last quarter's overview, where we pointed out what we think are serious flaws in benchmarks and, more important, in the mentality of benchmarking. To be sure, investors need to know if their strategy or manager is generating the desired results, and the right benchmark—if it is the right benchmark—may give a rough idea for comparisons, but a far more important benchmark is whether or not your investment problems are being solved.

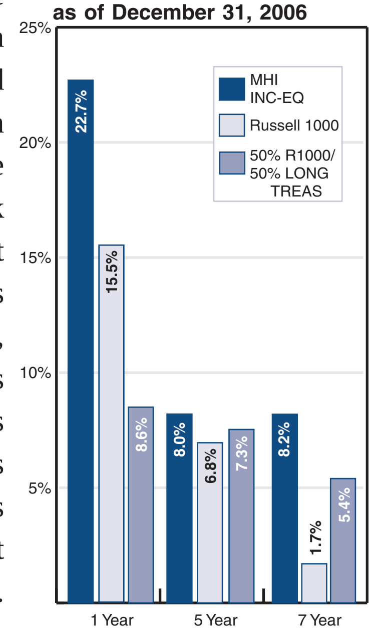
The mind naturally gravitates toward returns, and many media only report returns, totally ignoring how those returns were achieved. Yet that same mind would readily agree with Benjamin Graham's ageless maxim that a "sound investment operation provides a reasonable return at the lowest possible risk." While there is no explicit single-number benchmark that reveals the presence of that maxim—since there are, indeed, many ways to skin the cat of the market—there is a way to compare the efficacy, or dare we say efficiency, of one approach versus another. Like a fine alchemical formula, risk-adjusted return shows you how much return you are getting for a unit of risk, no matter what the investment. You should always choose the best risk-adjusted return, if you want to live a long and healthy investor life. If the return isn't high enough for you, you can always do like the big boys, and leverage it up. Your risk-adjusted return will still be better than any alternative.

So we have published some risk-adjusted returns for selected indices, as well as for our strategies on the front page of this review. We hope you will be as surprised at some of the results as we were, while also bearing in mind that many items may change places in the future (long-term bonds, for example, may not look so attractive in the future as they did during the unprecedented decline in interest rates over the past twenty years). Still, there may be some stimulus here to become aware of unconscious biases, and the true situation when risk-adjustment levels the playing field. ❑

INCOME - EQUITY STRATEGY

We typically outperform in the longer-term through stable returns in down markets. This quarter (as in the third quarter) we remained atop the broad market during a rousing upside period for all equities, and finished the year more than 40% higher than the major benchmarks (though, we hope we made it clear last quarter that we don't think the major benchmarks are especially relevant for investors who have investment problems to solve). What was particularly gratifying, and what also demonstrates the robustness of this portfolio and its diversification, was the fact that our strong performance was achieved despite several knocks from stocks that arose as a consequence of news that would be impossible for any manager to predict.

Annualized Net of Fee Returns as of December 31, 2006



PORTFOLIO HIGHLIGHTS

On that note…the Canadian minority Tory government was elected last year in part based on the promise that the tax-exempt status of their income trust sector would remain inviolate, and Finance Minister James Flaherty had, within the past 12 months, publicly stated that discussion of any changes was "put to bed and would not be re-opened." In the interim, however, BCE and other major Canadian corporations decided to file for Income Trust status, and the government began to fear an utter dwindling of corporate tax revenues. Flaherty decided to unilaterally adopt the position of his opposing political party, and decreed that henceforth new Income Trusts would be taxed as corporations (currently their income flows through to investors without tax), and existing trusts would have four years before a sunset on

Disclosure: Gross of fees performance is based on actual results calculated by using Checkfree Security APL's portfolio accounting software, which uses the BAI method of calculating performance. Contributions are time-weighted to the day and performance is linked to monthly calculate cumulative performance consistent with FAF (Financial Analysts Federation) guidelines. A complete list of all composites is available. Net of fees performance is calculated by deducting an annual fee of 100 basis points from gross of fees performance. Returns are total returns, dividends are assumed to be reinvested & portfolios are matched across all accounts (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.

"We're comfortable with the portfolio and continue to search for additional situations that combine safety with opportunity."

Quarter Composite Net of Fees*	
Income-Equity*	7.1%
50/50 SP500 & Long Treas	3.6%
Russell 1000	7.0%

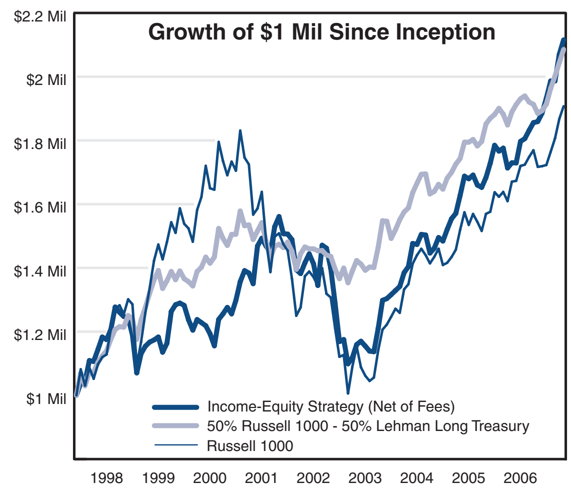
12-Month Composite Net of Fees*	
Income-Equity*	22.7%
50/50 SP500 & Long Treas	8.7%
Russell 1000	15.5%

9-Year Composite Net of Fees*	
Income-Equity*	6.7%
50/50 SP500 & Long Treas	7.1%
Russell 1000	6.2%

Included are all unrestricted portfolios that have been managed for one full quarter. As of 12/31/06: 634 accounts in composite, representing 55% of total assets in the strategy with a dispersion of 0.16. Inception: 5/97. We offer a customized version of Income-Equity that excludes Master Limited Partnerships. These accounts are not included in the composite and represent 30% of the total assets in the strategy.

their status. As we noted in our intra-quarter report on the subject, it was as if George W. Bush woke up one day and decided "we're gonna have a whole lot of new taxes!"

Predictably, the entire Income Trust sector fell sharply on the news. We ran a dividend-discount model to determine how far these stocks should fall based on full corporate taxation four years hence. What we found was that the stocks declined on the first day of the announcement almost the exact amount that a discount model would dictate. But most are now yet lower. And the model does not assume any reduction in tax paid from depreciation, depletion, return of capital, or any of the other tax-reduction techniques for which energy companies in particular are so well-known. Nor does the model assume any growth in underlying companies—and it is the basic strength of the underlying companies that interests us in these stocks in the first place. So, really, a ten-finger calculation on the long-term effect of this change on the companies would imply something in the neighborhood of a 5-10% immediate decline, with pricing thereafter to be determined by the strength of the company's ongoing fundamentals. But the majority of the stocks in the group are down 20% and more—at a time when comparable stocks have been rising. To put it differently, an investor today in these companies might build a position, including four years of tax-favored income, at book value or less, while comparable companies in the same industries today sell at 2-3 times book value. When we wrote our intra-quarter release we weren't sure about the "opportunity" aspects of the current situation. Now it's clear that many trusts are undervalued. And that's without any softening



in the government's position, which has already happened. Originally the trusts were not going to be permitted to add capital or grow during the four-year period. Now they're allowed to double. Could it be that existing trusts may be grandfathered when the dust settles? We don't know, but the legislature is closely split and it is a situation ripe for relief or good news. We'll see, but we're still buyers, and we continue to see excellent value in the underlying assets with or without a softening in pre-existing trust treatment. Regarding Enerplus, we might add, we're still up nearly 150% on original cost. Gains like that are never merely the result of favorable tax treatment.

We also had to rebound from Pfizer's announcement that it would cease trials on its promising anti-cholesteral drug torcetrapib. That dent to its pipeline prompted a brief and fairly mild sell-off in the stock, but it was still a drag for the quarter. As some literal and figurative compensation, the company raised its dividend 21%, reported earnings sharply better than consensus, and guided to high single-digit earnings growth for the next several years.

That's enough, we think, for a cash-rich company selling at a PE of 13 and a yield of just under 5% based on the new dividend.

The news was bright in nearly every other corner of the portfolio. Adding together Alberto Culver's $25 cash dividend, the Sally Beauty stock received, and the value of the ACV stock currently, we're up about 15% on original purchase. Because neither ACV nor Sally offers yield at the level required for this portfolio, we won't be involved for too much longer, but the idea has been a boon to cash flow as well as a total-return market-beater. Companies that either beat earnings expectations or guided upward include AT&T, Abbott, Bayer, Capital Source, Colgate-Palmolive, Enbridge Energy Partners, Energy East, Enterprise Partners, Johnson & Johnson, General Mills (we hold the Lehman convert), MCG Capital, Microsoft, NiSource, ONEOK, ONEOK Partners, Proctor & Gamble, St. Paul, Schering Plough, Tidewater, US Bancorp, and VF Corp. That's quite a list, but even those not making it continue to show good prospects and potential upside from acquisitions.

We don't really play the quarterly earnings game in this strategy, but we do pay attention: each stock has been purchased and held based on a kind of thesis or vision of how its prospects might unfold, and what it might be worth if its "story" comes true. Sometimes we need to fade the quarterly news and turn away, sometimes we need to grasp announcements in a chokehold, but in any event we need to know how the narrative is progressing. Because fundamentals ultimately drive price changes, a flow of good news in the portfolio implies future positive returns—since these stocks are modestly valued to begin with.

LOOKING FORWARD

As we've said before, in a world of low interest rates, grudging growth, flooding rivers of cash but dry streambeds of income, the portfolio remains in a sweet spot. The recent gains in the market carry a positive message for the longer term, though some short-term correction might be more likely now. Our portfolio valuations are not high, and our reliable income appeals to many in these times, as well as forming a defensive base when the market environment turns less sweet. We're comfortable with the portfolio and continue to search for additional situations that combine safety with opportunity.

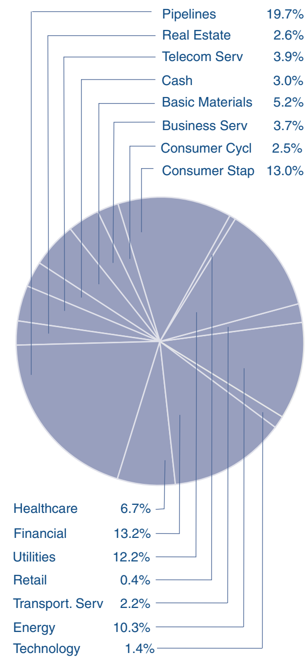
The "official" current yield of the portfolio is 5.2%, though that does not include dividend increases and special dividends that may be paid in the year ahead. Typically, the final income yield substantially exceeds a normal "current yield" figure. In 2006, the portfolio actually earned 6.4% in income as part of our 22.7% total returns (appreciation plus income) net of fees. We hope to capture just as much in the income portion during 2007, though of course that does depend on the precise level of dividend growth and the availability of special dividends. In the meantime, we're quite content to provide higher income than long-term bonds, at more favorable tax rates, with the possibility of growth in both income and principal. ❑

Annual ADV Update

If you would like a copy of our current ADV Part II, please contact Marilyn at:

(845) 679-9166 or marilyn@mhinvest.com.

The ADV will be mailed to you, free of charge.



FUNDAMENTAL CHARACTERISTICS

Yield	5.2%
Proj Dividend Growth	8.4%
Payout Ratio	60.1%
Market Cap	$35.6 Bil
Price/Book	2.9
P/E Ratio	14.9
S&P Rating	BBB+
Beta*	.54
R-Squared*	.50
Standard Deviation	11.8

**Relative to S&P 500, 12/31/97 - 12/31/06*

"...we attempt to keep the portfolio focused on leadership stocks with above-average dividend growth for both short and long terms, and we re-position our exposure as times or conditions warrant."

Quarter Composite Net of Fees*

Rising Dividend Plus*	6.1%
Russell 1000	7.0%
S&P 500	6.7%

1-Year Composite Net of Fees*

Rising Dividend Plus*	17.7%
Russell 1000	15.5%
S&P 500	15.8%

2-Year Composite Net of Fees*

Rising Dividend Plus*	21.1%
Russell 1000	10.8%
S&P 500	10.2%

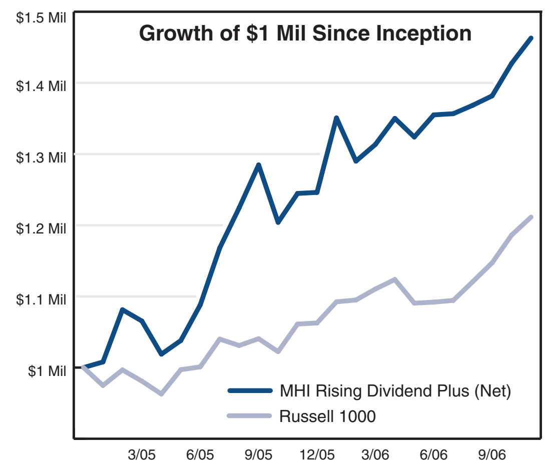
Included are all unrestricted portfolios that have been managed for at least one full quarter. As of 12/31/06: 5 accounts representing 86% of assets in the strategy, with a dispersion of 0.01. Inception: 12/04.

Rising Dividend Plus reached its two-year anniversary this quarter in good style, with returns that were similar to the broad indices in one of the strongest quarters overall for equities in a decade. The portfolio has outperformed each year and cumulatively more than doubled the return from the Russell 1000 net of fees, with no greater underlying volatility. We use a portfolio of large-cap and mid-cap stocks whose leading characteristic is a rising dividend generated by consistent and sustainable growth. In our view rising dividends demonstrate management's confidence in a company's future prospects, as well as serving to confirm the past and current reporting of financial results.

The portfolio may also include some special situation stocks with unique positioning or "stories." These include companies in transition and stocks whose technical profile is exceptional. It is a core strategy, but that doesn't mean we hew to benchmark sector weights at all times: we attempt to keep the portfolio focused on leadership stocks with above-average dividend growth for both short and long terms, and we re-position our exposure as times or conditions warrant.

PORTFOLIO HIGHLIGHTS

Goldman Sachs, one of the biggest beneficiaries of the 2006 M&A tidal wave, once again reported earnings far in excess of estimates (about 10% higher than expected) and once again appeared on our "best" list with a nearly 20% gain. The stock is up about 60% on the year (including dividends), a remarkable performance for a large-cap issue. Perhaps even more remarkable is that even though the pieces were obviously in place for strong investment banking business the company started the year at only about 7 times expected



earnings and even now trades at only a 10 multiple. We naturally feel vertiginous after a strong gain, but conditions remain favorable and for now we don't contemplate anything more radical than a trim.

Like Goldman, many of our companies reported earnings and/or revenues above expectations, and increased guidance going forward even as the majority of economists cower in predictions of an inevitable slowdown. In the third quarter we noted our purchase of Scott's Miracle Grow, pointing out its historically strong growth, its monopolistic characteristics, and likening it to a utility ("the utility of plant food")—though selling at a steep discount to utility valuations despite much more robust growth. This one also happened to ring one of our technical bells, and showed us some "miracle growth" almost immediately, rising some 17% for the quarter. Too, the company has announced a $750 million re-cap, including share-repurchases and a special dividend, the total equaling over $11 per share. It's a timely example of what can happen when you hold sustainable growth companies that are under-leveraged and under-priced.

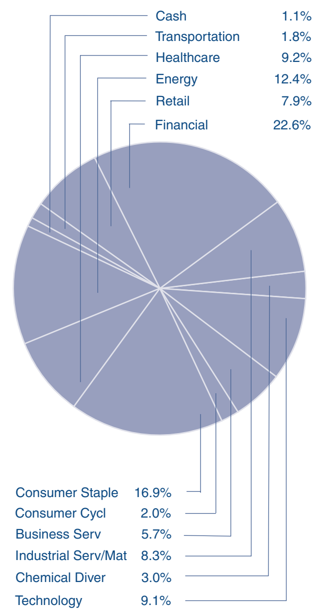
We like excitement (when it goes in the right direction!) but "boring" *can* be just as good. Packaging manufacturer Sonoco proved the point with a 14% gain, about half its year's total, though revenue and earnings reports were nothing special. This was, we think, simply a case of investors opting for moderate but sustainable growth, and re-rating the multiple they were willing to pay for that. Management hinted at an acceleration next year, but did not actually provide any concrete guidance that would explain the strong performance. Also in the "boring" zone, Avery Dennison returned about 14% on strong earnings and news that a 3-year old Dept. of Justice investigation into anticompetitive practices has been closed without any action. Ensco went from one of our worst performers to one of our best, despite spotty performance among energy-related stocks, as it joined the ranks of companies substantially outperforming earnings and revenue expectations.

There were a few underperformers but nothing was really damaging, and those that declined are reasonable candidates to lead in the upcoming months and quarters. Legg Mason hasn't quite settled its stomach in digesting Citigroup's funds, and some of their leading funds have been slow performers, so earnings were off and the stock, which had started strongly in our portfolio, fell back (though our position is still profitable). There's plenty of room for upside surprise here, as well as a robust private market for asset managers that should provide a floor. We saw evidence of this in Northern Trust, which rose for the quarter despite missing earnings expectations (though no doubt helped by an 11 million share—5% of capitalization—buyback authorization). Whirlpool provided an example of irrational investor myopia in the guise of rational analysis. The company reported earnings more than 10% ahead of expectations and raised guidance for 2007 by about 5%—which will represent a 40% increase over earnings that have been quite constant for the last several years. Investors are clearly thinking 'housing slowdown,' no matter what the company is telling them. Investors are also forgetting that with the purchase of Maytag the company now controls about 70% of the domestic large appliance market, with many years of potential cost savings as well as market dominance ahead of them. We don't think that guidance for a major and long-awaited earnings and revenue breakout next year warrants a 9.5 projected PE for a monopolistic company. Not only that, the spin cycle on our washer just broke! Truly! Let's just step out of character and call this one a future winner.

We bought Walgreen after a ridiculous decline based on Wal-Mart's promotional pricing on selected old-line generic drugs whose profitability was nil for everyone anyway. This resulted in a quick 10% gain, which is our preferred mode when commencing a long-term holding. The stock is still cheap, and as the leading drug retailer it's a great way to participate in the big wind known as the graying of America. We went bottom-fishing in Intel and Motorola in an effort to bring some technology representation to the portfolio, a move that hasn't born fruit so far. And we bought Colgate, historically cheap despite noticeably rising margins. We took profits on GE and Citigroup to make room, not a little perturbed that they made nice upward moves not long after our sales.

LOOKING FORWARD

This portfolio has flexibility. While our intent is to hold positions indefinitely, that will never interfere with our perceptions of opportunities as they arise through the unfolding of economic circumstances, or our willingness to alter our stance if tailwinds become headwinds for any of our positions or concepts. ❑



FUNDAMENTAL CHARACTERISTICS

Yield	1.4%
Proj Dividend Growth	11.1%
Payout Ratio	25%
Market Cap	$47.9 Bil
Price/Book	3.0
P/E Ratio	17.6
S&P Rating	A-

"...investors would do well to heed the investment characteristics of a portfolio and what the portfolio does in terms of solving their investment concerns rather than buying into the index-mania that has come to characterize the conformist approaches to viewing investments that dominate today."

Quarter Composite Net of Fees*

BTB/Util*	10.4%
Russell 3000 Utilities	9.0%
S&P Utilities	9.1%
LBGC	1.0%

5-Year Composite Net of Fees*

BTB/Util*	6.6%
Russell 3000 Utilities	5.0%
S&P Utilities	9.2%
LBGC	5.2%

10-Year Composite Net of Fees*

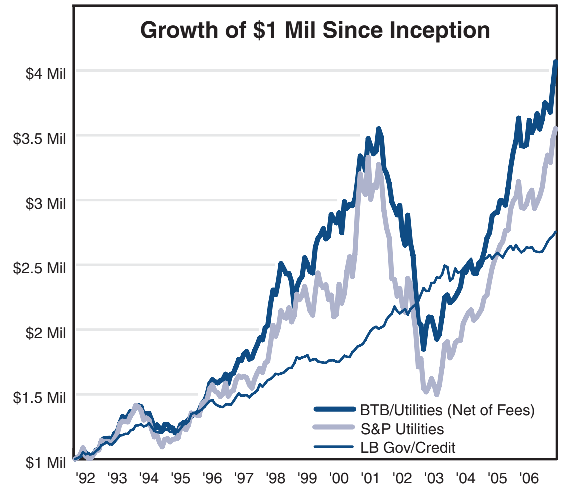
BTB/Util*	8.7%
Russell 3000 Utilities	5.1%
S&P Utilities	8.2%
LBGC	6.3%

Included are all unrestricted portfolios that have been managed for at least one full quarter. As of 12/30/06: 162 accounts representing 94% of assets in the strategy, with a dispersion of 0.09. Inception: 9/91.

Last quarter we pointed out some of the oddities in seeking an appropriate benchmark for this portfolio, which is like no other. The Dow Jones Utilities Average and S&P Utilities indices don't work, since they are dominated by large-cap nuclear electric utilities that we exclude from our portfolios through our social screens. The Russell 3000 Utilities is better, since it includes telecom and many other, small companies, of the type we use (though these latter are at low weights). But, as we've seen this year, the R3000 Utilities contains unstable potentials, as 28% of the index weight is represented by AT&T/Bellsouth and Verizon—a weight we would never hold in the portfolio in consideration of standard principles of diversification and prudence.

The indices do give an investor an indication of whether or not utilities have been naughty or nice, and whether electrics or telecoms have been the place to be. But there's an utter lack of precision or fit to the BTB/Utilities strategy in terms of return and risk. This was true in 2005, when we were radically ahead, and in 2006, when we were moderately lower. It was true as well in the third quarter of 2006 when lower domestic telecom weighting in our portfolio made all the difference. And it was true this past quarter, when T/BLS performed only decently, Verizon was a laggard, and gas stocks were relatively neutral to returns. Interestingly, the S&P Utilities, which has no phone companies, provided an almost identical return compared to the R3000 Utilities (which is more than half telecom). A returns-based analysis would say that they *are* identical, though of course we know they are not. Our return was quite a bit better than both, which shows…that there are many different lines of sight into the utilities sector.

As if to add an exclamation to the points above, we had 17 stocks in the portfolio with returns of 10% or more, and only one (Sprint) appears in the top ten weights for any of the major utility indices. In other words, this quarter's outperformance came from stocks that are not even meaningful to the indices. Last quarter we suggested that investors would do well to heed the investment characteristics of a portfolio and what the portfolio does in terms of solving their investment concerns rather than buying into the index-mania that has come to characterize the conformist approaches to viewing investments that dominate today. To paraphrase Ross Perot's famous line, "we rest our case."



PORTFOLIO HIGHLIGHTS

We suggested in October that conditions were favorable for this portfolio despite earlier gains, and the quarter was strong across the board, with essential service companies of all types reaching or exceeding absolute and relative valuation records. Foreign telecoms continued on a tear, benefiting from both strong local growth and a softening dollar. Indeed, for the year, three of our top five performers were foreign telecoms—and the same was true for the quarter, though the names were not the same. Previous laggard Brasil Telecom Participacoes led the quarterly list with a gain of over 40%. It was a beneficiary of the re-election of President Lula as well as renewed speculation regarding its acquisition by one of several major players in Brazil, each of which is a reasonable candidate in our view. Both Telefonos de Mexico and America Movil were helped by election results as well, though Mexican politics remains less stable and more contentious than it has been in many years——a factor we're watching closely. Still, Telmex is one of the world's cheapest legacy phone companies and America Movil one of its fastest growing, so those two ends of the investment barbell remain attractive to us. PT Telekomunikiasi added another 25% gain, bringing its one year return to over 90% and our return on original cost to over 110%, and prompting thoughts of trimming once gain in our minds.

China Mobile also gained more than 20% for the quarter (and over 80% for the year), as investors re-entered emerging markets during the quarter. This one gives us a mild infantile pleasure, as when we first entered the position most sell-side analysts had negative opinions on the stock and low price targets for it. We're acutely aware that no tree grows to the sky, but let us agree that this has been a solid way to invest in the communications needs of one of the most rapidly growing societies in the history of the world.

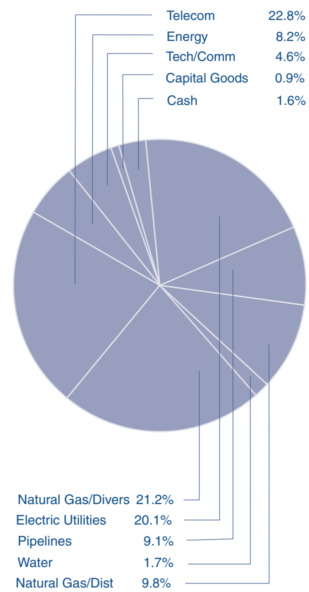
Other leaders include many names rarely found in other utility portfolios. Dynegy's recovery story continues apace, but it still sells at an enterprise/ebitda ratio 25% or so below anything comparable. Generator NRG engaged in some financial and hedge restructuring and received approval for a new and innovative combined-cycled gasification plant (clean coal) in New York State. These factors and a nearly 200% revenue increase prompted investors to bid up the stock over 20%. Equitable Resources rose about 20% even though the gas group showed little this quarter. Intimations of M&A? Possibly, though we trimmed a bit on valuation concerns. Enterprise Products delivered upside earnings, which should help increase their already very large payouts.

We bought El Paso, with good initial results as the company sold its ANR pipeline shortly thereafter, inducing a bump up in the stock. We bought a small initial position in Mueller Water Products, a supplier to municipal water systems, in anticipation of its full spinoff from Walter Industries, though that event didn't provide the short-term boost we'd anticipated. We also bought Spectra Energy—the natural gas division of Duke Energy—on a when-issued basis prior to its January 3rd launch on the NYSE and inclusion in the S&P 500. We think there are lots of profitable possibilities for this one, once it is free from the DUK corporate structure and it could be an acquisition candidate as well.

Bad news? None of any note this quarter. Cypress Semiconductor fell as takeover speculation was squashed by the company, but we think the value of its majority holding in fast-growing solar company SunPower—the reason why we hold it—will be realized for shareholders sooner rather than later.

LOOKING FORWARD

We're typically neurotic money managers and prosperity is a source of anxiety in our minds, rather than a source of joy in our hearts. We're not thrilled with the valuations of large-cap electrics or telecoms, but we're comforted by the fact that we have many non-index situations to which we can turn for both protection and opportunity. Three years of fantastic returns fairly beg for correction among the popular names, but our diverse positions have strong fundamental momentum and pricing is likely to follow those trends. ❑

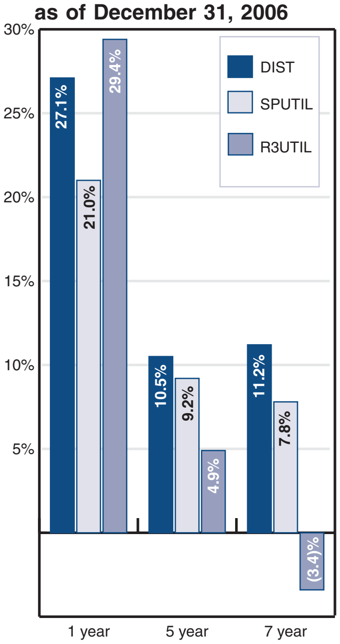


FUNDAMENTAL CHARACTERISTICS

Yield	2.4%
Proj Dividend Growth	6.4%
Payout Ratio	37.2%
Market Cap	$24.8 Bil
Price/Book	2.8
P/E Ratio	18.1
S&P Rating	BBB+
Beta*	0.59
R-Squared*	0.42
Standard Deviation	14.0

**Relative to S&P500, 12/31/96-12/31/06*

Annualized Net of Fee Returns as of December 31, 2006



Quarter Composite Net of Fees*

Distribution (Prelim)	10.7%
Russell 3000 Utilities	9.0%
S&P Utilities	9.1%
S&P 500	6.7%

1-Year Composite Net of Fees*

Distribution (Prelim)	27.1%
Russell 3000 Utilities	29.4%
S&P Utilities	21.0%
S&P 500	15.8%

7-Year Composite Net of Fees*

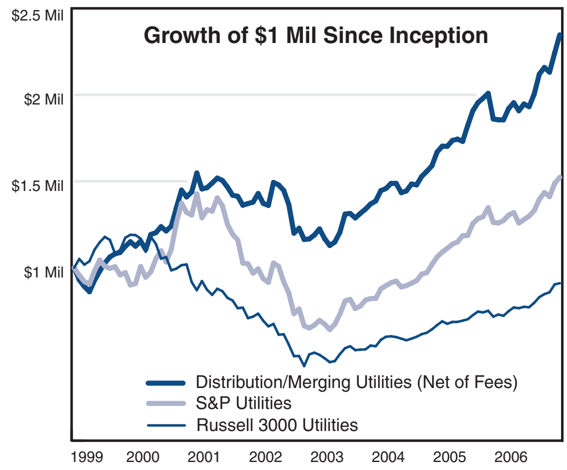
Distribution (Prelim)	11.2%
Russell 3000 Utilities	(3.4)%
S&P Utilities	7.8%
S&P 500	1.1%

Included are all unrestricted portfolios that have been managed for one full quarter. As of 12/31/06: 227 accounts, representing 95% of total assets managed in the strategy with a dispersion of 0.13. Inception: 1/99.

In the fourth quarter of last year this strategy experienced an unusual and sharp correction, as funds shifted abruptly to the telecom sector, among other reasons. But the underlying fundamentals of the companies had not changed (last time we checked there was no substitute for electricity and no replacement for heating fuel), nor had the appeal of infrastructure assets lost any sheen in the burgeoning world of private equity investment. We thought the opening of 2006 marked a kind of "restart" moment, and that the stocks were poised to deliver the same kind of solid returns investors have experienced since inception of the strategy. We will confess two things: first, we prefer conservatism and understatement in our outlooks—we think of that as realism. Second, we swear we did not expect our strategy to have a roughly 11% fourth quarter and outperform nearly every kind of domestic equity in sight, more than doubling the average diversified mutual fund for the full year. Really. Don't accuse us of keeping secrets! Indeed, if nothing else, 2006 was an object lesson in why equity investors generally do best when they stay fully invested in good assets: virtually no strategist that we can think of expected 2006 to be a good year for stocks generally, and even fewer (!) thought that our local monopoly acquisition candidate utilities would approach 30% returns for the year. To be sure, we and others thought that utilities and similar stocks had substantial appeal for investors under many potential economic scenarios, but, honestly, these kinds of returns are what the NASDAQ folks are shooting for (and almost never get). Shhhhh. Let's not tell them the action's really here.

PORTFOLIO HIGHLIGHTS

When we buy stocks for this portfolio that are a bit out of the mainstream—though still



consolidation candidates—we tend to adjust position size downward, as most of these are more volatile than our historic portfolio average (which has been ranked among the lowest for equity volatility by numerous databases). Too bad! We would have liked a triple-weight in flyer Vimpel Telecom, a fast-growth Russian cellular company that has been involved in takeover negotiations, which we sold after a 75% gain this year, 30% of it this past quarter. Also overseas, but more conventionally for us, we received a solid takeover offer for Scottish Power—our participation in the very active Eurozone utility consolidation trend—from Spanish utility Iberdrola, sending SPI up 20% for the quarter.

Indeed, double-digit gains were common in the 4th quarter: 60% of our stocks returned 10% or more on a price-only basis. Among these, our new addition El Paso brought a 10%+ gain and got busy on the M&A front only weeks after we bought it, selling their ANR Pipeline to TransCanada Corp. The debt reduction that will result from this deal should result in a return to investment grade credit rating for EP, a factor we thought was imminent, if not *so* imminent, when we bought the stock. Our interest in Dynegy has been an extension of our interest in the generation sector; overbuilding of plants five years ago resulted in excess capacity that has recently appeared filled by demand, and new plants are more in the planning stage than actually under construction. Too, most new plants considered today, in a turnabout, are coal-fired—and these large beauties take a long time to build. Firmer electricity pricing should allow DYN to continue to rebuild its financial house and to prosper as in former times. Some may still regard this one skeptically, but it appears to sell at about 7 times free cash flow for next year, and its assets become more attractive to acquirers with each passing day and with each new debt reduction.

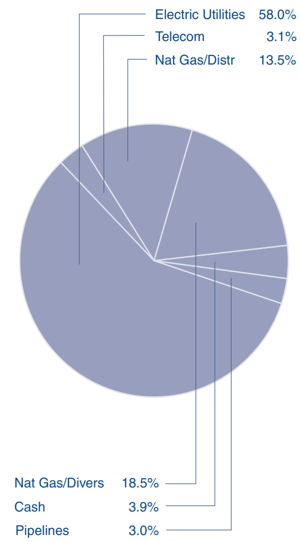
Heavyweight Sierra Pacific Resources continued to be a big contributor, up about 18%, and the recovery story here is blossoming into a full lift-off. The company has sold off some non-core assets and laid the groundwork for new generation and transmission projects, receiving continuing favorable treatment from state regulators. NiSource, which has been static (to put it politely) for many quarters, reported much better than expected earnings. This very cheap company may finally be ready to join the sector on the upside, we think, and its Columbia Gas pipeline division should be very attractive to many potential acquirers. Northeast Utilities is now essentially a pure local distribution company, and the market has responded favorably to its restructuring, re-rating the stock upward by 20% for the quarter and 42% for the year. It's getting a bit rich, in our view, warranting some trimming, but it's interesting strategic position does warrant a premium.

On the downside…well…we had no stocks down in the fourth quarter. For the year, Sprint was down about a percent from our cost, and that was it. Every other stock in the portfolio rose.

LOOKING FORWARD

2007 isn't likely to provide returns as giddy as last year, but there remains a plethora of solid values in the portfolio, and in a slowish economy investors will still be drawn to solid stories with moderate and sustainable growth. Consolidation activity has slowed—though we continue to see a steady if diminished flow of deals in the portfolio—in part because valuations have risen closer to private market values. But the majority of our positions remain notably below previous takeover metrics, and those metrics should begin to inflate a bit as a function of a dawning sense of scarcity among interested acquirers. Too, we hold many more turnaround stories than at some other times in the past, and these companies offer strong upward pricing prospects—since in every case the necessary milestones are being met and a return to "normalcy" implies much higher valuations. Still, some correction ahead should not be unexpected. And when that happens investors should remain aware that these stocks have an M&A constituency which becomes ever more enthusiastic as prices decline. Between corporate acquirers, private equity, traditional utility owners, and newly-awakened dividend seekers, these stocks have plenty of interested buyers. Further, there has been much M&A activity at the asset rather than the company level, and this has been and will be a driver for many of our companies.

Risk/reward results have been fantastic here, but, like any good investment, returns have been marked by occasional pauses and we should expect that pattern to continue in the future. ❑



FUNDAMENTAL CHARACTERISTICS

Yield	3.1%
Proj Dividend Growth	5.1%
Payout Ratio	48%
Market Cap	$8.8 Bil
Price/Book	2.0
P/E Ratio	17.0
S&P Rating	BBB+
Beta*	0.47
R-Squared*	0.27
Standard Deviation	12.5

**Relative to S&P 500, 12/31/00 - 12/3100/06*

WIND + WIND CATCHER = LONGEVITY

We purchased carbon offset credits from Native Energy as our New Year's gift to clients, advisors, employees, and friends.

NativeEnergy finances and builds new clean and renewable energy projects that help Native Americans and Alaska Natives create sustainable economic benefits, and that help America's family farmers compete with agribusiness. These projects will displace electricity from fossil fuels and reduce other greenhouse gas emissions on your behalf, making up for the CO2 emissions you can't avoid. A list of their current projects can be found on their website at www.nativeenergy.com.

Best Wishes for 2007 and beyond from all of us at Miller/Howard Investments.

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