

MARKET OVERVIEW

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.

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 / EMERGING UTILITIES

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

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.

Last quarter we noted that despite the apparent rooting in of “momentum” during 2003, the end of the year revealed the beginning of a reversal from low-quality stocks and aggressive issues toward larger and higher quality merchandise. This past quarter saw a continuation of that trend, though accompanied by a realization in the marketplace that the concerns we’ve been pointing out for some time are real. One percent interest rates have been a symptom, for example, of an economy that may stall if substantial new jobs are not produced—and yet this concern arises in the midst of fairly lively corporate profits and distinct increases in revenues. (Indeed, the most recent jobs reports and ISM reports on economic activity have been undeniably strong). The concerns have resolved into a kind of debate over whether the current market represents a new durable bull market, or the culminating phase of a substantial rally within the context of an ongoing bear market, or, neither bull nor bear, a range-swinging landscape.

For nearly two years we’ve suggested that broad ranges were more likely than either a persistent bear or bull market, primarily because there have been too many red flags to inspire confidence in relentlessly rising prices. At the same time the world has clearly not come to an end—and chances are it won’t. We suggested last time that the flow of funds into better quality stocks was a positive feature, but as became clear in March, this market is fragile enough to stumble when terrorist bombs go off across the ocean.

The nature of those elements in the picture that are amenable to rational analysis—as opposed to the now ever-present threat of external shocks—hasn’t changed very much. The overall picture is far healthier and more “normal” than it has been in recent years, leading to a more generally positive broad-brush assessment. The economic environment has taken root at a global level, and sent out new growth. Still, the picture is incomplete, and decorated like a voodoo tree with the rattles and mysterious signs of a context to which investors are trying to adapt, though it’s a context without historical precedent for guidance.

We’ve revised our “ten points” toward a more conventional analysis. The issue of investor confidence in corporate governance, for example, which was so cogent in 2002 seems irrelevant in a time when investors fail to leave mutual funds that have violated their trust (as well as their returns):

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"...now that the 'bargains' in the eyes of speculators have been lifted off the bottom, it's time for investors to look around and consider the broader prospects for the future."

SELECTED INDICES		
	1 st Qtr'04	12 Mo
S&P 500	1.70	35.13
Equity Inc	2.34	34.41
Util Fund	3.40	30.99
DJU	6.32	40.44
LB Long	5.32	6.45
LBGC	3.08	6.15
S&P 400	5.07	49.13
Wilshire 5K	2.61	39.39
Rus 2000	6.26	63.83

S&P 500 = Standard & Poor's Index
 Equity Inc = Avg Equity Income Fund (Lipper)
 Util Fund = Avg Utility Fund (Morning Star)
 DJU = Dow Jones Utilities Avg
 LB Long = Lehman Long Government
 LBGC = Lehman Bros. Gov/Credit Bonds
 S&P 400 = S&P Mid Cap Index
 Wilshire 5K = Wilshire 5000 Market Index
 Rus 2000 = Russell 2000

- 1) *The Fed.* The now-famous “patience” of the Fed is the most unsettling feature of the picture for us. If the Fed “can afford to be patient,” doesn’t this mean that there continues to be significant excess capacity here and globally (since so many of the products we buy are globally produced now)? Doesn’t this mean that there is little demand for the money the Fed so cheaply distributes? If there is little demand for the money, doesn’t that mean that there’s little need for new capital goods and facilities? Doesn’t this also mean that the Fed doesn’t really care about the expanded valuation plenum in equities and real estate that their policies have inflated? We’re supposed to have faith that this course will work—and recent numbers cast a vote in favor—but what happens when the boost from tax cuts fades in the second half? Alternatively, if the economy can really sustain recent progress, what happens to valuations in a higher interest-rate environment?
- 2) *Terrorism.* This factor is on investors’ minds, as was clearly shown in March. Given the success of the terrorists in Spain, it’s reasonable to think that they will seek a way to damage the current U.S. administration. And, in the process, a fairly fragile equity market may experience collateral damage.
- 3) *Traditional sentiment measures.* We’ve discussed at some length the fact that these measures——advisor bullishness, volatility index, and the like——provided no help in 2003, though they have a long record of predictive ability which we’re not ready to toss over. Sentiment may be better than it looks, as advisors were quick to dart for cover at the first signs of correction in March. But by historic measures, there are still too many bulls around to support a really solid market.
- 4) *Our proprietary options indicator.* This is still bullish, as it has been since early last spring, though the bloom is somewhat off the rose, and we rate it “moderately” bullish. What’s changed in this series are the ratings for the Dow Jones Industrials, which have diminished to no better than neutral.
- 5) *Valuations.* We are finding it harder and harder to find reasonably valued stocks in any sector. This is in part a function of the low current interest rates which tend to drive P/E ratios higher, and in part a function of the lack of alternatives for most investors (due to the same low interest rates), which tends to drive investment dollars into equities. The biggest question on the horizon is how investors in high-valued equities will react when the time finally comes for long-term interest rates to rise. We don’t think that Waterloo is on the horizon for the next quarter or two, but one never knows the precise timing of things in a world that discounts variable-length segments of the future. Will investors discount the next six months? The next two years? The next five years?
- 6) *The Dollar.* Euro-mania seems to have cooled for now; Euroland, Britain, and Japan, have survived the strengthening of their respective currencies, demonstrating once again the adaptability of market economies. Still, a struggle to meet growth goals in Europe is emerging, and consequent calls for interest rate reductions will likely result in a static Euro for a while. American multinationals should benefit from a higher plateau in the Euro and the Pound.
- 7) *Mutual Fund cash flows.* Strength remains. We shouldn’t forget that the growth in 401-K and state plans provided a steady source of demand for stocks through the 1990’s as well as during this decade, and though cash flows alone aren’t enough to induce strong markets, they

remain a support that was never present in previous epochs, and argue in favor of long-term bullish trends—interim volatility notwithstanding.

- 8) *Earnings.* Profits have been generally better than expected, though some contend that 2003 profits were frequently driven by lower tax rates (including accelerated depreciation) and job cutting/outsourcing. The situation has flipped from one of easy comparisons between 2003 and 2002 to tougher comparisons between 2004 and 2003. Revenues will have to grow yet further to keep up the pace of profit growth, and current modest job creation needs to move to a higher level to provide assistance on this score. But ISM numbers suggest hopes for eventual substantial job creation are probably no longer mere wishful thinking.
- 9) *There are hidden taxes.* Rising energy prices hurt all businesses, particularly manufacturers, while they also directly “tax” consumers, and there is no relief in sight. By our calculations, the average middle-class taxpayer has returned most of his or her tax cut in the form of higher gasoline and heating prices. In our view, there are many reasons to think that high energy prices will persist, and may even worsen in the coming quarters, providing a drag on growth.
- 10) *Insiders are reluctant.* Insider selling continues to dominate paltry insider buying to an overwhelming degree. Along with miniscule interest rates, this factor remains a distinct red flag.

In sum, now that the “bargains” in the eyes of speculators have been lifted off the bottom, it’s time for investors to look around and consider the broader prospects for the future. The economy and the markets appear to have successfully whistled past the graveyard in the

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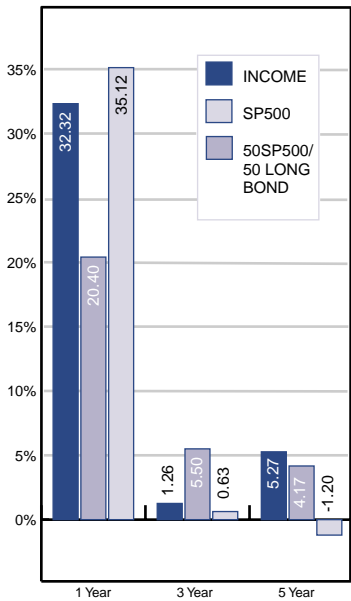
Following a year of outstanding returns, our portfolios managed to perform well yet again, finishing the quarter with positive returns that were slightly better than the S&P 500. A quiescent interest rate environment and a shift toward higher quality issues probably helped our performance, and there were no disappointing fundamental developments in our stocks. Our average annualized returns for the past five years are some 600 basis points above the S&P 500, during a time of turmoil and oscillation between growth and value stocks. While five years is not a lifetime, the case continues to build, in this election year, for a vote in favor of steady yield stocks versus the erratically fulfilled promises of growth issues.

PORTFOLIO HIGHLIGHTS

Growing concerns over REIT valuations in light of exponentially rising NAV premiums, kept our exposure to the group at marginal levels. Ironically, our best performing stock this quarter came from this most underweighted sector. Urstadt Biddle, our only pure REIT holding, finished the quarter up 16% before dividends. As we pointed out in our year-end report, UBA is one of the most conservatively managed companies in the REIT universe, no doubt overlooked due to its small size. Remarkably, even at current levels UBA is the only quality REIT trading at a discount to the net value of its assets, consisting primarily of grocery store-anchored shopping centers in upscale neighborhoods. In January we took profits in Cousins Properties as a combination of factors, including stretched valuations coupled with a mediocre earnings report and our general paranoia concerning the sector, proved conclusive. Indeed, as we write the

“Income-oriented investors have fewer and fewer places to turn in today’s world, and our portfolio is a logical solution to their problems.”

**Annualized Returns
as of March 31, 2004**



Quarter Composite Net of Fees*

Income-Equity (Prelim)	1.9%
50/50 SP500 & Long Gov	3.5%

12-Month Composite Net of Fees*

Income-Equity (Prelim)	32.3%
50/50 SP500 & Long Gov	20.4%

5-Year Composite Net of Fees*

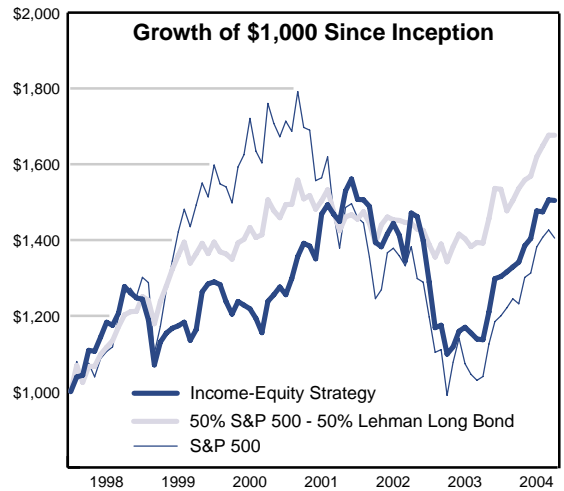
Income-Equity (Prelim)	5.3%
50/50 SP500 & Long Gov	4.2%

*See Performance Disclosure on page 12.

REIT sector is experiencing one of its sharpest short-term sell-offs in years. We did add high-yielding MFA Mortgage Investments, a REIT that invests primarily in highly rated adjustable rate mortgage securities—with the thought that adjustable-rate mortgages would actually benefit from a steepening yield curve, as opposed to nearly all other REITs, which will most likely suffer from it.

Our convertibles had a mixed showing, with Motorola leading the group (up 18%) on optimism surrounding the handset sector and a recovery in telecom industry spending. While we're impressed with Motorola's recent steps to secure and further strengthen its competitive position in the global marketplace, we felt it was prudent to trim our position in early March, just prior to a brief but sizeable correction in technology names. In this case, over time we've participated in a doubling of the underlying stock, with a 7% yield as an additional incentive to remain committed. Our utilities also helped this past quarter: each was up, and United Utilities led with an 8% gain. MLPs, banks and insurance companies were mixed, and our food stocks were generally higher.

Consolidation in the financial sector hasn't shown any signs of slowing down, with several dozen deals announced just in the first quarter, including one of our own — Union Planters will be merging with Regions Financial (which is itself a takeover candidate, in our view). Having examined recent M&A metrics, we note that all of our bank holdings continue to trade at a substantial discount to announced premiums, leaving plenty of room for capital appreciation. Just as important, dividend growth continues to steadily enrich shareholders in the industry. At the end of March we found a financial sector bargain overseas and added ING, a recovery story, on a pullback from recent highs. Fundamentals here remain strong,



making current valuation at 9x earnings and a soon to be received large mid-year dividend especially attractive to the portfolio.

Expanding our pharmaceutical exposure, we added a position in Merck, a rock-solid name, an AAA-rated company since the seventies, with a current yield of over 3% and tremendous dividend growth history. Much skepticism over Merck's dwindling pipeline, in our view, has been already priced in the stock, which should be supported going forward by its historically low valuations, attractive current dividend and prospects for future earnings growth from products in late development stages. Too, there is a significant trend of large pharma companies buying new pipeline prospects by acquiring smaller biotech companies with late-stage products, and Merck certainly has the wherewithal to participate in this way.

Toward the end of the quarter we took partial profits in Worthington Industries, a turnaround position we highlighted in previous reports. Having appreciated 6% for the quarter and over 30% since original purchase, WOR's valuation finally started catching up to the rest of the steel industry, which is enjoying a period of record growth. In recent quarters Worthington has been successful at passing on rising cost of raw materials to customers, driven

by strong demand and tight steel supply. Still, despite a positive outlook for industrial markets and pricing dynamics in the near-term, WOR remains a commodity-sensitive name and at close to fair value the name has become more vulnerable to changes in the commodity background—about which we’re not as bullish as we were when steel was much cheaper.

In our quest for extra dividend income, we decided to step out of the box, buying a typically non-yielding name, Anixter International, for its special dividend of \$1.50/share representing a one-time yield of over 5%. We’ve liked AXE, in the business of communications, cable and specialty wire products, for quite some time and we view the dividend as yet another signal of the quality of Anixter’s financial decision-making. In addition, current valuation leaves room for good earnings leverage should the networking infrastructure continue to unfold as expected. While it’s not our intention to hold this position over the long-term (and we are not buying it for new clients), we like the diversification offered by AXE, and its conservative exposure to technology growth. Not incidentally, as we write, the stock is higher than our purchase price—even after going “ex” to adjust for the cash dividend.

LOOKING FORWARD

Income-oriented investors have fewer and fewer places to turn in today’s world, and our portfolio is a logical solution to their problems. Treasury bond investors are now more threatened by higher rates than at any time in the last ten years. In the months ahead, should ISM numbers and job reports recapitulate those seen in March, investors in high credit bonds have nothing but capital depreciation in prospect. Junk bond and emerging market investors at this point can’t really get a higher

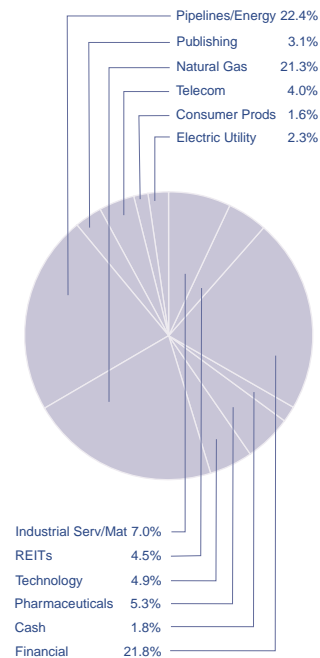
yield than our portfolio provides, and yet the average credit rating on our stocks is A-/BBB+. Our yield rises with dividend increases while the static (and lower) bond yields never change. Indeed, an investor in our Income-Equity portfolio at inception who re-invested all dividends would today be receiving a yield of nearly 9% on initial capital—from income alone.

Our stocks generally increase earnings and grow over the years, while bonds don’t grow at all. Investors in REITs, another high-yield equity area, must contend with the fact that they are paying 10-30% more than their assets are worth, and such premiums will no doubt regress to the mean. As we mentioned in the Overview, the environment is not without crosscurrents and vulnerabilities. But in a yield-starved world that is increasingly turning to quality issues, we would seem to be in a fine position.

Current yield for the portfolio is 5.6%, and expected growth of yield is approximately 4%. □

Continued from page 3

past six quarters, but there are enough red flags in the picture—historically high valuations, uncertainty persisting on the jobs front, diminished technical signals, continued low insider bullishness, questions about the sufficiency of economic growth, steady reminders of the terrorism threat—for us to think that a strong market isn’t incipient, and that any rallies will produce vertigo. Latecomers and recovery true believers are clearly present, and would likely become more evident as supporter in declines, but we think substantial digestion is necessary before the future roadmap becomes clearer. □



FUNDAMENTAL CHARACTERISTICS

Yield	5.6%
Proj Dividend Growth	4.2%
Payout Ratio	58.7%
Market Cap (MDN)	\$5.4 Bil
Price/Book	2.3
P/E Ratio** (MDN)	16.3
S&P Rating	A-
Beta*	.54
Standard Deviation	13.4%

*Relative to S&P 500, 3/31/99 - 3/31/04

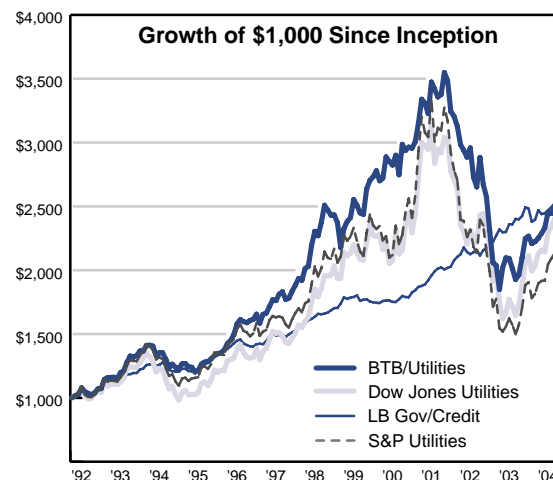
**REITs use P/FFO ratio

“Should the stars continue to move toward a genuine natural gas crunch – which is our expectation – we are prepared to increase our weight in natural gas producers...”

Our utilities portfolio got off to a good start this year with little in the way of news during the quarter beyond generally favorable weather and moderate economic activity. Within our portfolio, natural gas distribution companies fared best as a group, followed by our pure-play natural gas producers, and an assortment of electric utilities lifted by positive newsflow. We further reduced our exposure to the ever-more-competitive US telecom market, while introducing a little foreign, old-fashioned regulated telecom. Our thesis for a natural gas “Summer Surprise” remains wholly intact, and the portfolio is well-positioned to benefit from rising natural gas prices. Should the stars continue to move toward a genuine natural gas crunch – which is our expectation – we are prepared to increase our weight in natural gas producers as a complement to our more conservative utility holdings.

PORTFOLIO HIGHLIGHTS

Our natural gas distribution companies (most located East of the Mississippi) performed nicely this past quarter, driven by colder than normal temperatures in their territories, and rising commercial and industrial demand for gas: WGL Holdings (+8.31%), Peoples Energy (+6.21%), Atmos Energy (+5.23%) and Nicor (+3.50%). Our gas distributors with gas production and marketing divisions also performed well, though their strength in recent quarters contributed to more moderate appreciation in the current quarter: Keyspan (+3.86%), Questar (+3.69%), Equitable Resources (+3.49%), Southern Union (+2.99%) and Oneok (+2.13%). Pure-play natural gas exploration and production company, Burlington Resources posted our biggest gains for the



quarter (+14.90%), while fellow E&P companies Devon Energy and EOG Resources increased their dividends 100% and 20%, respectively, while continuing to pay down debt and strengthen their balance sheets.

Energy East was our biggest gainer among electric utilities (+13.21%), driven in part by the filing of a rate plan with NY State that will allow EAS to divest itself of its last generation plant to Constellation Energy this Summer, and become a pure distribution and transmission company. United Utilities (+8.03%), Britain’s largest publicly traded, regulated water utility announced recently that profits will rise this year following a much anticipated rate increase. Cinergy (+5.36%), electric and gas utility based in Cincinnati, Ohio, continues to make headlines as an early developer of Broadband Line Communications (high speed data services over traditional electric power lines), and a low cost producer of electricity in the Midwest. Pepco Holdings (+4.61%), the electric and gas utility serving Washington, DC and Maryland, witnessed some clouds related to Mirant’s bankruptcy begin to clear, and received a rate increase in Maryland. We believe that at current valuations, POM is a superb takeover candidate.

Quarter Composite Net of Fees*

BTB/Util (Preliminary)	2.1%
DJUA (total return)	6.3%
S&P Utilities	5.1%
LBGC	3.1%

12-Month Composite Net of Fees*

BTB/Util (Preliminary)	27.3%
DJUA (total return)	40.4%
S&P Utilities	36.9%
LBGC	6.2%

10-Year Composite Net of Fees*

BTB/Util (Preliminary)	7.3%
DJUA (total return)	8.6%
S&P Utilities	6.3%
LBGC	7.7%

*See Performance Disclosure on page 12.

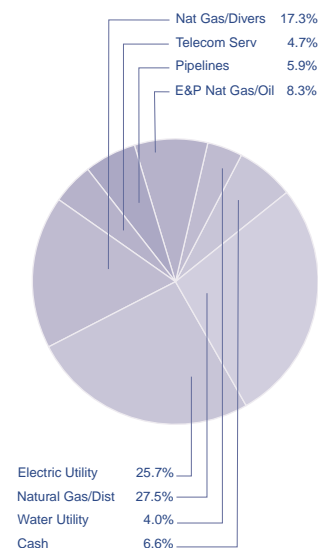
As promised, we continued to reduce our exposure to the US telecom industry by exiting our position in long-time favorite Alltel. Though we still believe that rural telecoms such as Alltel and CenturyTel have an insular advantage over the more urban-centric Baby Bells (and we might use them as trading vehicles to participate in positive news developments), the threat posed by Voice Over Internet Protocol (VOIP) casts a shadow over all US telecom companies, and we don't believe the risk/reward profile justified sticking around. We added Telefonos de Mexico (TMX) this quarter (+5.39% as of this writing), Mexico's dominant fixed-line and wireless telephone company, because of its solid domestic growth prospects, benign regulatory environment, excellent cash flow, modest valuation, and attractive dividend.

Earlier, we noted that the United States is marching steadily toward a natural gas "Summer Surprise" – by this we mean that when all the newly constructed natural gas-fired power plants are turned on this Summer (to run people's air conditioners and/or supply a growing economy) the market will see new, and rather inelastic, demand for natural gas on a scale never before witnessed in such a short period. Approximately 200,000 megawatts of new power plant capacity was built over the last few years, and has yet to be switched on ... that's more than 25% of the entire power capacity existing in the United States in the year 2000 ... or, equivalent to the total power capacity of the United Kingdom and France combined. Most observers expected to see some of this new capacity come "on line" last Summer, but the Eastern half of the country experienced the coolest summer in almost 40 years, effectively masking the new demand for natural gas that a normal summer will generate. Meanwhile,

natural gas production in the United States has fallen year-over-year by roughly 2-3%, and is projected to fall further in 2004, even with near-record drilling for new supply. These factors suggest that even beginning our "refill season" (when gas is traditionally pumped into storage for consumption during the winter heating months) at historically normal levels (1 Trillion Cubic Feet) will leave us "short" of gas for winter 2004-2005. And that's assuming we experience a Summer with normal temperature readings. The weather experts we consult indicate that Summer 2004 is likely to be hotter and more humid than normal, which will exacerbate gas demand to cool a sweaty population. We're not quite sure what could dampen natural gas price increases this year, short of a repeat of last year's frigid summer or a sudden cooling of industrial demand.

LOOKING FORWARD

Though the verdict may still be out on the state of the US economy, our conservative electric and gas utilities continue to chug along at moderate historical valuations, strengthening their balance sheets, raising dividends (10 positions this quarter), ready to benefit from a sustained uptick in industrial demand. Meanwhile, our positions with gas exposure continue to generate strong profits from high gas prices supported by fundamental supply/demand constraints, with a paradigm shift in natural gas pricing all but certain for the remainder of this decade. With looming shortages in the gas complex likely poised to provide our added alpha, we can also enjoy the peace of mind provided by the balance of a portfolio filled with conservative, back-to-basics, regulated utilities. □

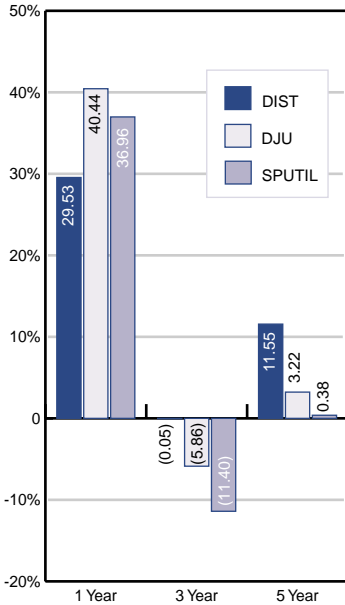


FUNDAMENTAL CHARACTERISTICS

Yield	3.7%
Proj Dividend Growth	3.6%
Payout Ratio	49.1%
Market Cap (MDN)	\$2.9 Bil
Price/Book	1.9
P/E Ratio (MDN)	14.4
S&P Rating	A-
Beta*	.58
Standard Deviation	13.6%

*Relative to S&P500, 3/31/94 - 3/31/04

Annualized Returns as of March 31, 2004

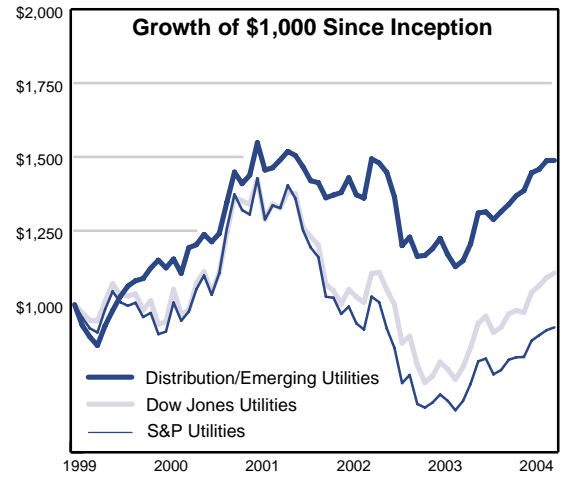


“One of the features of investing which keeps things interesting is the way in which results can unfold in an almost perverse manner.” – 4th Quarter ’03 Report

Amen. With legislation that would repeal the much discussed Public Utility Holding Company Act (PUHCA) languishing, if not dying, in Congress, one might assume that investors in a utility takeover strategy are paying a penalty for this legislative dalliance ... yet nothing could be further from the truth. Our Distribution strategy notched another fine quarter’s performance, posting a gain of 3.15% versus the S&P500’s return of 1.70%, even as prospects for the repeal of PUHCA have faded, and face little chance of passing until after the November election. Furthermore, 38% of our holdings increased their dividend this quarter, with an average increase of approximately 5%. Therein lies the charm of this steady-eddy strategy.

As a quick reminder, the Energy Bill (which included PUHCA’s repeal) died in the Senate last November due to bipartisan opposition to liability limitations for producers of MBTE (a House Republican priority and alleged “deal-breaker”) and renegade fiscal conservative Republican opposition to massive proposed energy tax incentives that Sen. John McCain and others slammed as unproductive and pure “pork.”

During the quarter, Sen. Pete Domenici of New Mexico continued his hunt for additional votes for his energy package without success, while refusing all entreaties to break apart the original Energy Bill into its constituent titles. Such a fragmenting of the original bill would have virtually assured the passage of popular measures – such as mandatory



electricity reliability standards – but would have deprived Republicans of leverage to get the MTBE liability provisions passed ... a sticking point that remains today.

As of this writing, however, Sen. Domenici is in the midst of trying to piggy-back the energy tax incentives portion of his Energy Bill as an amendment to the corporate tax cut bill (S. 1637) now pending in the Senate. Perversely, this portion of the bill is viewed by most analysts as offering little in the way of genuine incentives for adding supplies of gas and oil, and will surely be lampooned as nothing more than a giveaway to natural resources companies. What’s more, House Republicans still have not indicated a willingness to abandon their position that the original Energy Bill must be passed in its entirety, including MTBE provisions.

Ironically, the US-Canadian Task Force charged with investigating the massive blackout that cascaded from Michigan to New York on August 14, 2003, issued its final report on April 5th and made 46 recommendations, the most important of which was to “make reliability standards mandatory and enforceable with penalties for non-compliance.” The chances of Congress actually passing these reliability standards or other consensus measures, such

Quarter Composite Net of Fees*	
Distribution (Prelim)	2.9%
DJUA (total return)	6.3%
S&P Utilities	5.1%
12-Month Composite Net of Fees*	
Distribution (Prelim)	29.5%
DJUA (total return)	40.4%
S&P Utilities	36.9%
5-Year Composite Net of Fees*	
Distribution (Prelim)	11.6%
DJUA (total return)	3.2%
S&P Utilities	0.38%

*See Performance Disclosure on page 12.

as PUHCA repeal, however, remain virtually nil, so long as Sen. Domenici makes passage of controversial energy items a predicate to moving anything else. Should we experience another blackout this Summer, or see natural gas price spikes (see BTB/Utilities discussion), the politics of who's to blame for a failed energy bill will surely take center stage this November. In the meantime, we can be content with steady returns, rising income, and a current yield of 3.7%.

PORTFOLIO HIGHLIGHTS

Our holdings performed well across the board with few exceptions, leading us to sell two positions that appreciated to a point where most of the likely premium to be paid in a transaction was already reflected in the price: we sold UIL Holdings for a gain of 27.45%, and DQE for a gain of 19.45%. We replaced these two positions with some upweights, a familiar name, and a new name.

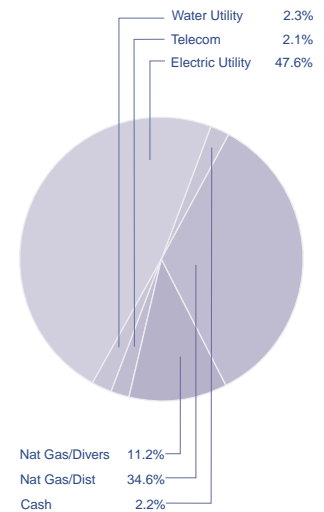
We introduced new position PNM Resources, the parent of electric and gas distributor Public Service of New Mexico, to the portfolio following the award of new, higher gas rates from regulators and a strong earnings report driven by long-term power contracts to wholesale customers and better cost controls. In addition to being an attractive takeover candidate, PNM has excellent earnings and dividend growth potential, plus, shortly after we added this position, S&P upgraded PNM's credit rating. TECO Energy, the holding company for Tampa Electric, which ran into trouble during 2002 and 2003 from its adventures in merchant generation, was added to the portfolio following a massive write-off of its unregulated electric operations, the sale of coalbed methane and synthetic fuel assets

as big steps in its back-to-basics program. With territory in one of the most demographically attractive regions of the country, TECO is poised for a comeback as it returns to blandness. Stay tuned for further debt reductions as it liquidates non-core assets and cleans up its balance sheet.

We added weight to two current positions in the strategy, based on our thesis that distributors with natural gas exposure will benefit from rising commodity prices. Southern Union operates one of the nation's largest pipeline networks, gas distribution businesses, and – most importantly – the Lake Charles LNG terminal, which it's in the process of expanding. Similarly, Sempra Energy, the largest natural gas distributor in the country, has both acquired the only fully FERC-permitted greenfield LNG terminal property in the country (Hackberry, LA), and is leading the charge to build the first LNG terminal in Baja, Mexico with its partner, Royal/Dutch Shell.

LOOKING FORWARD

At the risk of sounding like a broken record, we are looking for 2004 to mark the resumption of M&A activity in this space – with or without the repeal of PUHCA. It's important to remember that time remains on the side of these distribution companies: takeover valuations remain very attractive at these prices, the utility industry will be hard-pressed to find rapid, yet conservative, growth prospects absent mergers, and this portfolio's history demonstrates that transactions can and will occur even with PUHCA on the books. Further, we remain quite content collecting our rising dividends and enjoying moderate steady growth, while we wait for the merger activity to begin. □



FUNDAMENTAL CHARACTERISTICS

Yield	3.7%
Proj Dividend Growth	3.2%
Payout Ratio	57.4%
Market Cap (MDN)	\$2.4 Bil
Price/Book	1.6
P/E Ratio (MDN)	15.0
S&P Rating	A-
Beta*	.36
Standard Deviation	14.3%

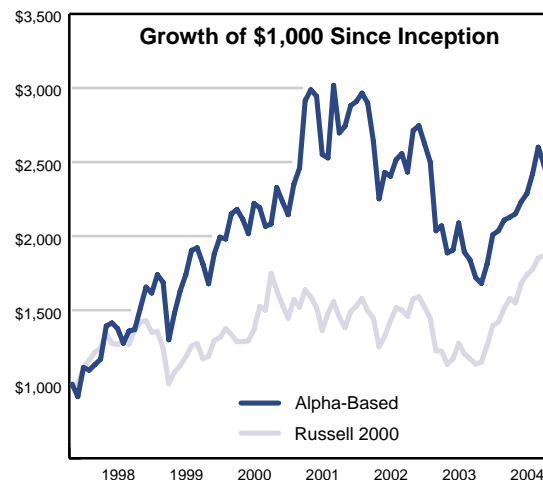
*Relative to S&P 500,
3/31/99 - 3/31/04

“With sharp market declines and a commitment to more concentrated portfolios comes added volatility.”

The first quarter turned volatile in March, and proved frustrating for us, since we’d outperformed significantly until then, carrying through on our momentum from the previous quarter. Our early lead deteriorated in early March following a 600 basis point correction in the Russell 2000. Though we held a substantial cash position throughout most of the quarter and going into March, it wasn’t enough to absorb specific instances of downside volatility in the portfolio—even though we’d raised that cash by making a series of very timely sells.

PORTFOLIO HIGHLIGHTS

In an anticipation of a likely small cap correction following the highs reached in 2003, our activity concentrated on capturing gains generated by our holdings. Early in the quarter we took timely profits in Sovereign Bank (14% above quarter-end prices), China Unicom (24% higher), Serono (15% higher), to name a few. And nearly everything we sold dropped notably thereafter. We also cleaned up portfolios by rotating out of positions with severe liquidity problems (MIKN) and lackluster growth prospects (MWRK). Our cautious outlook on the market, following strong performance in January (when our portfolios were up over 7% for the month), was either too cautious or not cautious enough, for the volatility of individual stocks we retained far surpassed benchmark fluctuations. A lack of quality candidates combined with a tricky market environment made it difficult to time our cash levels during sharp reversals in the index driven primarily by low-quality names. As we mentioned in previous reports, for some time we’ve been entertaining the idea of using Russell 2000 I-shares as a temporary substitute for cash during broad market rallies. This quarter we briefly made use of this instrument though without strategic benefit, as the market reversed



to the downside shortly after our purchase, forcing us to close the position with a minor loss.

On the brighter side, a few strategic bets discussed in previous reports have worked as expected this quarter. In mid-February, Rambus finally received a much-awaited ruling relieving the company of antitrust violation allegations in filing patents for designs of high-speed memory chips. Rambus, heavily represented in our portfolios, soared over 35% on the news then retreated toward the end of the quarter as investors thought twice about the possible duration of the litigation process. Finally, though, RMBS’ future seems brighter than ever now that the company may pursue royalty collections on the majority of RAM chips sold since 1999 and going forward. The stock will be volatile, and may hurt results periodically, but this stock has a relatively clear legal field, and the upside potential is enormous.

Our portfolio did have its share of success stories this period, such as OMNI Energy services, a diversified seismic support company for the E&P sector, up close to 100% since addition in early December on excellent earnings and raised revenue guidance for the year due to successful integration of strategic transactions and recently awarded contracts. Headwaters, reintroduced to the portfolio in

Quarter Composite Net of Fees*

Alpha-Based (Prelim)	(3.03)%
Russell 2000	6.26%

12-Month Composite Net of Fees*

Alpha-Based (Prelim)	39.7%
Russell 2000	63.8%

7-Year Composite Net of Fees*

Alpha-Based (Prelim)	12.9%
Russell 2000	9.48%

*See Disclosure on page 12

December, finished the quarter up 31% near 52-week highs on attractive valuation and expected solid earnings momentum going forward.

In January we added AU Optronics, and subsequently raised weight in the following month in this bargain-priced Taiwanese manufacturer of LCD and plasma display panels propelled by projected flat-panel demand growth of over 20% through at least 2007. We closed our position in mid-March, with an average gain of over 25%, hoping to revisit this holding in the future should it pull back to its original valuation levels.

We increased weight in Zoran, a leading developer of products for digital audio and video applications used in DVD players, set top boxes and HDTV. Given current valuation levels and prospects for growth, we believe ZRAN continues to be extremely attractive trading at 19x next year's earnings and long-term projected growth over 25%.

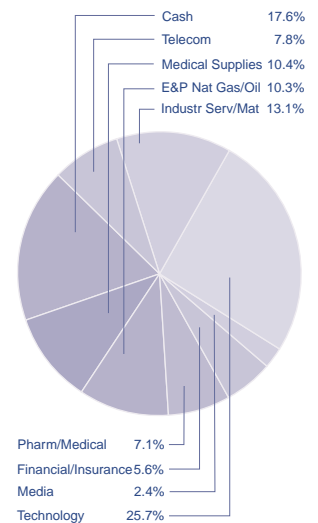
Our losers this quarter came from various sectors negatively affected by the winter's turbulent market. Brightpoint Cellular, bought in early January, lost all of its earlier gains, finishing the quarter down -21% as this wireless handset distributor missed analyst expectations on sharply lower profit margins and weak handset sales. We continue to hold CELL as a reasonably valued name with over \$6/share in cash, low debt and a decent probability of earnings recovery going forward. Gigamedia, a Taiwan-based broadband internet service provider, with intriguing growth prospects in a highly desirable market, temporarily hurt our returns as well, finishing the quarter down -32%, more on trading volatility due to its low price than on any fundamental changes.

During the quarter we also added several deep value turnaround stories from the European insurance sector. SCOR (down -17.3%), French re-insurer currently undergoing

aggressive restructuring with the intention of returning to profitability later this year, and Royal Sun & Alliance Group (-23%), British multi-line insurance operator, also in the midst of heavy strategic repositioning. In March we added a small position in Corillian Corp (down -14.2%), a domestic consulting company providing internet financial solutions to banks, brokers and other financial institutions in the US. Trading at 15x '05 earnings, CORI has substantial appeal and ability to penetrate and widen its customer base among banks with further recovery of business spending and consolidation in the financial sector. These stocks have hurt us so far, but we think they have outstanding longer-term prospects and we do need to inure ourselves a bit to their short-term volatility, as they're all quite low-priced, and low-priced stocks make greater short-term percentage moves.

LOOKING FORWARD

With sharp market declines and a commitment to more concentrated portfolios comes added volatility. As of this writing, the market correction appears to be waning, and our portfolio is moving into positive territory. We were on quite a tear for November, December, and January, and we see no reason why we can't be back on that track soon. The overall environment is characterized by a relative paucity of the type of high-growth bargains we seek, but there are decent values as well as intriguing individual stock stories which we can use. Still, we continue to think of the market situation as fragile (see the Overview commentary); we'll continue to be quick about taking large profits when they appear, and quick to exit if things become risky once again. □



FUNDAMENTAL CHARACTERISTICS

Forward P/E Ratio	18.5
Market Cap (MDN)	\$301 Mil
Price/Book	2.2
LT Growth Rate	23.6%
Beta*	1.0
R-SQR*	.43
Annualized STD	26.0%
Annualized Alpha*	10.3%

*Relative to S&P500, 3/31/99 - 3/31/04

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 3/31/04 was 201, which represents 84% of total assets managed in this strategy with a measure of dispersion of 0.19. 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 3/31/04 was 78, which represents 75% of total assets managed in this strategy with a measure of dispersion of .17. 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 3/31/04 was 164, which represents 95% of total assets managed in this strategy with a measure of dispersion of 0.19. 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.

Alpha: 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 3/31/04 was 26, which represents 86% of total assets managed in this strategy with a measure of dispersion of 0.28. 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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