

MARKET OVERVIEW

The second quarter was characterized by relatively minor fluctuations on both the downside and the upside, amounting to little net change, a relatively extreme version of the “trading range” idea we’ve held since our report for the second quarter of 2002. There is a kind of stasis or tension between conflicting forces that we’ve cited many times over the past three years, and, sorry to say, resolution doesn’t seem to be in sight. It’s an odd economy, sustaining decent reported growth figures while at the same time failing to generate much in the way of jobs growth. Energy prices have persisted at record levels, as we’ve suggested they likely would, soaking up whatever tax-cut benefits might have gone toward additional growth. The bond market is either misbehaving or predicting a substantial slowdown—more of a slowdown than the “soft patch” which proved a reasonable appellation for circumstances at this time last year; in either case bonds have spooked investors and inhibited the animal spirits so necessary for a resolution to either the up or the down side. After an April decline the market saw a May-June rally whose most notable features were its utter flaccidity (apart from three days in May), unsustainability of any group strength apart from energy and utilities, and a definitely noteworthy waning of volume. Indeed, volume was below average on the majority of days during the quarter. Investors remain uninspired by an inconclusive landscape.

As volatility and volume shrink investors are increasingly wondering what to do in a world which is likely to offer single-digit (or nearly so) returns at best for some years. Despite a surprisingly tenacious buoyancy, bonds hardly seem like the answer here, as low rates offer little or no real return, and little margin of safety—bond portfolios contain dangerous vulnerability should rates increase for whatever reason. We’ve pointed out that jobs growth has been inadequate, and at current levels a rousing rate decline would be almost unthinkable in the short term; who really wants to own bonds when they seemingly offer no real return, despite a good year to date performance? Yet on the equity side capital goods and technology suffer from restrained confidence on the part of corporate management, financials are swimming upstream against shrinking spreads, healthcare is mired in headline problems, materials are already up and volatile to boot, energy (though we continue to favor this area) is certainly less cheap than it was, small stocks value advantage to large stocks is gone—the list goes on, it’s hard to know what to do.

We think our approach, which has always been a good approach in nearly all kinds of markets, is especially attractive at this point in time. Outliers aside (and there will always be a few outliers), we invest in financially solid companies that provide goods and services essential and necessary for everyday life. The markets in which they operate are proven over many decades, and their products and services are rarely replaced by new developments. Importantly, our stocks provide high and rising income reflective of their moderate and sustainable earnings growth.

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 / MERGING UTILITIES

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

ABSOLUTE VALUE

An absolute return strategy designed to restrict downside volatility and enhance returns from a portfolio containing high-yielding, high-quality stocks. Layered below and above the base portfolio are hedge and leverage tools intended to prevent drawdowns and amplify gains.

TABLE OF CONTENTS	PAGE
MARKET OVERVIEW	1
INCOME-EQUITY STRATEGY	4
BETTER THAN BONDS/UTILITIES	6
DISTRIBUTION/MERGING UTILITIES	8
ABSOLUTE VALUE	10

“...it is the basic principle upon which all capitalism and wealth creation is built. We’re not trying to build a dam and a waterfall to change this river, we’re trying to flow with it.”

As the income—the profits shared with investors every year—rises, so does the value of the securities providing that income. It’s a simple formula that has worked forever. And today our stocks offer the same or higher income than bonds (depending on the strategy) with prospects of future growth that should parallel historic experience. If you add together our single-digit yields and mere single digit expected growth, you get high single-digit returns, perhaps double-digit returns, with the lowest volatility and the highest financial strength available in the publicly traded markets.

When we say “it’s a simple formula that has worked forever” we’re not merely promoting what we do. It is a simple formula that’s worked forever, and that’s why we do it. Indeed, when we think a little deeper on the subject, away from the transient details of this economic scenario or that one, we believe we’re acting based on eternal verities of capitalism.

To be a bit bold about it, our approach replicates the essential transactions of money and property from the very inception of Western capitalism.

Scholars may argue the point, but we date the basic capitalist concepts as we know them today, in our society, from the Feudal period. Wealth was measured in land and workers of the land (serfs), owned by a handful of kings and lesser nobility. The feudal lord collected rents in cash and in goods and services, enabling his noble lifestyle and enabling the expansion of his lands to produce more rents. Those rents might fund an army to produce even more rents, and those higher rents created still more wealth to acquire yet additional assets and rents, and on and on and on.

The principle is reproduced in income-producing stocks. They are our lands, and their income is our rent roll. The entire corporate enterprise can be seen as our serfs. The harder and better they work, the more rents we collect. The more we collect, the more we can re-invest, or support our spending needs. Over the years our rents increase (unlike a bond, whose income stays flat) and the value of the “lands” producing our rents increases proportionately.

This notion may not fit neatly into a Morningstar-type style box, and it may not be the kind of thing that calculates out to five decimal places or resolves into a formula that wins the Nobel Prize for economics, but it is the basic principle upon which all capitalism and wealth creation is built. We’re not trying to build a dam and a waterfall to change this river, we’re trying to flow with it.

Meanwhile, investors and the investment industry want to know: what’s coming next?

Our “ten points” are mixed, suggesting a continuing mixed market.

- 1) Growth may be decelerating but the Fed continues its “measured pace” of normalizing interest rates. Rising rates have never been a positive for financial asset prices, but one has to give the market credit for persistent resilience in the face of these increases. Perhaps the fact that the rise has begun from such an anomalously low level helps explain the (thus far) diminished importance of this factor.
- 2) For now, terrorism and other extrinsic events are off the front page. We’re still concerned about potential financial terrorism, however, in the form of vast pools of leveraged derivatives, pools so vast that no one knows their size or possible impact.
- 3) Traditional Sentiment measures (advisor bullishness, volatility index, short interest and the like) continue to express complacency or bullishness. While the broad market can make grudging progress against such readings (as evidenced in the past quarter), the odds of a major rally are diminished when too many participants are already bullish. We’ve suggested that the smoothly rising Advance-Delay line was due for a rest, and it does appear that fewer and fewer stocks are driving what gains we’ve seen. A rising A-D line would confirm any rallies, but that’s not in the picture now. Importantly, volume has been dwindling even before the typically slower summer quarter; sustainable and/or strong rallies are rarely seen without rising volume.

SELECTED INDICES

	2 nd Qtr’05	12 Mo
S&P 500	1.36	6.32
Equity Inc	1.93	10.22
Util Fund	8.69	30.70
R3UTIL	5.70	23.00
LB Long	7.70	16.79
LBGC	3.44	7.26
S&P 400	4.26	14.03
Wilshire 5K	2.47	8.38

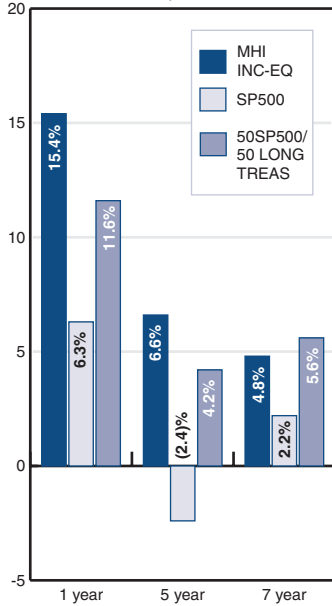
S&P 500 = Standard & Poor’s Index
 Equity Inc = Avg Equity Income Fund (Lipper)
 Util Fund = Avg Utility Fund (Morning Star)
 LB Long = Lehman Long Government
 LBGC = Lehman Bros. Gov/Credit Bonds
 R3UTIL = Russell 3000 Utilities
 S&P 400 = S&P Mid Cap Index
 Wilshire 5K = Wilshire 5000 Market Index

- 4) Our proprietary options indicator has remained remarkably stable, and somewhat contradicts the more conventional sentiment indicators. This indicator measures what index options traders are actually doing (as opposed to what they're saying), and it continues to suggest modest downside risk. These players are not particularly optimistic, and that is a positive for pricing.
 - 5) Valuations have gotten better, but, since valuations are usually perceived relative to interest rates, they're not so attractive if one is bearish on bonds. If rates rise, P/E ratios normally compress. That's probably why the market has such trouble moving up now that P/Es are not so intoxicated. On the other hand, corporations are increasingly loaded with cash (currently at a multi-decade high), yet this aspect is seemingly ignored by investors right now. Of course we think it's a big plus, as large cash positions, combined with extremely low dividend-to-earnings payout ratios, promise strong future dividend increases.
 - 6) The dollar is still strong, confounding the magazine covers of 6-9 months ago, as always. Last quarter we suggested the dollar could well surprise the continuing bearish sentiment around it, and the quarter was indeed a strong one. European Union problems obviously come to mind, but the yen was down about 5% as well. The dollar starts to look like as safe haven again as global growth is slowing, but we think the damage to other currencies has already been done. That view is counterbalanced by the fact that our rates are now relatively high, which will lend continuing support.
 - 7) Mutual Fund equity fund cash flows declined during the quarter, though they remained positive. This reversed the situation during the first quarter, when equity funds received decent levels of cash but the market still declined. It may be that the world is changing and we need to incorporate ETF fund flows in these numbers, or it may be that this is no longer a particularly cogent factor. We'll be looking into it.
 - 8) We still see earnings as a possible wrench in the wheel, since overall growth is slowing. Corporate costs are rising for both materials and labor. Comparisons are not likely to look as good as in the past two years, again bringing valuations into question despite currently non-threatening levels. During the earnings "warnings" season in June, there were many more downside versus upside revisions than there have been in recent years. As we asked last time, what will induce investors to pay higher prices for equities in the near term in the absence of strongly rising earnings and in the face of rising short-term interest rates?
 - 9) Hidden taxes from energy continue to drain consumers of buying power and continue to tax corporations at the margin. We're in a world of \$30-40 gas tank fill-ups, and our leaders tell us Iraq will drain the treasury for the foreseeable future. It is true that tax receipts at the federal and state levels are up sharply, and yet federal debt grows by the day. What happens when those receipts begin to moderate, as the economic numbers now suggest that they will?
 - 10) Insiders are still fairly absent as buyers. Again, the continuing question: if insiders won't buy their own shares in today's environment, why should we?
- The "good news" is that the economy doesn't appear strong enough to prompt the Fed to overshoot a fed funds target perhaps 50 basis points higher than current. When investors are convinced that the Fed has stopped raising rates, stocks are likely to get at least a short-term boost, and the short-term could well become intermediate, since the global landscape of promising investment opportunities has become somewhat barren. Indeed, it's not hard to envision some degree of rally even as *long* bond rates increase, if institutional investors re-allocate and re-balance to align with the more promising equity asset class on a relative basis. □

"Valuations have gotten better, but, since valuations are usually perceived relative to interest rates, they're not so attractive if one is bearish on bonds."

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.

Annualized Returns as of June 30, 2005



Quarter Composite Net of Fees*

Income-Equity (Prelim)	4.0%
50/50 SP500 & Long Treas	4.5%

12-Month Composite Net of Fees*

Income-Equity (Prelim)	15.4%
50/50 SP500 & Long Treas	11.6%

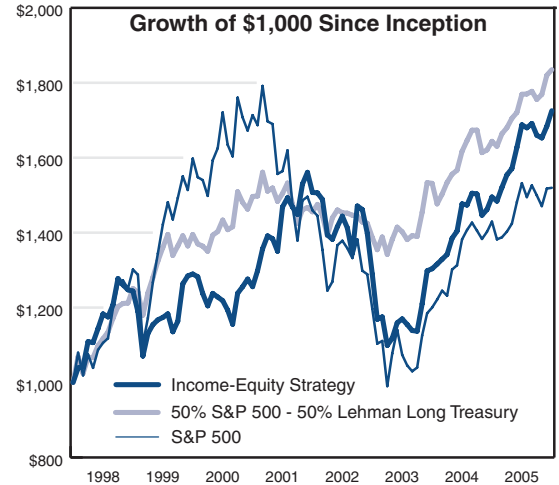
5-Year Composite Net of Fees*

Income-Equity (Prelim)	6.6%
50/50 SP500 & Long Treas	4.2%

Included are all unrestricted portfolios that have been managed for one full quarter. As of 6/30/05: 397 accounts in composite, representing 49% 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 37% of the total assets in the strategy

Many have complained that the recent market contains all the excitement of watching grass grow, and it turns out that the persistent declines in the volatility indexes have been...astute. While we can't disagree with the "watching grass grow" assessment, we can and do disagree with the attitude behind the comment. We think dull is good, boring is good. A little bad boy deep inside would like a bit more action, but in fact it is steady, consistent, step-after-step progress over time that makes an investment a good investment at the end of the line, so those who want to quicken the pace might consider taking care in what they wish for. Too, a measure of stability helps cushion the markets against unforeseen developments—like \$60 oil and long-term interest rates under 4%...at the same time!

In fact the intrinsic stability and low volatility of our portfolio (Income-Equity ranks in the top 5 for low volatility in our category of long-only portfolios for the past five years according to Money Manager Review—most recent report 6/30/2005) is well suited to current conditions. This past quarter we outperformed the broad market averages significantly, and came near our blended benchmark (50% S&P 500/ 50% Lehman Long) despite the monumental surprise rally in long bonds which rose some 8%, supplying nearly the entire bond gain for the year (and a gain which we think, Brigadoon-like, is a good bet to disappear back into the mists from which it came). The spread between long and short-term rates is becoming miniscule, and while many traditional economic and investment relationships seem to have broken down somewhat in recent years (forcing investment managers to fall back on actually thinking



through a scenario rather than relying on hypnotic rules of thumb), we are hard pressed to envision a growing economy in which long rates do not trade significantly higher than less risky short-term rates. Should growth wane (as bond behavior might be predicting), we will be happy to be positioned in companies that offer a repeat-business model of mostly essential products and services.

While not every stock can be strong every quarter, in general we've been obtaining from our portfolio that which we always seek: high current income, rising dividend yields, and some appreciation, in financially strong companies.

PORTFOLIO HIGHLIGHTS

This quarter the portfolio has many more winners than losers, as you would expect during a market where yield stocks have taken the lead. Our top performer is also our only REIT, Urstadt Biddle, a commercial property manager, which was up 13.8%. The next three best performers are all involved with natural gas: pipelines Kinder Morgan Energy Partners and Energy Transfer Partners were up 13.2% and 10.6%, respectively. Energy East, a

distribution company, gained 10.5% during the quarter. Chubb and Baxter convertible preferreds were a help, and utility distribution company NiSource finally came to life after a long period of static performance.

Among portfolio drags was Nam Tai Electronics, last quarter's best performer, which gave back -14.5% from last quarter's very strong showing, but whose fundamentals remain exceptionally good, especially for a tech sector stock. ConAgra Foods lost ground because of continued problems with promoting its brands such as Peter Pan, Egg Beaters, Butterball, Healthy Choice, etc. We're awaiting the company's announcement of a new CEO to replace the current chief who resigned, at which point we expect some firmness in the stock.

During the quarter we sold all of our Merck position. We did well by increasing our holdings when the stock fell earlier on due to the Vioxx surprise, but at this point we think a still-weak pipeline combined with a continuing assault by plaintiffs' bar producing a flow of negative headlines will place a lid on the stock. However, we still think it is a good long-term value and as circumstances change in the future we could reestablish a position.

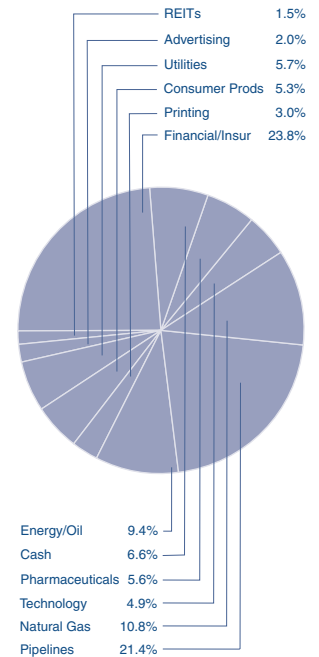
We established a new position in Campbell Soup Co. in April. The company is recovering from prior problems and new, higher margin, products and packaging have been well received by consumers. The company is paying down debt and has begun increasing their dividend, a trend that seems likely to continue. The stock is up over 6% from our purchase price, considerably outperforming the broad market indices.

Last time we noted our hope for new special dividend stocks that could help diversify our portfolio. Wish granted. We took a position in Clear Channel based on its strong industry dominance, cash flows etc, and the recent announcement of a restructuring which will include a \$3 dividend and spinoff in addition to an increase in the regular dividend, bringing the income-only yield on this stock to over 12% for the next twelve months. The stock is historically very cheap—it's also down by 65% from its 2000 high, though it could hardly be called an internet speculation—and now we're being paid to wait as management works to recover valuation.

LOOKING FORWARD

We don't see notable changes in the environment, nor in the status of our stocks or the candidates on our "bench." The overall scene may be odd enough to be more vulnerable than usual to surprises, but we think our solid values can withstand any turbulence that may develop.

As of July 5th, yield for the portfolio, forward-looking and adjusted out for recent special dividends, is 5.5%, up from 5.2% at the end of June. Some databases and portfolio accounting systems may not show the same current yield, as most systems are unable to account for prospective special dividends and announced dividend increases. Note also that during just the first six months of this year, special dividend payments and accruals meant that the portfolio earned 3.4% in cash from dividends. □



FUNDAMENTAL CHARACTERISTICS

Yield	5.2%
Proj Dividend Growth	6.5%
Payout Ratio	48%
Market Cap (MDN)	\$8.6 Bil
Price/Book	2.6
P/E Ratio**	15.4
S&P Rating	BBB+
Beta*	0.6
Standard Deviation	12.5

*Relative to S&P 500, 6/30/00 - 6/30/05

**REITs use P/FFO ratio

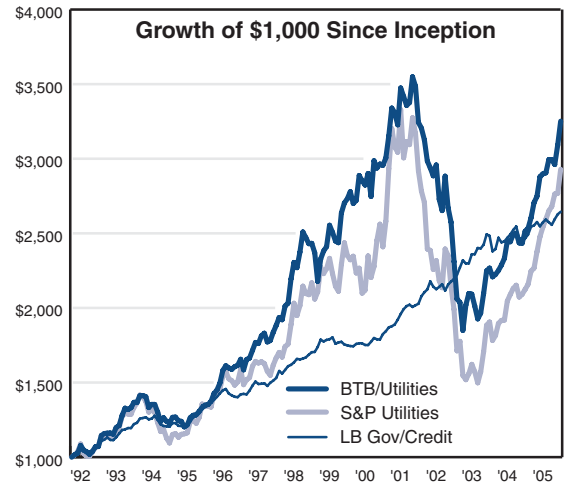
Income-Equity (No MLP Version)

Quarter (net of fees)	3.3%
12-Month (net of fees)	11.0%
Yield	4.7%

“Institutional investors are still largely underweight the utilities sector...and the reluctant flow of cash from large funds will probably keep the general utilities area fairly buoyant...”

Last quarter we suggested that factors such as modest valuations on our distribution companies and gas producers combined to give us a reasonable confidence level, despite the solid gains that utilities large and small have experienced over the past three years. (We don’t want to pour salt in anybody’s wound, but we would like to recall that in our report of the second quarter of 2002 we shouted “buying opportunity” for only the second time in our history—the other was spring of 1994. Perhaps people thought we had a self-interested agenda at the time, or perhaps people were simply in shock from Enron and its fallout, but our table-pounding didn’t exactly attract any attention then). Momentum carried through strongly over the quarter past, and our portfolio was even stronger than the large-cap utilities indices.

Speaking of those indices, there is at last a benchmark that is reasonably appropriate for the kind of investing we do - the Russell 3000 Utilities Index. As long-time clients and interested parties know, the issue of benchmarking our portfolio has been thorny for many years. The problem is that we don’t own—by social investment policy or by analytic choice—the stocks that are contained in the popular indices normally associated with “utilities.” We buy stocks because we want to be partners in particular companies, not because those companies are heavily weighted in a popular index. Gas distribution, for example, has almost no weight in the Dow Jones Utilities or the S&P Utilities. Mid-cap stocks in general (relative to the utility universe) have almost no weight. Over the years our telephones have added to or detracted from overall performance



relative to the benchmark only because there are no telecom stocks in the common utility indices.

There were no good alternative indices with long enough track records to choose from except mutual fund averages, which have their own problems as benchmarks, and the CFA Institute asserts that peer group averages are inappropriate for benchmarks. But as of the end of June, the Russell 3000 Utilities Index finally has ten years of performance, so it is a usable benchmark for our portfolio. For example, the Dow Jones Utilities Index has 15 members and 42% of the index weight comes from 3 stocks (assuming the merging Excelon and Public Service Enterprise are counted as one issue). The S&P Utilities has more stocks, but isn’t really any broader in terms of industries and capitalization sizes. By contrast the Russell 3000 Utilities includes essentially all the domestic utility stocks we’ve ever used or ever will in its 141 members. Clearly, foreign phones or utilities, or gas stocks, which we also use, are not in this index. But at least, if there is

Quarter Composite Net of Fees*

BTB/Util (Preliminary)	8.7%
Russell 3000 Utilities	5.7%
S&P Utilities	9.3%
LBGC	3.4%

1-Year Composite Net of Fees*

BTB/Util (Preliminary)	29.4%
Russell 3000 Utilities	23.0%
S&P Utilities	37.9%
LBGC	7.3%

10-Year Composite Net of Fees*

BTB/Util (Preliminary)	9.2%
Russell 3000 Utilities	4.5%
S&P Utilities	8.1%
LBGC	6.9%

Included are all unrestricted portfolios that have been managed for at least one full quarter. As of 6/30/05: 153 accounts representing 95% of assets in the strategy, with a dispersion of 0.11. Inception: 9/91.

tracking error due to these groups or, for example, our current paucity of domestic telecoms, it will be a function of our management decision, and not the inappropriateness of the index. We're a bit apologetic over shifting the benchmark after just 5 quarters from the previous move, but the Russell 3000 Utilities is a far better fit for our management style—now with a long enough track record to justify the change.

PORTFOLIO HIGHLIGHTS

There were representatives of all of our industry sub-categories both above and below the portfolio return for the quarter—distributors above and below, gas above and below, foreign phones above and below. Of note, there were no significantly bad stocks during the period.

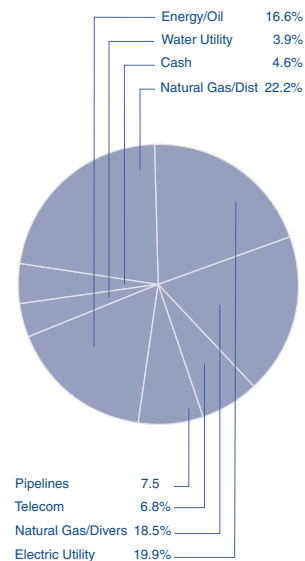
Our best performer was Aqua America, one of the few water companies with enough “liquidity” in the marketplace to be investable. When the stock rose to a valuation similar to that of American Water Works when the latter was taken over several years ago, we trimmed our position by about half. Gas companies like Equitable Resources and EOG delivered solid double-digit gains, and what would a strong quarter be without another double-digit gain from Questar?

Interestingly, some of our quieter distribution companies made some of the largest contributions. Energy East rose 10.5%, Pepco Holdings 14.1%, and Nicor frankly surprised us with a gain of 11.0%. To put these performances in perspective, our holding in Cinergy rose slightly less on a takeover offer from Duke Energy.

Foreign phones performed well, too. We chose to go this route because the foreign companies have much greater protection from competition than our Baby Bells, and for many their strategies for growth are more in a realization phase. Quite simply, growth is stronger and valuations have been lower than domestic counterparts. Brazil Telecom's acquisition situation has been clarifying, and the stock rose on those developments as well as on a generally strong Brazilian currency. Investors started to get the message that with a possibly revaluing yuan and a growth rate greater than its P/E, China Mobile has global appeal. Telmex rose on news of its burgeoning wireless success.

LOOKING FORWARD

Though with one eye we view our past few years' performance and experience with a bit of vertigo, with the other we see excellent potential for the groups mentioned above. Institutional investors are still largely underweight the utilities sector (that's why they underperform the broad indices!), and the reluctant flow of cash from large funds will probably keep the general utilities area fairly buoyant—and positive overall sector tone is always good for our stocks even though they are a bit off the beaten path. The upcoming deliberations on the Energy Bill in Congress should have an impact—it is an imponderable at the moment though matters look good as of this writing... □

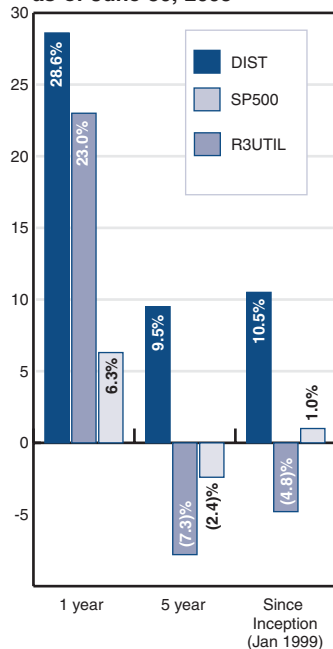


FUNDAMENTAL CHARACTERISTICS

Yield	3.1%
Proj Dividend Growth	6.7%
Payout Ratio	42%
Market Cap (MDN)	\$4.3 Bil
Price/Book	2.7
P/E Ratio	17.8
S&P Rating	BBB+
Beta*	0.6
Standard Deviation	13.7

*Relative to S&P500, 6/30/95 - 6/30/05

**Annualized Returns
as of June 30, 2005**



Quarter Composite Net of Fees*

Distribution (Prelim)	9.5%
Russell 3000 Utilities	5.7%
S&P 500	1.4%
S&P Utilities	9.3%

1-Year Composite Net of Fees*

Distribution (Prelim)	28.6%
Russell 3000 Utilities	23.0%
S&P 500	6.3%
S&P Utilities	37.9%

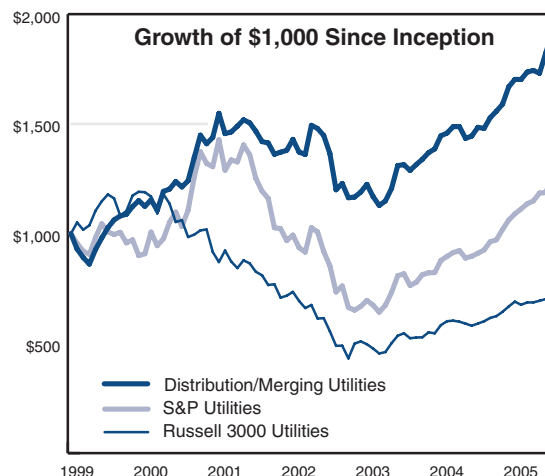
5-Year Composite Net of Fees*

Distribution (Prelim)	9.5%
Russell 3000 Utilities	(7.32)%
S&P 500	(2.4)%
S&P Utilities	3.98%

Included are all unrestricted portfolios that have been managed for one full quarter. As of 6/30/05: 171 accounts, representing 95% of total assets managed in the strategy with a dispersion of 0.08. Inception: 12/98.

For several years we've had strong returns and low volatility from this strategy even without the utility consolidation theme which was its original premise, and which was indeed responsible for our excellent returns in our first few years after inception. Starting in 2001 the U.S. Congress failed repeatedly to pass an Energy Bill that would resolve many issues related to utilities, including repeal of the Public Utility Holding Company Act—legislation from the 1930's whose net effect today inhibits utility mergers and the infusion of outside capital into the industry. But in the post-bubble world investors have warmed once again to the notions of value, reliability, and yield in the equity world. Our stocks, which had been depressed and undervalued due to the terrible performance of a few bad apples in the industry, have risen to become the best-performing portfolio in the mid-cap arena on a risk-adjusted basis (according to Money Manager Review Reports of approximately 1500 private account managers), and in the top few on an absolute return basis (even ignoring risk levels) for the past five years.

And now the consolidation drums are beating once again. Last December, Exelon made a somewhat surprising offer to buy Public Service Electric and Gas (NJ), skirting PУHCA restrictions since the two companies' territories are contiguous. It was surprising to us due to the scale of the deal and the problematic nature of PEG's operations, but it did send a message that nearly any utility might be an acquisition candidate, and weaker operators were fair game, as well. Then Duke Power offered to buy our holding, Cinergy. At nearly the same time Warren Buffet, who's been vocal about



the need for PУHCA repeal, offered to buy Scottish Power's Pacificorp utility operations (we owned Pacificorp before Scottish Power bought it). Perhaps in anticipation of the passage of an Energy Bill, the industry is feeling it: let the games begin.

The prospects of actually getting an Energy Bill passed this year have never been higher. Both the House and Senate have already passed their respective versions and now the work to reconcile the two is active in Washington's front and back rooms. On the surface the differences may appear great, but the heart of both bills shares the same objectives. Without trying to sound like a broken record, we finally think it will get done this time, by late summer.

The three large deals already announced in recent months demonstrate that consolidation is continuing with or without legislative change, though the repeal of PУHCA would certainly add fuel to the flame and open up the party to fresh money investors. The attractive characteristics that have drawn Miller/Howard to invest in utilities for the last fifteen years are gaining popularity. The small to mid-size utilities appear poised as easier acquisition targets, but

as we have already seen, any utility might be fair game. Beyond acquisitions, the prospects for capital deployment to upgrade infrastructure in the country look attractive, too. Many of the companies in our portfolio have a backlog of upgrade projects that provide significant organic growth (regulated utilities earn an incremental return on investment in upgrade projects). Financial players are beginning to realize the beauty of regulated or semi-regulated low double-digit returns, and want to participate. Now, and as time goes by, stock prices also begin to reflect a new factor: scarcity value. Local monopolies with guaranteed rates of return aren't exactly in unlimited supply.

PORTFOLIO HIGHLIGHTS

During the quarter we bought more Sierra Pacific (SRP) and sold Constellation Energy (CEG). Constellation has been a very good investment for our clients. We took profits to re-deploy elsewhere given the higher valuation and likelihood that Constellation is now more likely to be an acquirer than an acquired. Early in the quarter we fattened SRP to our top weight, and more positive news came on the regulatory and litigation front. This is an excellent utility turnaround story, in a company that serves the fastest growing demographic in the country and which sells far below private market value for utilities.

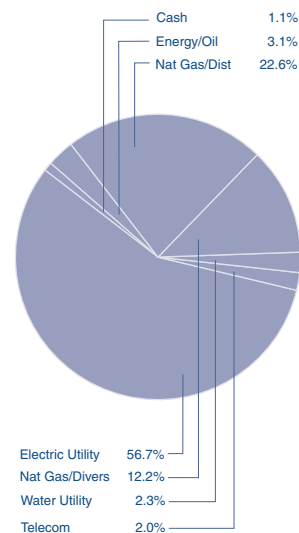
We also returned to CenturyTel (CTL), as it had fallen and become a bird's nest on the ground. CTL is a solid independent local exchange carrier operating with limited competition in rural areas in 22 states. On a free cash flow basis it would not be hard for

an acquirer to absorb this one. As you know we're attuned to the various competitive problems in the telecom area, but these concerns were more than priced into the stock, we thought. The moment was ripe, and now that we sit on a quick double-digit return, we may trade it in for another timely strong value in the future.

The quarterly return—we basically earned a year's return last quarter—was attributable to a portfolio in which every oar but one pulled to positive returns. Many of the strongest performers like Teco Energy (+20.6%), Sierra Pacific (+15.8%), and CMS Energy (+15.5%) continued their rise from the first quarter as the individual company outlooks improved and the prospects of more consolidation in the utility sector heated up.

LOOKING FORWARD

The very strong absolute performance has brought most valuation metrics in the portfolio rather higher than they were in the pits of post-Enron 2002. Yet our valuations are not really higher than they were in 1999, when deal after deal was announced, and our portfolio showed excellent returns even as the large-utility indices declined. We're a little leery of the large-cap electrics, but we think the factors that drive this portfolio provide strong compensation. The prospects of continued activity seem likely with or without PUCHA repeal, but with passage of an Energy Bill we may yet hear that symphony of transactions for which we have waited. □



FUNDAMENTAL CHARACTERISTICS

Yield	3.0%
Proj Dividend Growth	3.7%
Payout Ratio	51%
Market Cap (MDN)	\$3.2 Bil
Price/Book	1.9
P/E Ratio	18.3
S&P Rating	BBB+
Beta*	0.4
Standard Deviation	13.5

*Relative to S&P 500, 6/30/00 - 6/30/05

“The goal is to maintain a high level of current income, permit the portfolio to participate in positive market periods, and hedge to prevent portfolio declines during negative broad market phases.”

Quarter Net of Fees*

Absolute Value	2.9%
S&P 500	1.4%
HFRI Equity Hedge	1.3%

1-Year Net of Fees*

Absolute Value	19.8%
S&P 500	6.3%
HFRI Equity Hedge	7.2%

Cumulative Return Since Inception Net of Fees*

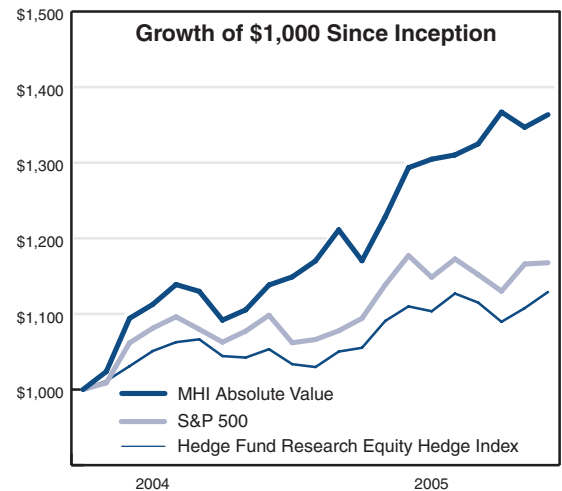
Absolute Value	36.4%
S&P 500	16.8%
HFRI Equity Hedge	12.9%

Performance is of a representative account. It is proforma and calculated by deducting an annual fee of 100 basis points from gross of fees performance accrued monthly. Performance fees are deducted at the beginning of each quarter and applied in arrears. Returns are total returns, dividends are assumed to be reinvested.

Last quarter we issued the first review for Absolute Value, a dynamically hedged and enhanced strategy based on our Income-Equity portfolio. Layered above and below the Income-Equity long portfolio are hedge and leverage tools intended to amplify gains and prevent drawdowns. The goal is to maintain a high level of current income, permit the portfolio to participate in positive market periods, and hedge to prevent portfolio declines during negative broad market phases. In a nutshell, this strategy adds a layer of dynamic active manager skill to the effective long-term buy and hold approach of Income-Equity. The strategy hopes to capture all of the upside and diminish the downside over both short and long terms. It is, in effect, a classic hedge strategy, building on the strengths of Income-Equity and reducing I-E’s already-low risk profile.

For the second quarter our return net of all fees (including performance fees) was 2.9%, and we registered our seventh consecutive quarter of positive returns since inception (11/03). This quarter wasn’t our best but we outperformed the S&P 500 and the HFRI equity hedge index. It’s important to note the risk side of the equation too, however. Our portfolio was 100% hedged against risk about half the quarter, unhedged about 25% of the quarter, and 50% hedged for the balance. While bottom-line return is what matters in an absolute return portfolio, it still needs to be evaluated in risk-adjusted perspective.

The underlying Income-Equity portfolio is managed primarily on fundamental principles. The additional longs and shorts through which we hope to add Alpha, however, are managed using a combination of fundamental and technical tools, in what’s today called “fusion”



analysis. For example, we might overweight a position in the I-E portfolio at a particular moment when we believe it is ripe to add excess performance, returning it to portfolio weight when the probabilities revert to a more normalized picture. On the short side, we tend to use stocks that are the mirror-image of our long holdings—companies with problems and/or intoxicated overpricing, shorting them when our tools suggest the timing is right. These “extra” positions might last months or days, depending on market conditions and individual stock circumstances.

PORTFOLIO HIGHLIGHTS

April, the cruelest month for the market during the second quarter, was our best month, as we uncovered a good deal of alpha through short-selling. We’ve long felt that Eastman Kodak was a company on life support, rushing to replace their decades-old film business with competitive offerings in the digital world. It’s true that they still have some muscle and cash flow to support the transition, but it’s not been our view that they could move fast enough in

the pits to take the checkered flag. Our short position initiated in early April worked out much better than expected when the company reported disappointing earnings and sales, resulting in a 20% 5-week gain. Also early in the quarter we thought that a slowing economy would prompt investors to exit the previously strong rail group, and we did well (up 10%) in a short-term short-selling foray with a package of stocks.

In a tight market it sometimes feels like spinning your wheels; we had gains in “extra” long positions in Yellow Freight, PT Telecomm, Optimal Robotics, but they were tiny, and offset by losses in First Marblehead, Choicepoint, Gen-Probe, and Cleveland Cliffs. Our index hedges also showed a loss of about 2%, so it was basically up to the shorts to keep us even. Looked at another way, our short positions paid for an insurance cost during the quarter. Though the first quarter reflected a similar situation, other quarters have shown a different profitability mix, so we don’t think it’s a pattern. If it is, that’s okay: our primary goal is to hold the underlying portfolio and avoid losses.

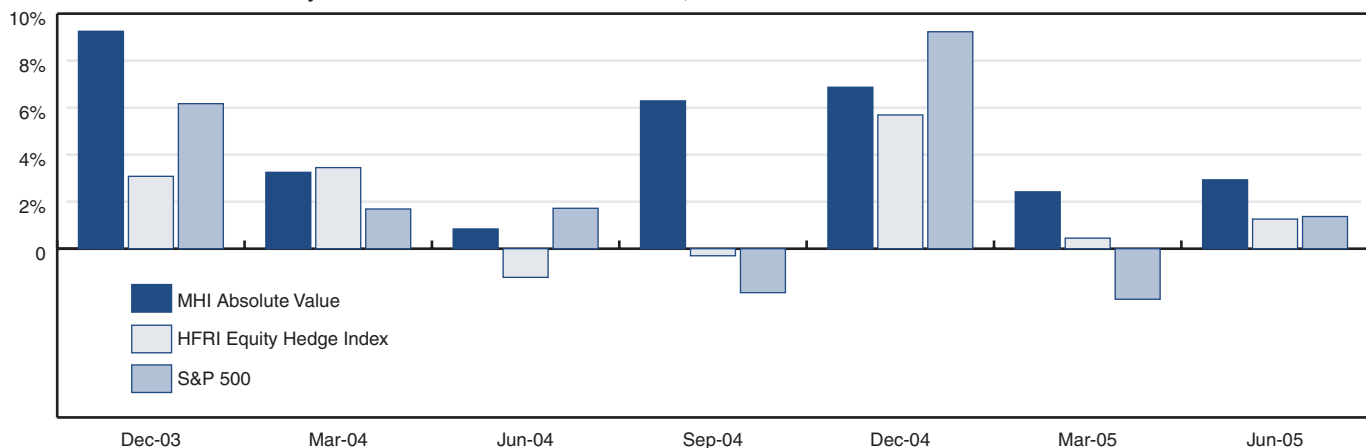
LOOKING FORWARD

Though our returns for the first half imply double-digit gains for the year, we’re not taking anything for granted in this range bound market, and we enter “extra” positions with a short-term frame of mind. It takes a light touch to do well in this kind of market; there’s no place for heroic stands or sustained disagreement with price trends. So, while the underlying Income-Equity long portfolio remains a solid base as it has been, we expect incremental longs and shorts to be judicious, even dainty, until there is a clearer directional picture.

“These ‘extra’ positions might last months or days, depending on market conditions and individual stock circumstances.”

For further information, please contact Helen Hamada for a brochure and performance information. (Helen@mhinvest.com, phone 888-282-8845). Please bear in mind that this strategy is managed in individual accounts, and is open only to qualified investors (similar to hedge fund qualifications). Reports on this strategy will appear in our main quarterly summary only as space permits. □

Absolute Value Quarterly Net of Fees Returns as of June 30, 2005



“Do you know the only thing that gives me pleasure? It is to see my dividends coming in.”

- *Oil Magnate John D. Rockefeller*

Utilities are a “reasonable place to put money...it's not going to be a place to get rich,
but it's a place to stay rich, and that's the way we look at it.”

- *Warren Buffett, June 2005*

Our conservative, dividend-oriented portfolios invest in
high-quality companies with rising income.

MILLER/HOWARD INVESTMENTS DIVIDEND-GROWTH STRATEGIES

PORTFOLIO	FOCUS	YIELD	EST. GROWTH OF YIELD	5-YEAR BETA	P/E	1-YEAR NET OF FEES RETURN
Income-Equity Strategy	Dividend growth companies, broad market	5.2%	6.5%	0.6	15.4	15.4%
Better Than Bonds/Utilities	Utilities sector: natural gas, electric, telecom, and water	3.1%	6.7%	0.6	17.8	29.4%
Distribution/Merging Utilities	Local distribution utilities, takeover candidates only	3.0%	3.7%	0.4	18.3	28.6%

as of June 30, 2005

Miller Howard
INVESTMENTS, INC

PO Box 549
Woodstock, NY 12498

Contact Information:
Helen Hamada
helen@mhinvest.com
www.mhinvest.com
(888) 282-8845