Miller/Howard INVESTMENTS, INC

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, sanitation and water.

DISTRIBUTION / EMERGING UTILITIES

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

ALPHA-BASED STRATEGY

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

Momentum, momentum, momentum. The 4th quarter of 2003 was the period in which that word became respectable again, after having demolished so many naïve portfolios in the previous negative three years. Once again, as in the second and third periods, small and aggressive stocks were superior, but investors must have experienced some vertigo; higher quality large stocks regained interest as well. We saw the beginnings of a change during the quarter, but the fact remains that over the past twelve months stock returns have been exactly inverse to both size and quality.

We still don't like tiny short-term interest rates. To us it appears a big gamble on the part of the Fed to encourage credit spending and inflate asset values. The Fed will surely want to take credit for economic improvement, and perhaps they deserve it, but the pre-emptive strike of unprecedented low rates also pre-empts any further ability of the Fed to deal with the economy on the level of interest rates. And additional tools are really an unknown. We can't recall a time when economic repair efforts skated so close to the edge, though, to be sure the edge has grown a bit more distant and current low inventories suggest an additional margin of safety for the economy going forward.

We can see as well as anyone else that the economic numbers are better, though the jobs situation remains feeble. Corporate loan demand has not picked up yet either. So corporations are clearly still relying on their existing infrastructure and existing employees. In our minds, questions about the economy and the market have evolved; now that a bottom for both seems to be in place, do we have the goods to justify a rip-snorting bull, or merely factors that suggest the right companies can succeed without too much economic drag?

Perhaps the "ten points" we began in June of 2002, a much more "questionable" moment, can shed some light. This time, a way shortened version:

1) *The Fed is loose*…but the guillotine is slowly dropping for bond investors, and the longer the Fed stays loose, the more certain an eventual inflation-related rate rise. In the meantime, low rates make margin buying more attractive, arguably inflating assets beyond their intrinsic worth. Traditionally emotional and "weak" margin holders add an element of potential rapid volatility and destabilization to equity pricing.

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"While valuation concerns make it hard for us to envision substantial upside now, in recent years momentum has become an increasingly important and even durable factor, which one needs to respect until it 'breaks.'"

SELECTED INDICES

	4th Qtr'03	12 Mo
S&P 500	12.18	28.69
Equity Inc	11.86	25.26
Util Fund	9.44	22.34
DJU	7.49	29.26
LB Long	(1.15)	2.59
LBGC	(0.03)	4.67
S&P 400	13.18	35.64
Wilshire 5K	12.43	31.65
Rus 2000	14.52	47.25

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

2) *Investor confidence in corporate governance is at the lowest point...* In the third quarter it was the NYSE. In the fourth quarter, mutual funds. To a casual observer, the entire financial system must appear corrupt from top to bottom. But investors don't seem to care about this factor.

3) *Sentiment measures are inadequate to support an intermediate-term rally.* The traditionally successful strategy of positioning contrary to newsletters and individual activity was a failure in 2003. As of this writing, matters have gotten even worse from a sentiment perspective, with about 60% bulls and 20% "correction." There's hardly a bear to be found. Misdirection over the past year or so, we don't like the unanimity of publicly voiced bullishness.

4) *Short-term options activity has improved but stocks are not currently oversold.* And yet our proprietary put/call open interest indicator remains positive, meaning that real investors with real money are not so bullish at all. Rather, the open interest on index puts and calls reflects considerable worry, and this is a positive. It would be more positive if stocks were oversold. Whereas this series last quarter suggested a bias in favor of small stocks and/or aggressive stocks, it is now more neutral as to size or character.

5) *Valuations support upward price adjustments in some sectors but not all.* Apart from energy, healthcare, and utilities, one is hard-pressed to make a cogent argument in which valuation is a positive factor at this point. Indeed, most bulls now offer economic and market momentum as the most supportive factors.

6) *"The dollar has weakened and may well have reversed its long-term upward trend."* Our call, 18 months ago with the Euro below 90 cents, gets an A+. So far dollar weakness has been interpreted as a positive for US exporters and therefore for the entire US economy, but we continue to wonder how low the dollar can go before it undermines the financial markets as foreign investors tire of the currency confiscation process in their investments. It's likely that the dollar decline will wane now that all eyes are upon it.

7) *The macro-environment has changed...* We often quibble with government statistics, but not with the ISM. For now, the economy has a green light, and the fact that inventories remain historically low implies that recent economic strength should be sustained at least until inventories return to normal—whatever that is, in a just-in-time economy.

8) *Earnings comparisons are easier...* No longer. Earnings were quite good in 2003 as a result of the biggest cost-cutting binge in memory. Revenues lagged, however, and 2004 will definitely be a challenging year from an earnings growth standpoint, as there are limits to how much improvement can be achieved from cost-cutting alone. Unlike last year, revenue growth is now mandatory if investors are to avoid disappointment.

9) *The old highs reflected a vastly different economic and sentimental framework.* Last quarter we suggested maybe the bubble mentality, with e-traders maniacally pushing buttons from their home offices, may not have died in the bubble. Indeed, it may have become a permanent fixture of what has also become a vastly more democratized marketplace. The fourth quarter gave us no reason to pull back from that musing, as worthless garbage continues to float like empty Tang containers in a manned space capsule.

Indeed, in our Alpha portfolio we've had more success following volume shifts in small stocks than in hewing to fundamental precepts. Ugh.

10) *Corporate insiders have not been buyers.* Corporate insider buying activity was the lowest in 15 years during 2003, and selling was at normal or higher levels. There is not yet a vote of confidence from those with inside knowledge of corporate progress.

This market has already broken many rules of thumb, so strong opinions aren't warranted. However, in our historic studies we have found that an uncorrected rally of more than nine months duration is a fairly extreme rarity. So in terms of probabilities, anyway, stocks are due for a correction…like…right now. The combination of a building economic recovery and the positive tone of our options index open interest indicator implies to us that such a correction would be limited in depth and duration. And the apparently delayed "schedule" for an interest rate hike implies that stocks may have another decent run after that—until the fjord of rising rates must be crossed.

While valuation concerns make it hard for us to envision substantial upside now, in recent years momentum has become an increasingly important and even durable factor, which one needs to respect until it "breaks." Identification of a break is never easy—just ask those who lost their wallets in the aftermath of the internet bubble—but we'll opt for the traditional technical condition of failure to gain on extraordinarily high volume. If this were accompanied by market-extrinsic factors that inspire uncertainty, such as a dollar crash or radical terrorism, the bell would be ringing and a move to a protected position would be warranted. ❑

INCOME - EQUITY STRATEGY

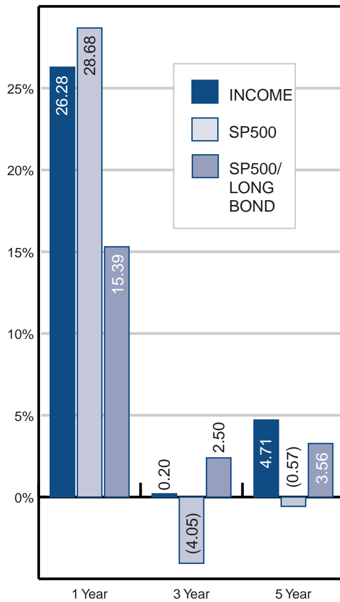
Although dividend stocks did not rank high for 2003 performance - surprising in view of the favorable new tax provisions - our high yielding portfolio kept pace with the S&P 500, far above our balanced benchmark. Indeed, it will probably surprise many observers that our group of high-income, dividend-growth companies outperformed the S&P 500 by about 500 basis points average annualized net of fees for both the past three and five years. Positive economic news and positive fundamental developments helped otherwise lower beta issues keep pace with a mini-bubble environment this past quarter.

"…investors have become increasingly interested in alternatives to fixed income investment, now that there is a reasonable chance the great interest rate decline that dates back to 1982 may finally be over."

PORTFOLIO HIGHLIGHTS

Worthington Industries, a pure basic industry play, appreciated over 40% for the quarter on investor realization that recovery of this value name may be accelerating. We reintroduced WOR to our portfolio back in mid-July when its credit market spreads narrowed (having sold it two years ago when credit spreads widened sharply). While recent earnings exceeded bleak analyst estimates by an incredible 85%, momentum can continue as the lifting of steel tariffs may further enhance company profits.

Financials were strong, fueled by continued M&A activity. Our best performer in the quarter was US Bancorp, appreciating over 24%. In addition to a recently announced 17% dividend increase, the company provided a 10% share buyback and a special stock dividend from a Piper Jaffray spin off. Community Bank Systems, our small cap takeover idea, continued its run finishing the quarter up over 11% and 66% in one year.



Quarter Composite Net of Fees*

Income-Equity (Prelim)	10.11%
50/50 SP500 & Long Gov	5.41%

12 Month Composite Net of Fees*

Income-Equity (Prelim)	26.28%
50/50 SP500 & Long Gov	15.39%

5 Year Composite Net of Fees*

Income-Equity (Prelim)	4.71%
50/50 SP500 & Long Gov	3.56%

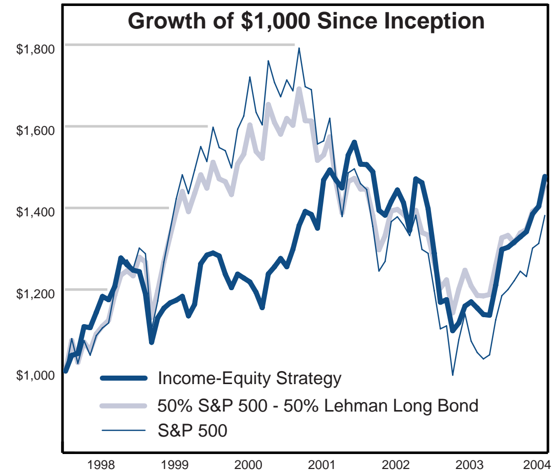
**See Performance Disclosure on page 12.*

We trimmed our exposure here in September as price appreciation substantially reduced current dividend yield, although we believe that CBU continues to exhibit every characteristic attractive to a potential buyer, and the great wave of bank consolidations shows no sign of letting up.

In early October we added a position in Conagra, the third-largest food company in the U.S. CAG is in the process of divesting substantially all of its commodities businesses in order to focus on higher-margin branded packaged products. Shortly after our purchase, insider buying involving some 2.4MM shares, at prices higher than our cost basis, confirmed our enthusiasm about this item with a 4% yield and 5-year dividend growth of over 9%. Their new business model should result in more stable and predictable operating income and cash flow; the company is headed toward a new and higher level, we think, and a recent announcement that the company will buy back 7% of outstanding stock adds to our confidence.

We increased portfolio yield by heading to Great Britain for United Utilities, the biggest public UK water company, with a current dividend of over 8%. Attractively valued, at only 9.4x 04 EPS compared to an average P/E of 26x for domestic water utilities, UU recently received a much welcome 8.9% rate increase through 2005, which should significantly benefit its water business, in addition to continued strength in non-utility segments.

Our cautious attitude toward REIT valuations, in spite of a continued rally, prompted us to exit our position in Rouse in late October at 10% over available NAV estimates. We remain cautious on the group, but we're still willing to hold good value. We added a beginning position in Urstadt Biddle (formerly HRE Properties), one of the few REITs selling at a discount to NAV. UBA is a Greenwich-based shopping center REIT focused in the northeast US, with a 9% discount to NAV, conservative balance sheet, ten consecutive annual dividend increases, current yield over 6%, recent FFO growth in the teens, and experienced management that owns 17% of the company. As investors looking for quality and stability, we view grocery-anchored shopping centers (UBA's specialty) as one of the more reliable and stable property types.



Energy-related holdings, after a modest showing in the 3rd quarter, helped drive performance on increased volumes, favorable pricing, and an improving economy. BP, our only vertically integrated pure oil and gas play, appreciated over 17% for the quarter as strong commodity markets and cold temperatures helped the bottom line. On the MLP front, Enerplus was the top performer in the group, up 17% for the quarter. Kinder Morgan (KMP) followed closely, finishing the quarter up 15% on strong earnings and a recent announcement of a projected 8% increase in dividend distributions in 2004. We continue to like KMP and believe that it is very well positioned to achieve targeted growth due to its high quality portfolio of strategically located assets, excellent management team and successful history of integrating accretive acquisitions—though performance has been so strong it may pause here.

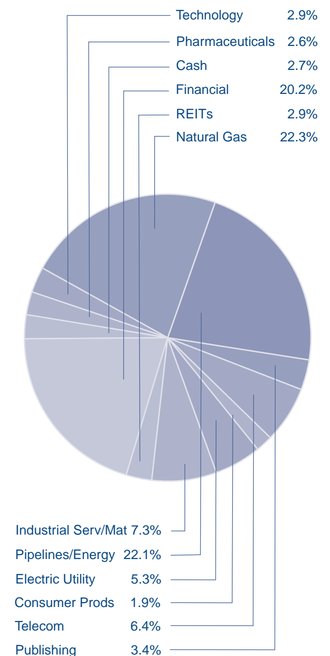
We've felt for some time that the MLP area was ripe for consolidation (since the MLP universe does have growth companies that continually need to add assets at a given hurdle rate to increase distributions.) Late in the quarter Enterprise Partners and Gulfterra combined forces (in fact, an EPD takeover with GTM retaining a large interest) in order to form the second largest publicly traded partnership with an enterprise value of over 13 billion. In general, we like the MLP area due to increased transportation demand, consolidation potential, distribution growth, legislative efforts to open ownership to a greater portion of institutional investors, and a great national need for fuel transport infrastructure.

In October we sold our position in Nordic American Tanker, a Norwegian MLP in the business of leasing double-hulled tankers to BP, when BP opted not to renew future charters. We added Northern Borders Partners, a quality pipeline with the current yield over 8% and a reasonable chance of recovery from a slight exposure to the ghost of Enron (due to Enron's ownership of 1.6% of the general partner), which we believe is already priced in the stock. Union Planters offered a melancholy earnings report and guidance, but we continue to hold the company and continue to believe it is a good candidate for takeover, with many strategic locations that another company might better manage.

LOOKING FORWARD

As the economic picture matures now, we expect that investors will place a higher priority on the "sure thing" quality of dividends, as much of the speculative price action last quarter and last year was discounting potential growth well in advance. We expect some of the factors that were helpful last year, such as a firmer economic base and tax attractiveness, to continue. Too, while potential interest rate increases do loom and are a question mark for all equities, rates will have to climb high indeed to match our current yield of 5.65%, which is projected to grow by about 5% this year and in the years ahead. We think the appeal of "certainty" and stability coupled with moderate growth will draw a continuing stream of investors to help our stocks perform well in more normal times—as dividend stocks have always done over long periods.

Further, investors have become increasingly interested in alternatives to fixed income investment, now that it seems the great interest rate decline, that dates back to 1982, may finally be over. We all know that as rates rise, bond prices decline. It is a mathematical certainty. However, Income-Equity has had a negative correlation to long-term Treasuries since inception, and there is no predictable relationship between interest rates, bond price movement, and our portfolio. Indeed, this past year, bond investors had a flat year, while we offered more income than bonds coupled with equity market returns. Other periods might be different, but at least the last seven years demonstrate conclusively that rising rates, for example, don't necessarily imply poor returns for high yield equities. Importantly, our income rises and our companies grow larger—two features totally absent from bonds. ❑



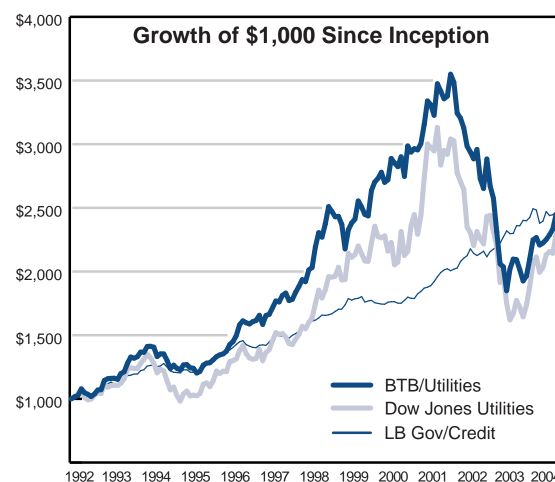
INCOME-EQUITY STRATEGY FUNDAMENTAL CHARACTERISTICS

Yield	5.6%
Proj Div Gro	4.6%
Payout Ratio	56%
Market Cap (MDN)	$4.9 Bil
Price/Book	2.2
Beta*	.5
STD	13.5%
P/E Ratio(MDN)**	16
S&P Rating	BBB+

**Relative to S&P 500, 12/31/98 - 12/31/03*
***REITs use P/FFO ratio*

"We've been suggesting that natural gas prices would climb to a new plateau for two years now, and any one who heats with gas is probably finally becoming a believer."

The year ended on a positive note for utilities, and particularly well for our diversified portfolio, with positive economic news and "normal" weather pointing toward increased demand for utilities' basic services. Within our portfolio, our gas E&P portion led the way last quarter, followed by strong performance from water companies, utilities with natural gas divisions, and companies that have delivered on their "back-to-basics" promises. Ongoing fundamental problems led us to exit our remaining Baby Bell positions, which allowed us to add some conservative electric and gas utilities at bargain prices with generous yields. For the quarter, our high-quality portfolio outperformed the Dow Jones Utilities Index, up 8.6% vs. 7.49%. The DJU, it should be noted, owed half its performance this past year to rebounds in four junk-rated stocks (Williams, AES, Pacific G&E, and Edison Int.). In contrast to the DJU's speculative character for the year, our portfolio of conservative utilities with exposure to natural gas production earned its 2003 return (+17.18%), and is poised for another year of steady growth and rising dividends.



Quarter Composite Net of Fees*	
BTB/Util (Preliminary)	8.83%
DJUA (total return)	7.49%
LBGC	(0.03)%
Util Fund	9.44%

12 Month Composite Net of Fees*	
BTB/Util (Preliminary)	17.08%
DJUA (total return)	29.26%
LBGC	4.67%
Util Fund	22.34%

10 Year Composite Net of Fees*	
BTB/Util (Preliminary)	6.11%
DJUA (total return)	6.41%
LBGC	6.98%
Util Fund	6.45%

*See Performance Disclosure on page 12.

PORTFOLIO HIGHLIGHTS

We've been suggesting that natural gas prices would climb to a new plateau for two years now, and any one who heats with gas is probably finally becoming a believer. Average levels this year are at spike levels of previous years, and double the average of 2001. There is room for debate about whether these prices are fundamentally justified and/or sustainable going forward, but we think a combination of factors will support prices into the foreseeable future: (1) historically high oil prices mitigate the likelihood of fuel-switching, (2) winter weather has returned to normal, and it is cold, (3) mounting evidence that domestic producers are having difficulty maintaining production, let alone increasing their production, and (4) domestic and global economic recovery adds further demand to a tight supply situation. Perhaps most importantly, as we discussed in our last quarterly report, companies with natural gas production are being valued as if gas will return to yesterday's prices. In response to the reality of current high gas prices, companies have seized the opportunity to lock-in highly profitable sales of future production. This quarter, our gas stocks finally began to get the respect they deserve: Anadarko (+22.15%), Devon (+18.82%), Burlington Resources (+14.90%), EOG Resources (+10.61%). Furthermore, our pipelines and traditional utilities with gas divisions also reaped the benefit of rising commodity prices, including: Kinder Morgan Energy Partners (+15.12%), Questar (+14.09%), Oneok (+9.47%), and Southern Union (+8.24%). From our perspective, there is ample room for further appreciation as the market gradually comes to grips with a new paradigm in natural gas pricing.

Several of our veteran positions posted strong gains for the quarter too, including: water utility Philadelphia Suburban (+14.72%), which expanded its customer base by 20% in 2003 through conservative, strategic acquisitions, Ohio utility DPL (+21.75%) which raised its

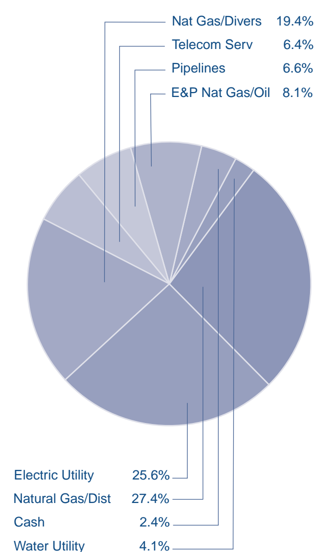
dividend, reduced debt and improved its liquidity, and Idaho electric utility IDACORP (+17.33%) which reached a settlement with the Federal Energy Regulatory Commission over allegations of malfeasance during the California electricity crisis, filed for a rate increase with local regulators and is (finally) enjoying a normal winter with precipitation for its many hydroelectric dams.

Our concerns regarding the fundamental outlook for the Baby Bells – despite their present financial strength, attractive yields and history of steady returns – reached the breaking point this quarter. With ramped-up investment in Voice Over Internet Protocol (VOIP) by cable companies – and others – foreshadowing a decidedly commoditized era of telecom competition and pricing, anecdotal evidence suggesting that broad adoption of VOIP by consumers is only a matter of time, and legislation permitting number portability from wireline to wireless raising questions about the value of the Bells' legacy assets, we decided to swap these remaining positions for more conservative opportunities.

We added several new positions this quarter and increased the weight in some familiar names: Newcomer United Utilities (UU) is a British, regulated water company whose stock was underperforming because of rising infrastructure expenses that weren't matched with rate increases from regulators, thereby pressuring earnings. Shortly after we bought UU with an 8.3% safe current yield (+12.55%), regulators acknowledged UU's investments and granted an 8.9% rate increase through March 2005. Domestically, we added National Fuel Gas (NFG), a regulated, natural gas distribution company with a 4.3% yield, serving the geographically strategic area of western New York/Pennsylvania as well as operating extensive pipeline, storage and gas production assets. We borrowed two takeover candidates from our Distribution strategy, Pepco (POM), the electric utility for D.C. and Maryland, and WGL Holdings (WGL), another electric and gas utility serving D.C., Maryland, and Virginia. Both are conservative distribution utilities, fine fundamentally, and are potential acquisition candidates. POM has also recently been released from a legal cloud regarding its supply contracts with Mirant. We added weight to OKE because of their continuing low valuation and favorable exposure to the Rocky Mountain gas environment, and increased our weighting in Cinergy (another takeover candidate with good fundamentals) and Con Edison.

LOOKING FORWARD

Our hearts are warmed, for as we write, record cold temperatures grip the nation and forecasts call for abnormally cold temperatures for the rest of January in the heavily populated Midwest and Eastern seaboard. We're ever more firmly of the view that, now, with the near-apocalyptic financial and business challenges that shook the industry solidly behind it, investors can focus on the two key drivers of utility growth: favorable weather (cold winters/hot summers) and economic expansion. With the weather doing its part, and further evidence suggesting continued economic growth (for now, at least), we expect moderate earnings expansion across our portfolio next year, coupled with dividend increases, and additional strengthening of balance sheets. Throw in a little exposure to high natural gas prices for our companies with production, and some form of Energy Bill (see our discussion in Distribution) acting as a potential catalyst for takeover activity and valuation multiple expansion, and 2004 emerges as a year we can all look forward to. ❑



UTILITIES PORTFOLIO CHARACTERISTICS

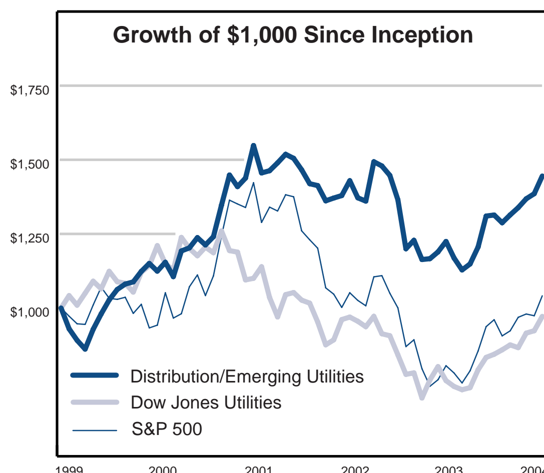
Beta*	.6
Dividend Payout	48%
Proj Dividend Growth	4.5%
Current Yield	3.7%
Annualized STD	13.7%
Market Cap (MDN)	$2.9 Bil
Price/Book	1.9
S&P Rating	BBB+
P/E Ratio (MDN)	14.3

**Relative to S&P500, 12/31/93 - 12/31/03*

One of the features of investing which keeps things interesting is the way in which results can unfold in an almost perverse manner. We've been focused on passage of energy legislation for more than two years as a catalyst for strong performance in this portfolio. And yet our year and quarter yielded strong returns despite the failure in November of the comprehensive Energy Bill to reach a vote on the floor. Indeed, immediately after the faux-filibuster our portfolio had some of its best days ever!

The bill itself is/was warty and filled with pork, with shockingly little attention paid to forward-looking solutions to the nation's energy problems—though it does/did contain provisions (repeal of the Public Utility Holding Company Act) that will benefit us as investors. In the end, liability limitations for producers of MBTE proved its downfall, just as drilling in the Arctic National Wildlife Refuge was the sticking point last time around. But we think there will be another act this quarter or this year, as passage of a bill is a high priority for the Bush administration, the specter of a blackout remains, gas prices are soaring, and this is…well…an election year. It may be that the electricity provisions (which are the areas of interest to us) are cast in a separate bill, or simply that horsetrading to get a comprehensive bill is passed, but from all we can detect some momentum remains.

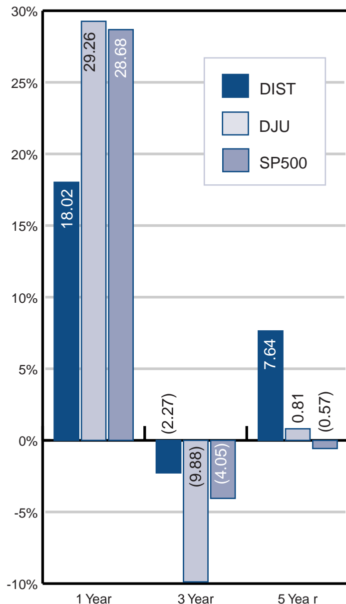
And the principle of consolidation in the electric and gas delivery industries remains fungible. Just before the legislative stumble, an essentially financial transaction for Arizona Public Service was announced at an attractive premium. It's a reminder that we've had over 20 transactions in this portfolio even without an energy bill, and there's no doubt more will follow, especially in today's low interest rate and weak dollar environment. But repeal of PUHCA remains a Valhalla for utility acquirers—of whom there are many: it also remains a favored provision of legislators in both parties, and we think the odds are still good for congressional action soon.



In the meantime, we can be content with returns close to 20% for the year and a dividend yield of just under 4%. We've always suggested that one of the appeals of this portfolio is that it's a nice conservative equity approach even without the symphony of deals which we anticipate on PUHCA repeal, and 2003 certifies that notion.

PORTFOLIO HIGHLIGHTS

Our formerly "outcast" local distribution companies delivered the best performances in the portfolio this quarter, signaling investors' awakening to the eternal verity that distribution utilities are here to stay, and that time will heal most wounds. Recent addition, UIL Holdings (+28.89%), the Connecticut electric distributor



Quarter Composite Net of Fees*	
Distribution (Prelim)	7.97%
DJUA (total return)	7.49%
S&P 500	12.18%

12 Month Composite Net of Fees*	
Distribution (Prelim)	18.02%
DJUA (total return)	29.26%
S&P 500	28.69%

5 Year Composite Net of Fees*	
Distribution (Prelim)	7.64%
DJUA (total return)	0.81%
S&P 500	(0.59)%

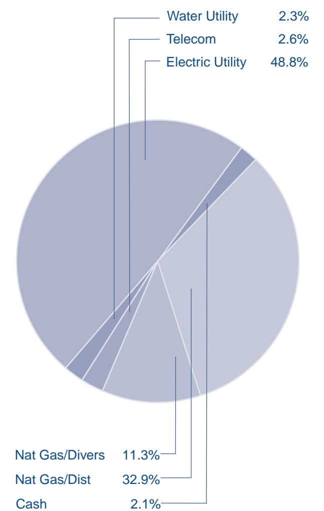
**See Performance Disclosure on page 12.*

that was trading at book value (rather absurd) when we added it, illustrates this point. UIL was languishing from poor relations with its local regulators and a cash drain from underperforming businesses, giving investors reason for concern for the security of its dividend, until – lo' and behold – they reached a settlement with local regulators regarding the disposition of increased pension and retirement benefit costs, and sold their underperforming, bill-payment service for cash. DPL (+21.75%), the Dayton electric distributor and generator – which sits in the geographic sweet spot for future M&A activity, in our view – has begun to restore investor confidence in its core operations, paired with a dividend increase, reduced debt, and improved liquidity. Duquesne Light Holdings (+18.78%) too continues to deliver on last year's back-to-basics pledge, and the generous yield of 5.5% with strengthening business fundamentals is clearly attracting attention. CMS Energy (+15.60%) continued its recovery aided by a restructuring, improved liquidity from its sale of pipeline/LNG assets to Southern Union, and settlement of energy trading allegations with the CFTC. Alliant Energy (+13.18%), a diversified utility based in Madison, Wisconsin, continued its remarkably steady upward march from our entry point last January (+49.80%) as it sold non-core assets, spun-off its petroleum business, received two rate increases, and paid down debt. PEPCO (+13.08%), a prime takeover candidate (incredibly, still trading at book value!) with a generous 5.3% yield, benefited from a landmark federal court decision ordering bankrupt-Mirant to continue honoring power purchase contracts with POM.

Utilities with natural gas producing divisions continued to post solid gains, riding the strength in natural gas prices this quarter, including Questar (+14.09%) and Energen (+13.41%), which just boosted its 2004 earnings forecast for the second time in one month.

LOOKING FORWARD

As of this writing, our companies are surely working overtime to meet the heating needs of homes, businesses and factories, grappling with some of the coldest temperatures to grip the nation in many years. With predictions of more abnormally cold weather to come in the eastern half of the country, our distribution utilities – which benefit from increased demand for their services – are poised for an excellent 1st Quarter, and earnings may even match last year's blockbuster comparisons if brutish winter conditions materialize as forecast. Longer term, we are looking for 2004 to mark the resumption of M&A activity in this space – with or without an Energy Bill repealing PUHCA – as utilities seek conservative means to grow earnings more rapidly than organic growth driven by demographic change and economic activity is likely to provide. We also expect potential buyers will feel pressured to pounce on their respective takeover targets sooner rather than later, since improving industry fundamentals threaten to increase the cost of consummating a transaction. We, however, remain quite content collecting our rising dividends and enjoying moderate steady growth, while we wait for the action to start. ❑



FUNDAMENTAL CHARACTERISTICS

Yield	3.8%
Proj Div Gro	3.0%
Payout Ratio	62%
Market Cap (MDN)	$2.2 Bil
Price/Book	1.7
P/E Ratio (MDN)	14.5
S&P Rating	BBB+
Beta*	.3
STD	15.0%

**Relative to S&P 500, 12/31/98 - 12/31/03*

"...there is also a kind of "normalcy" returning, in which stocks with sound fundamentals and outstanding technicals should add nicely to investor returns."

We had a solid quarter in the Alpha-Based strategy this past period, finishing up 13.04%, though the quarter was a couple of days too short for us. We had a very strong December, performing almost twice as well as the Russell 2000, and while we finished the quarter a bit lower than the index, within the first couple of trading sessions of the new year our momentum continued—taking us ahead of the index since the end of the 3rd quarter. Sometimes the exact reporting date can be a bit arbitrary, and this was one of those times.

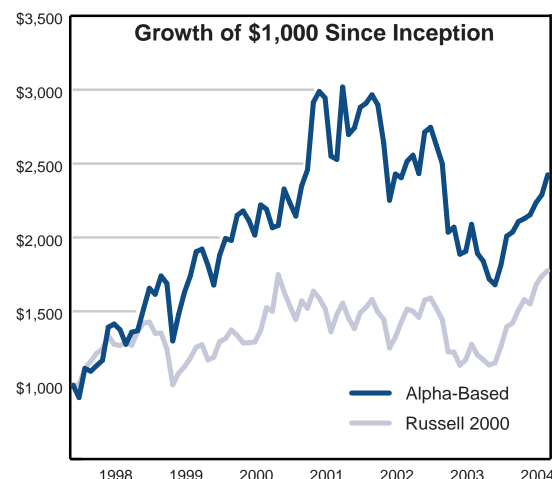
Two factors contributed to a better showing. First, while the marketplace continues to feature momentum play in nostalgic names from the bubble-era that have yet to demonstrate a solid business foundation, by late fall investors began to recognize good companies with good businesses that generate actual earnings. Unlike the activity since March, stock performance in the late fall began to bear a relationship once again to underlying quality. Second, we began to be more aggressive in implementing some technical signals we've been researching for many quarters. Indeed, we think the small-stock market has become increasingly influenced by individual investors (visions of sugar-plums trading on-line) and smaller hedge funds, meaning that it has become quicker and more technical. The technical side of analysis has always been an important part of our strategy; now more so than ever.

Quarter Composite Net of Fees*	
Alpha-Based (Prelim)	12.54%
Russell 2000	14.52%
12 Month Composite Net of Fees*	
Alpha-Based (Prelim)	27.91%
Russell 2000	47.25%
5 Year Composite Net of Fees*	
Alpha-Based (Prelim)	4.70%
Russell 2000	7.13%

*See Disclosure on page 11

PORTFOLIO HIGHLIGHTS

Our heavy weight in natural gas play Chesapeake was a hindrance in the third quarter, but it came on strong late in the year, as our conviction in higher gas prices was rewarded. The stock gained 26%, prompting



us to take some profits though it remains our largest holding.

The efficacy of market-driven moments became evident in purchases such as Omni Energy Services, a diversified seismic support company in the business of providing a range of services to geophysical and E&P companies, which was up nearly 70%, and a weight doubling in Rambus, which rose about 60% for the quarter and started 2004 with a strong performance on renewed optimism that it will prevail in a legal fight with Infineon and Micron Technology in a price-fixing case and be that much closer to a positive ruling in the FTC antitrust litigation due in February.

Our representation in the Technology sector helped overall returns this quarter following the addition of several new names in the space. RF Monolithics, a developer of radio frequency components used in the automotive, computer, and telecom markets worldwide, gained 38% since our purchase in early November, lifted by stronger than expected earnings as well as improved investor sentiment. AMX Corp., in our portfolio since October, finished the quarter up over 35% as well. AMXC, a $95MM company involved in

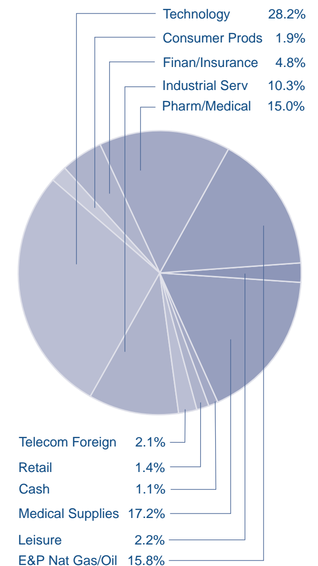
design and marketing of integrated control systems and network applications compatible with the internet, is a model Alpha-based holding. In addition to having recently reported its strongest revenue quarter in eight consecutive periods and one of the most profitable quarters in the company's 21-year history, AMXC continues to exhibit strong margins despite a weak economy and anemic capital spending, while maintaining a solid balance sheet with 7% debt/equity ratio uncommon in computer networking space.

The Financial sector had an excellent quarter as well. Sovereign Bancorp, originally purchased for its attractive takeover profile, generated 28% quarter-to-date and 79% since its addition to our portfolio, on rumors it received a bid of $26/share from Royal Bank of Scotland. Let no one say big gains only come from racy stocks! In financial services, we added Newtek Business Services. Newtek, is involved in providing technological support for the financial sectors such as IT, payment processing and tax preparation, even after its recent strong performance, it continues to trade at 13x earnings, carries no debt on its balance sheet and is expected to generate solid earnings growth of over 20% in 2004 given a modest recovery in business spending.

The Medical products and equipment group, commonly found in our portfolio, presented us with interesting and rewarding opportunities as well. In November, we added Medical Action Industries, manufacturer and distributor of disposable surgical products, after the company reported the highest quarterly revenue growth in its history and raised guidance for 2004, reflecting successful integration of prior acquisitions and strong growth across most of its product segments. MDCI finished the quarter gaining close to 19%. We also added a small position in CardioDynamics (CDIC), manufacturers of noninvasive digital cardiac output monitoring devices, up 30% for the quarter. In December we raised out weight in Hologic, a developer of x-ray equipment, on very strong performance results in two core businesses (mammography and bone densitometry), representing a majority of total revenue. We also took profits in Merge Technologies, realizing gains of over 80%, and Quest Diagnostics, in order to make room for other candidates.

LOOKING FORWARD

Generalized caution restrained our performance somewhat in 2003. In truth we're still cautious on the market, but recent strength in the economy tells us that there will be opportunities in individual companies who are properly positioned in areas of growth. There will be more focus on specific situations, we think, and less on overall index movements. Many of the more speculative stocks are likely to disappoint this year, but we believe our combination of fundamental and technical disciplines is more attuned than ever to the prospects for companies that will succeed. After the recent run there are sure to be moments of volatility and frustration ahead, but there is also a kind of "normalcy" returning, in which stocks with sound fundamentals and outstanding technicals should add nicely to investor returns. ❑



FUNDAMENTAL CHARACTERISTICS

Forward P/E Ratio (MDN)	19.8
Market Cap (MDN)	$361 Mil
Price/Book	3.3
LT Growth Rate	23%
Beta*	.96
R-SQR*	.40
Annualized STD	26%
Annualized Alpha*	7.6%

**Relative to S&P500, 12/31/99 - 12/31/03*

Disclosure

Yield-Oriented Portfolios: Gross of fees performance is based on actual results according to standards set forth by the Association for Investment Management and Research (AIMR). Miller/Howard Investments has prepared all performance results. AIMR was not involved in the preparation or reporting of these results. Net of fees performance is calculated by deducting a weighted average annual fee of 100 basis points from gross of fees performance. A complete list of all the firm's composites is available. Returns are total returns and dividends are assumed to be reinvested. Portfolios are matched across all accounts so that each client holds substantially the same issues at the same weights. Portfolios are typically fully invested and hold minimal cash, although cash holdings may fluctuate somewhat on a residual or transitional basis. No representation is made that future returns will approximate past results, and none should be implied.

Income-Equity Strategy: Included in the results are all portfolios that are unrestricted and that have been managed for at least one full quarter. The number of accounts in the composite as of 12/31/03 was 180, which represents 81% of total assets managed in this strategy with a measure of dispersion of 0.46. Inception of the Income-Equity Strategy composite was May of 1997.

Distribution: Included in the results are all portfolios that are unrestricted and that have been managed for at least one full quarter. Number of accounts in composite as of 12/31/03 was 48, which represents 76% of total assets managed in this strategy with a measure of dispersion of .43. 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 12/31/03 was 190, which represents 95% of total assets managed in this strategy with a measure of dispersion of 0.53. 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 12/31/03 was 31, which represents 93% 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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