

MARKET OVERVIEW

The fourth quarter was surprisingly strong across the board. We suppose we shouldn't have been surprised, since over the past few quarters we've found little reason for enthusiasm but at the same time found ample evidence to deny the bearish case. In the low-volume third quarter, however, there was apparently plenty of cautious pent-up demand building, and when the questions about the election were resolved, that demand carried stocks higher on a resumption of fairly normal volume.

Though we're as susceptible to mental extrapolation as the next person, the higher pricing doesn't inspire us to be thinking along "more of the same" lines. In fact, we're still thinking along the same old lines that characterized recent quarters: while arguments against substantial downside still obtain, in the current environment there just aren't many palpable opportunities. Nothing that anyone who's been around the track a few times has ever learned would suggest that stocks are cheap, or bonds are cheap, or that bulging deficits augur for good times ahead, or that there is no cause to worry about the unfolding of world events (not to mention earthquakes).

Strong opinions about broad market movements are rarely appropriate—though everyone seems to want to have them and hear them—and this is hardly one of those "rarely" moments. Seasoned handicappers like Jeremy Grantham and Steven Leuthold don't know what to bet, and all the academics are looking for single-digit returns, with some even wondering if that is too optimistic. Few seem to want to mention that given the historic average volatility of stocks, a single digit projection could just as easily be negative as positive. After all, at the index level, this year's decent showing occurred entirely and only in the final two months of the year.

But this was not the case for our dividend-driven portfolios, whose gains were more evenly distributed throughout the year. Why the difference? Dividends are always positive, so even in a flat market there are returns available from the cash payouts. More important at this moment, however, is the fact that the value of dividends has re-emerged as a correct and appropriate feature of a long-term equity investment—after years of disdain orchestrated by number crunchers ignorant of the intimate and trust-based relationship between investors and their corporate managers. We all want some cash now, in addition to our dreams of asset-inflation riches. This homey truth is being embraced by more than one generation of investors today, and it will be many years before the epochal swing of the pendulum loses its relative momentum.

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.

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.

NOTE: The quarter report for the **ALPHA-BASED STRATEGY** can be found on our website, www.mhinvest.com.

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“...there's always a 'Heisenberg principle' at work in the markets: that which is closely observed changes as a result of the observation.”

Once again, there is a kind of stasis in our ten points. The most intriguing question of the moment is whether we're still in a “soft patch” or not. Clearly, the economy is not going backwards at this point. Yet, at the same time, growth has not yet been strong enough to generate the kind of job growth and/or demand for money that would certify a true recovery. Is it just a slowly evolving thing, or are the legs too old and tired to run anymore? It's a question, which, unfortunately, will only be answered in the fullness of time.

1) *The Fed.* The Fed keeps raising by quarters, and insists it will keep doing so. We wonder if rates in the 1% range really had that much of an effect anyway, since commercial and industrial loan growth has remained modest. We do have a kind of syllogism in mind, one with a blank in it: If Fed rate reductions inflated the real estate market, then Fed rate increases should _____ the real estate market.

2) *Terrorism.* There's a tired old saw that goes “in crisis resides opportunity,” and if that's really true, then the recent earthquake/tsunami may be just what's needed to show US compassion and to bring the world community back together in a joint effort. Domestically, we have been free of major threat recently, but the nature of terrorism compels us to consider that this could change quickly. At the moment, popular perceptions of terrorism are focused primarily overseas on efforts to destroy the fledgling democracy we've built in Iraq and creating chaos where an election was supposed to be.

3) *Traditional sentiment measures* (advisor bullishness, volatility index, short interest, and the like). These still argue against a rousing market. Ignored for now, they'll surely get plenty of hindsight attention if prices turn lower. An item that probably

belongs in this category is the advance-decline line. This ratio of rising to falling stocks began a stealth and unremittingly bullish move last July; it is not often that one sees the A-D line so smoothly and consistently rising for a full six months without a noticeable interruption. In our view this is a positive portent for the intermediate and longer term, though it is due for a rest soon.

4) *Our proprietary options indicator.* Continues to suggest modest downside risk, and continues to remain surprisingly constructive. We'd never put all our eggs in the basket of one indicator, but this measure of greed and fear, taken by examining the open interest in index puts and calls, has been much the best since winter of '03.

5) *Valuations.* The rally in stock indices heads them back on the road toward high, though not historically unprecedented valuations. The value conundrum right now revolves around the fact that the probabilities for bond rates remaining “low” aren't very good, especially if the economy should show some strength. It would be unusual for PE ratios and other valuation measures to rise in the face of increasing bond rates, so higher prices would have to depend on stronger earnings. Yet most analysts believe that corporate earnings are in the process of peaking—squeezed by moderating sales and increasing cost inputs. This leaves investor enthusiasm as the primary driver in any scenario of higher prices. That can happen, but it's not the best foundation...

6) *The Dollar.* The dollar was weaker than we expected last quarter, but that weakness brought it to the front pages and to the focus of consciousness among investors. While we agree with a number of the arguments that have been put forth

SELECTED INDICES

	4 th Qtr'04	12 Mo
S&P 500	9.23	10.87
Equity Inc	8.57	11.90
Util Fund	11.89	23.43
DJU	14.45	30.16
LB Long	1.44	7.70
LBGC	0.81	4.20
S&P 400	12.07	16.50
Wilshire 5K	10.33	12.62
Rus 2000	14.09	18.33

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

which assert further dollar weakness, we also think there's always a "Heisenberg principle" at work in the markets: that which is closely observed changes as a result of the observation. Put more simply, extreme movements don't happen when everybody's looking for them. So we think dollar strength is more likely than weakness in the short term, with more weakness to follow later on.

7) *Mutual Fund cash flows.* Equity fund inflows have remained steady, if not spectacular. This remains a supportive factor for the broad market.

8) *Earnings.* We continue to think that earnings are at risk of becoming the fly in the ointment of the current scene. Historically, earnings rates of change have rarely been higher than in recent quarters, and the curve will almost inevitably flatten out. At the same time raw materials prices are higher, energy inputs are higher, minimum wage rates are rising in various states, and interest rates may take a greater bite soon as well. We don't have a crystal ball on this issue, but we do know that tech companies are once again complaining about "lack of visibility," companies are not generally providing upside guidance going forward, and discounter retail sales, the meat-and-potatoes of retail, have slowed. Even a stronger economy might not help earnings here, since productivity increases have flattened and new business is likely to require, finally, more employees (and therefore more costs.) The real issue is that good earnings are all the more urgently needed for rising prices if expanding PEs are unlikely to be the driver.

9) *Hidden Taxes.* In our minds there's no doubt that mass market retailing has suffered due to the "hidden tax" of higher energy costs—we think energy has taken an incremental 5% of pre-tax earnings for

the median income household. Too, our informal research indicates also that there is no municipality or state in the US or in the rest of the galaxy where local taxes are declining.

10) *Insiders* are still staying home. With rare exceptions, insiders do not believe in their own companies enough to buy stock. Previously there were some followers of insider activity who suggested that the readings had become more neutral, though we didn't see how they could have reached that conclusion. Recently, these voices have become silent.

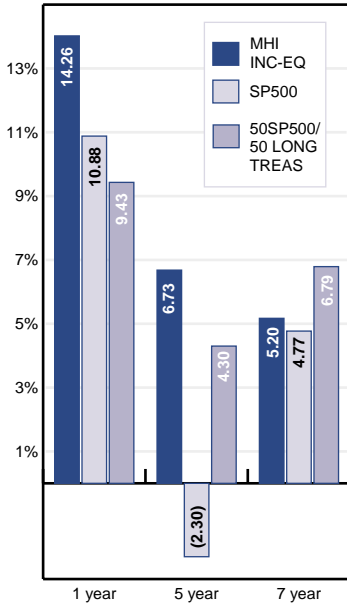
So here we are again, staring at a rather inconclusive set of factors. Importantly, though, there is nothing that suggests an aggressive posture. In the second quarter report of 2002 we suggested that a post-bubble environment was likely to involve a trading range, rather than a new "bull" or "bear" market. Since then the indices have had their ups and downs, but the S&P 500 isn't very different from where it was then (indeed, without November of this year it might very well have been unchanged for the entire period). Given the thrusts and parries still present, that's still what we're looking for: some ups, some downs, no reason to take a strong position.

If anything we'd tilt to the negative for the broad indices, having already seen gains from the strong points present in the picture. But we don't—and this is not because of our particular specialization—find reason for apprehension about dividend stocks. Even some backup in interest rates, which we expect will be orderly and not radical, won't deter the compensations of reliable earnings and dividend growth in *the right yield-oriented companies*. The millions have still to make the march to our land, and when they get here they will find much to like. □

"Even some backup in interest rates, which we expect will be orderly and not radical, won't deter the compensations of reliable earnings and dividend growth in the right yield-oriented companies."

1/04/2005

Annualized Returns as of Dec 31, 2004



Quarter Composite Net of Fees*

Income-Equity (Prelim) 8.6%
 50/50 SP500 & Long Treas 5.3%

12-Month Composite Net of Fees*

Income-Equity (Prelim) 14.3%
 50/50 SP500 & Long Treas 9.4%

5-Year Composite Net of Fees*

Income-Equity (Prelim) 6.7%
 50/50 SP500 & Long Treas 4.3%

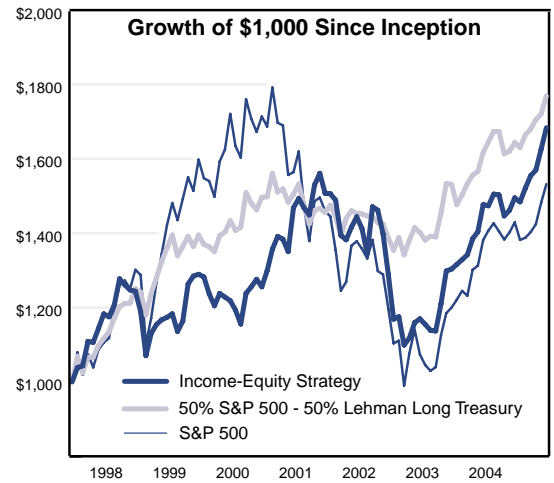
Included are all unrestricted portfolios that have been managed for one full quarter. As of 12/31/04: 257 accounts in composite, representing 42% of total assets in the strategy with a dispersion of 0.9. Inception: 5/97.

Last quarter we suggested that most likely “more of the same” lay ahead for our stocks, as conditions were ripe and they were hardly the object of rampant speculation on either fundamental or technical grounds. That pretty much tagged the quarter, though we should have said “much more of same,” as we registered one of our best quarters since inception. For the year we outperformed nearly every kind of equity strategy, on both an absolute and a risk-adjusted basis. Though by the end of the quarter we were feeling a little queasy when contemplating the relentless and unanimous quality of the year-end rush, we suppose sometimes you just have to let your winners be a little frisky. In any event, part of the steam is letting off as the year begins, and we continue to find solid prospects in our portfolio as well as in our candidate list.

PORTFOLIO HIGHLIGHTS

The diversity of industries that generated gains for the portfolio was gratifying, since we make a constant effort to diversify as broadly as possible consistent with high and rising income and good quality. Among our top dozen performers we had representation in MLPs, utilities, foreign financials, foods, our sole REIT, printing, insurance, banking, and large pharmaceuticals. Further down the list, but still contributing, were office products, telecom, and international oil. Like the overall market, gains were broad-based.

You may recall we were nicked at the end of the third quarter by the surprise announcement that Merck would take its painkiller Vioxx off the market. At that time we said that the stock had been cheap before its fall, the high dividend was safe, the lower



price induced thoughts of a possible merger, and that withal, the news was not good. We suggested we would await a bounce for a “graceful exit.” Instead, damning articles purporting more bad secrets started appearing in the news, and the stock dropped much further. But, having lived through astounding moments of speculative incendiary journalism during the Enron period, we were ready! If it was cheap in our view at 34, how did we feel about it at 26? Well, based on our calculations it was of course a better buy, and despite the transient roar of opinions we took a contrary position and doubled up at the lows and wound up the quarter with a 22% gain on the move and an overall cost basis not very different from current prices. We continue to believe that the stock should trade higher, and in the meantime we’re being paid handsomely to wait, a dividend payout which we don’t believe is at risk under current circumstances.

Special dividends have played a noticeable role in the portfolio income this year, but the stocks offering them have also performed very well subsequently. It might be something about having an interest in shareholders...or simply that a company that

can afford a large special dividend is a clear cash generator. In any event, in nearly every case we've earned at least the dividend and an equal amount in stock appreciation, and it seems to be a fine path for both buoying the income side of the portfolio and capturing some good diversification. This past quarter we bought Ralcorp Holdings ahead of its approximately 3% special dividend at 36, and held beyond the full 61-day tax period as the stock rose without pause after its ex-date (we do have the option of selling quickly in tax-exempt accounts, but there's no point in that if the stock, as expected, is a strong performer) to finish the year at 42, a 16% gain added to the 3% special dividend. We expect to become involved in many more special dividend stocks in coming years, and, indeed, as we write we are eliminating our position in Ralcorp (which has no regular dividend going forward) in favor of a new security which offers the largest special dividend we've yet seen—an extra “feature” in a stock that's been on our candidate buy list for over a year anyway.

We added Startek, a company offering customer service management products and services primarily to the telecom industry: the stock got extra points from us for providing yet more diversification at a solid yield. On the other hand, significant customer concentration is part of the picture here, so the extra risk—in addition to its small size and modest liquidity—prompted us to initiate a fairly small position. We added Tidewater, giving us exposure to the oilfield services market in a quality stock with a decent yield, albeit a smaller yield than we normally seek. We also added convertible preferreds in Schering Plough, perhaps the leading turnaround candidate in an industry which itself awaits turnaround catalysts.

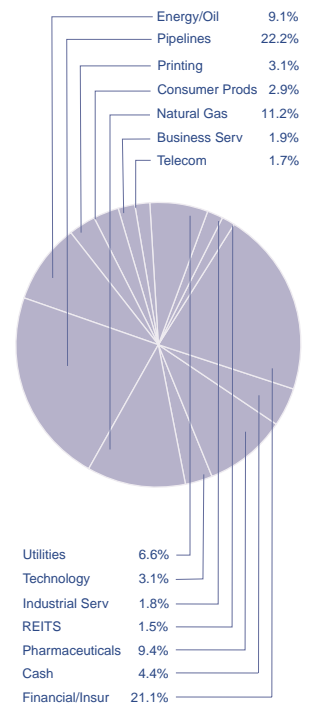
LOOKING FORWARD

This portfolio has historically been one with modest turnover, however, the past quarter involved quite a lot of activity. We do feel moved to action when opportunities arise, while never losing sight that we are long-term investors (as we've often said, we'd like to hold these stocks forever if they continue to do their job in our high-quality compounding machine.) We'll be adding one special dividend stock this coming quarter with nothing else on the horizon at the moment. Nevertheless, we're watchful of situations where investors may become overly fond of one of our holdings, and we'll regularly trim what's grown high when needed. Overall we're comfortable with our holdings. And why not? These are the kinds of stocks without which life as we know it can't exist!

The current yield for the portfolio, adjusting *out* for December's Microsoft special dividend and *in* for a new security with a comparably large dividend upcoming, is 5.6%

Introducing Our New Absolute Return Strategy

A dynamically hedged portfolio based on our **Income-Equity Strategy**. Layered below and above our long only portfolio are hedge and leverage tools intended to prevent drawdowns and amplify gains. The goal is to maintain a high level of current income, permit the portfolio to participate in positive periods in the marketplace, and hedge to prevent declines in asset value during negative periods for the broad market. With more than a year of quite stellar performance under our belts, we're now offering this strategy in separate accounts to qualified investors. To learn more, contact Helen Hamada, helen@mhinvest.com.



FUNDAMENTAL CHARACTERISTICS

Yield	5.6%
Proj Dividend Growth	3.9%
Payout Ratio	55%
Market Cap (MDN)	\$6.4 Bil
Price/Book	2.8
P/E Ratio** (MDN)	13.5
S&P Rating	A-
Beta*	0.5
Standard Deviation	12.8

*Relative to S&P 500, 12/31/99 - 12/31/04

**REITs use P/FFO ratio

Income-Equity (No MLP Version)

Quarter (net of fees)	9.0%
12-Month (net of fees)	13.0%
Yield	4.9%

"Utilities are under-owned, overly shorted, an unknown and superior growth story, undervalued relative to the proto-typical 'growth' sector, and generally hated. These seem to us to be the characteristics of a sector that might have a very high probability of outperforming in 2005."

*- Richard Bernstein
Chief U.S. Strategist,
Merrill Lynch, Dec 2004*

Quarter Composite Net of Fees*

BTB/Util (Preliminary)	7.2%
S&P Utilities	12.2%
LBGC	0.8%

12-Month Composite Net of Fees*

BTB/Util (Preliminary)	18.4%
S&P Utilities	24.2%
LBGC	4.2%

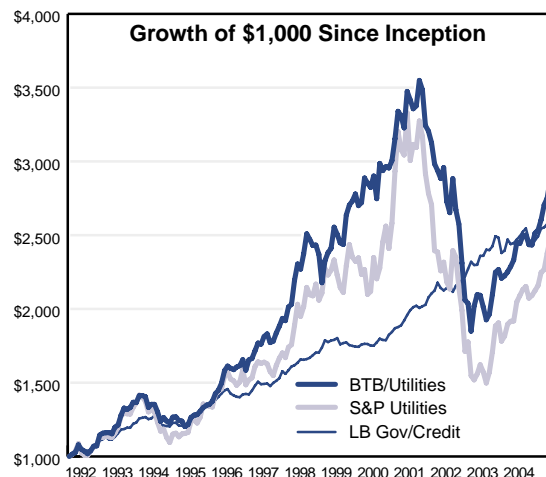
10-Year Composite Net of Fees*

BTB/Util (Preliminary)	9.1%
S&P Utilities	8.1%
LBGC	7.8%

Included are all unrestricted portfolios that have been managed for at least one full quarter. As of 12/31/04: 158 accounts representing 95% of assets in the strategy, with a dispersion of 0.10. Inception: 9/91. History includes one institutional client, 45% of the composite, that held a 2% position not held by others in the composite.

You'd think at some point investors would get over their surprise that utilities can perform so well—after all, for the trailing ten years utilities have been equal to both large cap (S&P 500, DJIA) and small cap (Russell 2000) indices, though with a much higher yield. But once again, it seems that every commentator is simultaneously surprised when utilities perform well and totally dismissive of the possibility that they ever will again. Perhaps this is why the sector isn't owned by supposedly sophisticated institutional investors (Richard Bernstein at Merrill Lynch has called utilities "the most under-owned sector"), but the fact is, Enron and all, an investment in utilities over the past ten years (that's a pretty long time, isn't it?) would have outperformed most fancy broad mutual funds, with their slick brochures and armies of research assistants.

Of course this year and this quarter there were some special cases, though that was true last year and may be true more often than we like to think. Frustratingly for us, many of the unique situations this past quarter involved electric utilities with nuclear generation. Nuclear is making a comeback among investors (not in the real world, there are no nuclear plants being built in this country now) because the rise in fossil fuel prices such as gas, coal, and oil, has made it, wonder of wonders, the low-cost method of producing electricity today. It was only a decade ago, really, that because of plant cost overruns and intense regulation nuclear power was the *most* expensive means of production. How that pendulum does swing. Too, some rather vocal previous opponents of nuclear power due to its obvious risks (accidents and storage of "spent" fuel problems) have now warmed to its clean, environmentally friendly



side. Watch out for that swinging pendulum, here it comes again!

PORTFOLIO HIGHLIGHTS

The big driver in the utility indices, both for the year and the quarter, was TXU, definitely the turnaround story of the decade so far. This stock fell from over 50 to about 10 in the space of roughly four weeks during 2002 after the bankruptcy of its European operations prompted a charge of over \$4 billion and an 80% dividend cut. New management came in, reducing costs and focusing on low-cost nuclear generation and lignite coal in a generally high-cost region. In 2004, major asset sales, debt reduction, and cost cutting initiatives resulted in an equivalently major turnaround for the company, and the stock rose from about 24 to about 64 over the course of the year.

Also boosting the large-cap electrics was Exelon, with its fleet of now low-cost nuclear generators, and Public Service Enterprise Group of New Jersey, for which Exelon bid a modest premium just near quarter's end (we discuss this in the Distribution quarterly review).

Until this past quarter, with its large-cap fireworks in the indices, our much more heterogeneous portfolio, a mix of docile distributors, spicier gas exploration and production companies, plus some water and some foreign companies, had performed better than the indices (despite having no TXU), primarily on the back of the excellently-performing gas stocks. But at the end of the quarter energy markets became volatile, finally tipping over, and, incredibly enough, quarterly returns such as 7.5% for EOG or 6% for Burlington were actually laggards. Long-term, we'd like to see that every quarter, but sometimes your bubble is smaller than their bubble.

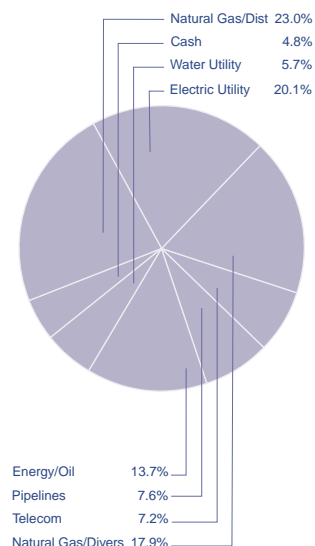
The relatively light amount of activity we had for the quarter was helpful. We added small positions in Avaya and Sierra Pacific Resources, both of which were up about 15% from cost. The former is a key supplier and systems integrator for Voice Over Internet Protocol (VOIP) phone service, one of the many current threats to the Baby Bells. Since we've foregone exposure to the Bells for now (we'll never say never if the time is right), we thought it appropriate to hold a disruptive antagonist selling at very modest valuations. Sierra Pacific has more potential than any utility we see right now. Unfortunately, as we discuss in the Distribution report, there are some legal tangles for the company to get through before blue sky appears. We're ready to add more as the situation clarifies. Late in the quarter we also added China Mobile, modestly priced considering the vast potential of its market, and sold DPL as it had become, in our view, fully valued.

Elsewhere, we benefited from a weaker dollar as foreign holdings Telefonos de Mexico

and United Utilities (a British water company) added 20% gains. (We intend to add more international holdings, though we've currently paused due to pricing considerations). Questar continued to gain, and is now more than three times our original cost basis. Our distribution companies and gas utilities were all clustered with gains in the 5-10% zone.

LOOKING FORWARD

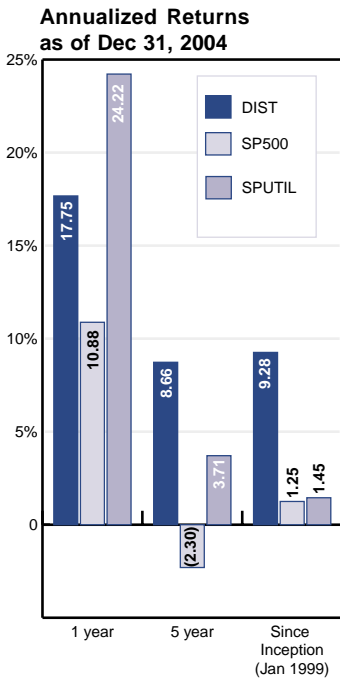
Times have been good for the past two years as measured by the various utilities indices. But both this year and last there were special situations present that drove the indices which may not be so dominant in the quarters ahead. That doesn't mean the environment can't continue strong, however, for the strength of the indices has masked a good but not nearly so awesome performance by the more truly average utility stock. Obviously, we benefit from strong gas prices and volumes remaining in the current higher range though as we write another round of unnaturally warm weather has blunted the long-term edge that we think these stocks continue to possess. There are also many opportunities among our stocks to reap the benefits of consolidation. In general, we're looking for a steady performance that may be resistant to the potential profit-taking which some of the earlier leaders may find. For now, a background of continuing low interest rates and decelerating profit growth among industrials accentuates the relative attractiveness of the sector, and relative performance is likely to stay strong, if not as startling as the past two years. A surprise economic boom might change the picture, but we assign a low probability to that, given the evidence available today. □



FUNDAMENTAL CHARACTERISTICS

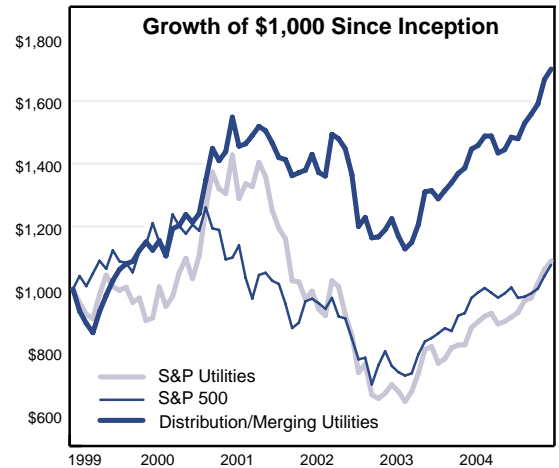
Yield	3.7%
Proj Dividend Growth	5.2%
Payout Ratio	49%
Market Cap (MDN)	\$4.3 Bil
Price/Book	2.4
P/E Ratio (MDN)	15.9
S&P Rating	BBB+
Beta*	0.6
Standard Deviation	13.5

*Relative to S&P500, 12/31/94 - 12/31/04



We had quite a tailwind for the past quarter (and for the full year) from generally strong and supportive buying of yield-oriented stocks, and of utilities in particular. This strategy remains, as it has been for more than five years, one of the best performing portfolios in any equity style or sector—coupled with minimal volatility compared to the rest of the equity world. For the past three years performance has been strong despite a dearth of takeovers, though mergers and acquisitions are what the approach is all about. Thus one of the reasons we’ve always been fond of the strategy: even in the absence of deals the stocks deliver solid returns and are a fine fit for any conservative investor.

Toward the end of the quarter there was one big deal announced—Exelon (EXC) proposed a takeover of Public Service Enterprise Group (PEG), the big New Jersey utility, at a modest premium. We didn’t have this stock in our portfolio, somewhat to our chagrin, thinking that PEG was too big and too messy to be a strong candidate. But the strategic fit with EXC, in retrospect, is undeniable, extending the reach of EXC from Chicago to the edge of New York. (Now we have some new ideas, companies that are a little bigger than those we’ve held, and that are strategically logical). It’s also an important deal in that it demonstrates, as we’ve said for some time, that there are plenty of deals possible in the absence of repeal of the Public Utility Holding Company Act.



PORTFOLIO HIGHLIGHTS

There were really no bad stocks in the portfolio this quarter (not one had a negative return), and there were some pleasant surprises. California Water checked in with a 28% gain, after reporting a solid quarter and defeating a municipalization effort in one city. The company also paid its 240th consecutive dividend (!) we might also note. Southern Union also surged during the quarter. We’ve mentioned before that their success as a consolidator of small properties has inspired confidence, including the confidence of General Electric, which has partnered with SUG to take over the crown jewel pipelines of the former Enron. SUG now holds takeover appeal not only as a package of smaller utilities, but also as a substantial interstate pipeline company, and we value the common stock at 30-40% above recent quotes.

We opened a modest position in Sierra Pacific Resources, which is, most notably, the electric utility for the Las Vegas area, the fastest and most consistently growing location in the

Quarter Composite Net of Fees*

Distribution (Prelim)	9.3%
S&P 500	9.2%
S&P Utilities	12.1%

1-Year Composite Net of Fees*

Distribution (Prelim)	17.8%
S&P 500	10.9%
S&P Utilities	24.2%

5-Year Composite Net of Fees*

Distribution (Prelim)	8.7%
S&P 500	(2.3)%
S&P Utilities	3.7%

Included are all unrestricted portfolios that have been managed for one full quarter. As of 12/31/04: 128 accounts, representing 76% of total assets managed in the strategy with a dispersion of 0.10. Inception: 12/98.

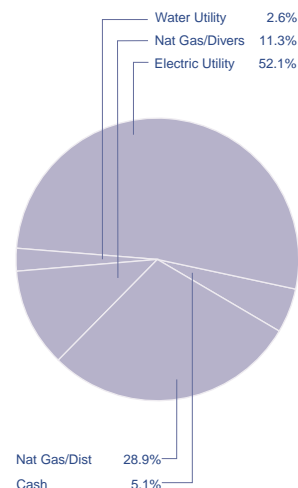
country. SRP has been beaten up since the Enron years. Nevada regulators, which had been difficult at best, required SRP to buy outside power. After SRP contracted for power from Enron, the regulators in effect said they'd paid too much, and refused to incorporate the higher costs in service rates. SRP subsequently sued Enron for fraud, but Enron is in bankruptcy. So there's a legal cloud over the whole situation. However, in the meantime Las Vegas has continued to boom and the members of the regulatory body have changed significantly, creating a board that's now quite sympathetic to the company (as manifested in recent rulings). We'd like to boost SRP to a major position, since we think it's both considerably undervalued on its own and is a very likely acquisition candidate, but we'll wait to add more until there's been some resolution on the legal front. A worst case result wouldn't be terribly damaging long-term, although the stock could suffer a bit on the news, so we'll likely step up the position no matter what the legal outcome, as long as what's now uncertain becomes a part of the past.

LOOKING FORWARD

Though we can't expect the broader utility universe to provide the kind of support that's been present for the past two years, we still think the chances for yet another good year are strong. We've already seen that mergers of considerable size are possible without the chimerical energy bill for which we've waited so long. And the November elections produced a Republican result which augurs well for a

renewed attempt at passage of relevant legislation, in pieces if not in a whole bill. We can't say that much has been heard of this out of Washington just yet, but surely the rise in energy prices since the last go-round has gotten the attention of legislators and created a "do something" atmosphere. With or without a push from the government, though, we can't imagine that European acquirors—whose intentions are already clearly on the record—can much longer resist the allure of US assets purchased with strong Euros.

In the interests of clarity, we're changing the name of this strategy slightly. Henceforth, it will be called Distribution/Merging Utilities, and we'll bet you hardly noticed the only change is an "e" dropped from "emerging." □



FUNDAMENTAL CHARACTERISTICS

Yield	3.5%
Proj Dividend Growth	3.3%
Payout Ratio	57%
Market Cap (MDN)	\$2.9 Bil
Price/Book	1.8
P/E Ratio (MDN)	15.7
S&P Rating	BBB+
Beta*	0.4
Standard Deviation	13.8

*Relative to S&P 500,
12/31/99 - 12/31/04

Disclosure, Yield-Oriented Portfolios: Gross of fees performance is based on actual results according to the Association for Investment Management and Research (AIMR) standards. MHI has prepared all performance results. AIMR was not involved in any preparation or reporting. 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, 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.

Over 65 years of portfolio management experience at work for you!



Lowell G. Miller

President, Chief Investment Officer and Director of Research

Oft-quoted in the press, Lowell is regarded by financial media as one of the leading experts on utilities and dividend growth companies. His opinions and stock picks are regularly sought by *Investor's Business Daily*, *Wall Street Journal*, *The New York Times*, *Barron's*, *Crain's New York Business*, *Newsweek*, *Business Week*, *Forbes*, *Bloomberg*, and *Dow Jones News Service*. He has also been a featured guest on Louis Rukeyser's *Wall Street Week* as well as *CNN-FN*.

Lowell is the author of three critically acclaimed books on investing: *The Momentum-Gap Method* (G.P. Putnam's, 1978), named "Stock Market Book of the Year" by the Hirsch Organization; *The Perfect Investment* (E.P. Dutton and McGraw-Hill, 1984); and most recently, *The Single Best Investment* (Adams Media, 1999). He has also written on financial subjects for *The New York Times Magazine*.

A leading expert on utilities deregulation, Lowell has been asked to serve on a number of prestigious panels, including a discussion on deregulation hosted at The Yale Club; and a research panel as part of the Bloomberg Forum.

Lowell holds an undergraduate degree from Sarah Lawrence College and a Juris Doctor from New York University School of Law. He began his studies of the securities markets while still an undergraduate, and has continuously pursued the notion of disciplined investment strategies for over thirty years. He founded Miller/Howard Investments in 1984.

In addition to his financial expertise, Lowell is also a 5th degree black belt in the martial art of aikido, a prolific writer, poet and sculptor.



Bryan J. Spratt, CFA

Portfolio Manager and Research Analyst

Bryan has been in the investment industry for over fifteen years, the majority of that time as a portfolio manager. He graduated summa cum laude from Spring Arbor College with a BA in Economics/Computer Science. He has a broad and diverse background in both fundamental and quantitative research. Before joining the firm, he was the utility and telecom analyst for the Value Team that managed the Small, Mid and Large Cap Value One Group Mutual Funds at Banc One Investment Advisors. Prior to that he was a portfolio manager at various investment subsidiaries at Comerica Bank. At Munder, he was a founding member of the Energy and Power Team that developed, launched and managed the Munder Power Plus Fund among other portfolio management responsibilities. The Fund had a broad and global perspective on investing in the energy and power universe. His primary research responsibilities were alternative energy and power technology companies in addition to traditional energy companies. Throughout his career, Bryan has specialized in capital intensive and yield-oriented companies. His main area of focus is utility and energy companies. His passion for alternative energy continues and you will likely be hearing more from him in this area in the future.



John E. Leslie III, CFA

Portfolio Manager and Research Analyst

Jack grew up in Boston and earned his BS degree in Finance from Suffolk University and his MBA from Babson College. He has over fifteen years experience in the investment industry with twelve years as a portfolio manager managing equity portfolios for large pension plans, smaller institutions and foundations, endowments, open-end mutual funds, and high net-worth individuals. Jack brings a high level of expertise in both fundamental and quantitative research skills. He designed and implemented both the fundamental and quantitative models, as well as the structured investment decision-making process, for M&T's Equity Income Strategy (large cap value). While at Dewey Square, in addition to managing money as a member of the Large Cap Value Equity Team, he worked on restructuring how DSI's existing valuation models were presented and used in an effort to better exploit their information content. His primary area of responsibility is researching dividend growth companies in the non-utility and energy areas of the market as well as the day-to-day management of portfolios.

THINK DIVIDENDS

“Dividends are good because they remind the CEO four times a year that it’s not his company.”

- Michael Goldstein, Finance Professor at Babson College

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	5.6%	3.9%	0.5	13.5	14.3%
Better Than Bonds/Utilities	Utilities sector: natural gas, electric, telecom, and water	3.7%	5.2%	0.6	15.9	18.4%
Distribution/Merging Utilities	Local distribution utilities, takeover candidates only	3.5%	3.3%	0.4	15.7	17.7%

as of December 31, 2004



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