

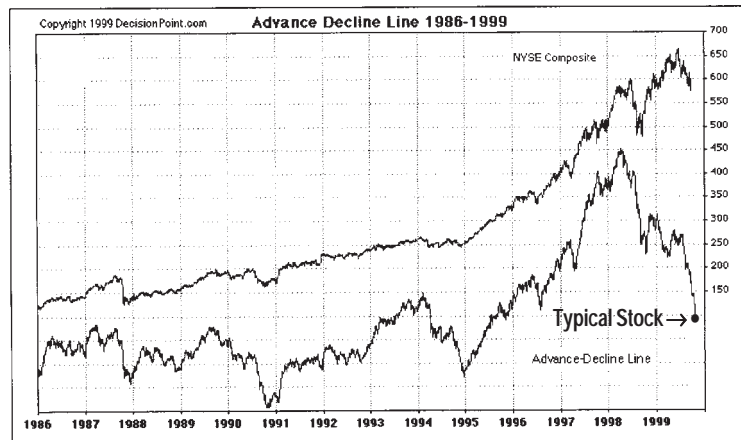
December 1999

Dear Client,

PERCEPTION VERSUS REALITY
(Or A Year-End Investment Opportunity)

As this letter takes form and ideas take shape in words, the stock market (Thursday, December 9) is displaying its unusual yearlong deception. We are reminded of the popular Mercedes Benz radio spot pointing out some Mercedes models are actually not that expensive. The message is its *perception* (expensive) versus *reality* (not expensive). The stock market has been using the same gambit in the perception (market is up) but the reality is different (stocks are down). The perception this morning is the Dow Jones "Average" is up 63 points, yet there are 668 more stocks declining in price than are going up and three times more stocks making new yearly lows than highs. Now, if this continued day after day, wouldn't you become suspicious that something was very misleading about stock market perception versus reality?

In fact, the performance difference between the "averages" and the average stock over the past 20 months has witnessed the most extreme divergence ever. We have research back to 1927 and this behavior has never been so divergent or so misrepresented. The most popular "averages", the Dow Jones Industrials and the New York Stock



The Advance-Decline line has absolutely collapsed — the biggest drop in the past 13 years.

Exchange (NYSE) Index, are near their all time highs; yet the Cumulative Advance-Decline Line has just today broke to another 4 year low! One look at the chart illustrates the typical stock has been in a severe downtrend for the past 20 months, very unlike any of the stock market "averages".

What does this mean? How does this affect my portfolio? Is there a profit opportunity in this situation?

The weak performance of the advance/decline and for the average stock also indicates just how difficult this year has been to build profits in portfolios. Other ways to measure how weak stocks really are is to assess what percentages of stocks are below their 30 week average price. Would you believe 71% of all listed companies are struggling below their 30 week moving

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average? There has been very little opportunity to make portfolios grow this year; the percentages just were not there.

The consistent price erosion for the average stock, especially over the past year, has depressed many companies' stock prices to extremely low levels. As we approach the end of the year, many stocks that had been weak tend to get even weaker as institutions dump these for "window dressing" purposes while individuals sell in order to take the tax loss. This has pushed many stocks to bargain values. Once the year-end dumping and tax loss selling is finished, generally by mid to late December, these overly punished stocks tend to have a rebound as they start the New Year. This is called the "tax bounce" effect. So, an excellent opportunity is presented to buy good quality companies that have been temporarily depressed. As the 1999 advance-decline line shows, there should be an extraordinary list of tax bounce candidates based on the year-long weakness for the average company.

How do we propose to take advantage of this year-end phenomena?

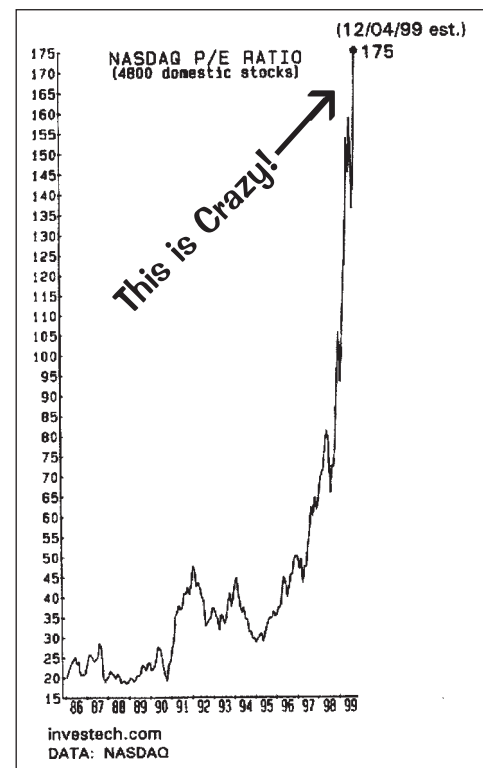
We are quite concerned with the extreme exuberance and mania-like behavior of speculators as they chase the technology and internet stocks. These two sectors have also joined to push the "averages" up for the year, even as the average stock (Ned Davis Research 6000 stock database) is down 27% since April of 1998 and down 6% so far in 1999.

It is quite likely that there will be a letdown in the areas that have been subject to the most speculation, and that could be messy. A big correction in those companies might even spread to these year-end bargains making them even cheaper. This is our management dilemma. We see great bargains on the shelf, but are also very concerned with how the current mania for technology and internet sectors will end (**badly!**), and if that event would further depress today's bargain stocks.

This is how we think it best to take advantage of these diverging outlooks. An old approach to investing is the 'dollar cost averaging' tactic. This means identifying the investment and spreading the investment dollars over a period of time rather than buying the entire position at one time. This way if there is a fallout from the speculative collapse of the mania driven areas, and it further dampens value stocks, we will still have ample reserves to pick up value investments at possibly even better prices. In other words, let's participate but proceed carefully.

What are the characteristics we are looking for in this year-end strategy?

First, invest in good quality companies with solid balance sheets. Second, we screen for stocks that have been knocked down from their 12 to 18 month high prices and still close to or at their low prices. Third, the low price has been recognized as a bargain by the people most knowledgeable about their company's prospects, *insiders*. We prefer to see insiders or the company itself buying their own company stock at these prices. Fourth, if possible, an attractive dividend yield in case we have to wait a while for price appreciation, and get paid well while we wait. Now, it



may be that not all the characteristics line up for every company, but there are lots of companies where most of these traits show up.

We have elected not to participate in the areas that are best described as speculative and outright crazy, ie, the technology and “.com” rage. This may appear that we are not alive to the new “paradigm” that is taking over the world. We do believe that the internet is a phenomenal tool and changing the way the world processes information and executes business. We look forward to taking advantage and participating in the investment opportunities of this exciting change. But, the problem today is that this sector is in the midst of a dangerous mania and has priced in the most ridiculous overvalued and overinflated terms we have experienced or ever read about. There is simply a craziness taking place, and it is going to hurt many people whom have no idea the risks they are taking on.

When...not if, the bubble pops and the inevitable takes place, we will be able to sift through the survivors for the bargains and the companies that have real products and real profits. In the meantime, look for us to add real companies with real dividends and real value to your portfolio as we take advantage of the year-end bargains.

If we have to wait for price appreciation due to temporary Y2K or other problems, we will still have peace of mind knowing that we own high quality companies with good income and the management and other company insiders owning stock at the same price as us. This certainly gives us peace of mind and a roadmap to conservative profits.

We wish the Happiest of Holidays to you and your loved ones.

Note: The data is just in for last week. A total of 884 stocks hit new 52 week lows. This is nearly one-quarter of all New York Stock Exchange listed securities. And this in the same week that the S & P 500 reached an all time high! Now you know what a distorted picture this presents. This group of 884 gives fertile ground for stock selection for our year-end strategy.