January 1, 2000

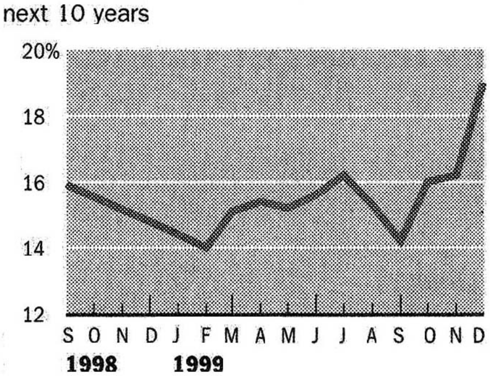
FOURTH QUARTER COMMENTARY

"Each man believes only his experience."

Empedocles, 495-435 B.C.
Greek Philosopher

Is, in fact, experience the only benchmark by which we judge the prudence of our investment actions? If so, as Empedocles suggests, we may safely conclude that those whose experience encompasses only the past decade possess expectations that would be judged unrealistic by those whose experience is of greater duration. A recent Gallup poll shows that investors with less than five (5) years experience expect stock returns of 22.6% per annum over the next decade. Those with twenty (20) years experience expect 12.0% returns. Markets in 1987, 1973-74 and 1969-70 taught wholly different lessons believed to be obsolete by purveyors of the new paradigm. These days investors whose long experience includes these nasty episodes are mocked and ridiculed for the needless conservatism with which they approach the investment process. Furthermore, they are "proven" to be fools as their investment performance is left in the dust by modern-day investment gunslingers worshipping at the NASDAQ altar. Just a few years ago NASDAQ was virtually unknown; it was the Dow Jones Industrial Average or the Standard & Poors 500 that

Investors' expected annual return for next 10 years



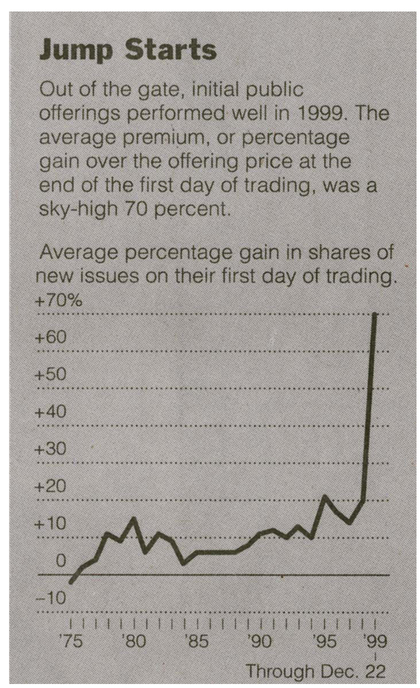
mattered. How quickly things change! Even the legendary Warren Buffett seems to have lost his touch with Berkshire Hathaway down 20% in 1999. As for Empedocles, he committed suicide by throwing himself into the volcanic crater of Mt. Etna.

We believe the U.S. stock market has entered a dangerous new phase characterized by rampant speculation among IPOs/Internet related names and extremely narrow leadership by technology stocks. Meanwhile, the broad list of issues continues the relentless decline that began in April of 1998. We offer the following seven (7) observations as signposts of valuation danger in the U.S. stock market:

1. Seventy (70) percent of all NYSE, NASDAQ and AMEX issues are down since April 1998. This is incredible deterioration all while the NASDAQ cap-weighted average is up 85% for the year!

2. Of the 1200-plus technology IPOs since the debut of the personal computer in 1980, 5% have created 86% of the wealth. And only one founded during the early PC boom survives (Apple). Dell and Compaq emerged after the bursting of the PC bubble. Microsoft went public in 1986. The 241 Internet stocks have a combined market value of $549 billion, aggregate sales of $24 billion and annual losses running $7 billion.

3. The IPO mania has reached a white-hot intensity: the average IPO in 1999 rose 70% the first day of trading! One-third of all IPO companies in 1999 paid their investment bankers more to go public than they had in annual sales! Wow!! Since the average IPO fee is about 4%, that means 1/3rd of these IPO's were floated at 25X sales or greater. For reference, the 75-year average multiple of sales for NYSE companies is about 0.8X. Therefore these valuations are running about 31 times the average NYSE historical valuation based on corporate revenue.



4. Technology stocks now comprise 30% of the S&P 500, with an average cap-weighted P/E ratio of 54 and an average non-cap-weighted P/E ratio of 40. This might suggest vastly superior return-on-equity numbers for technology stocks, but such is not the case. The average ROE for technology stocks in the S&P 500 is 18.0% versus 16.2% for the S&P 500 itself, somewhat better but not enough to justify the extreme P/E ratio disparity (40.3 median P/E vs. 19.7 median P/E).

Sector Shifts in the S&P 500

Industry Sector	1992	1994	1996	1997	1998	'99YTD
Basic Materials	7%	7%	6%	5%	3%	3%
Consumer Cyclicals	13	12	10	9	9	9
Consumer Staples	17	16	16	16	15	12
Finance	11	11	15	17	15	14
Capital Goods	9	10	10	9	8	9
Energy	10	10	9	8	6	6
Technology	7	10	13	13	19	24
Communications Services	9	9	6	7	9	8
Transportation	2	1	1	1	1	1
Utilities	6	5	4	3	3	3
Healthcare	9	9	10	11	12	13

Sources: International Strategy and Investment Group

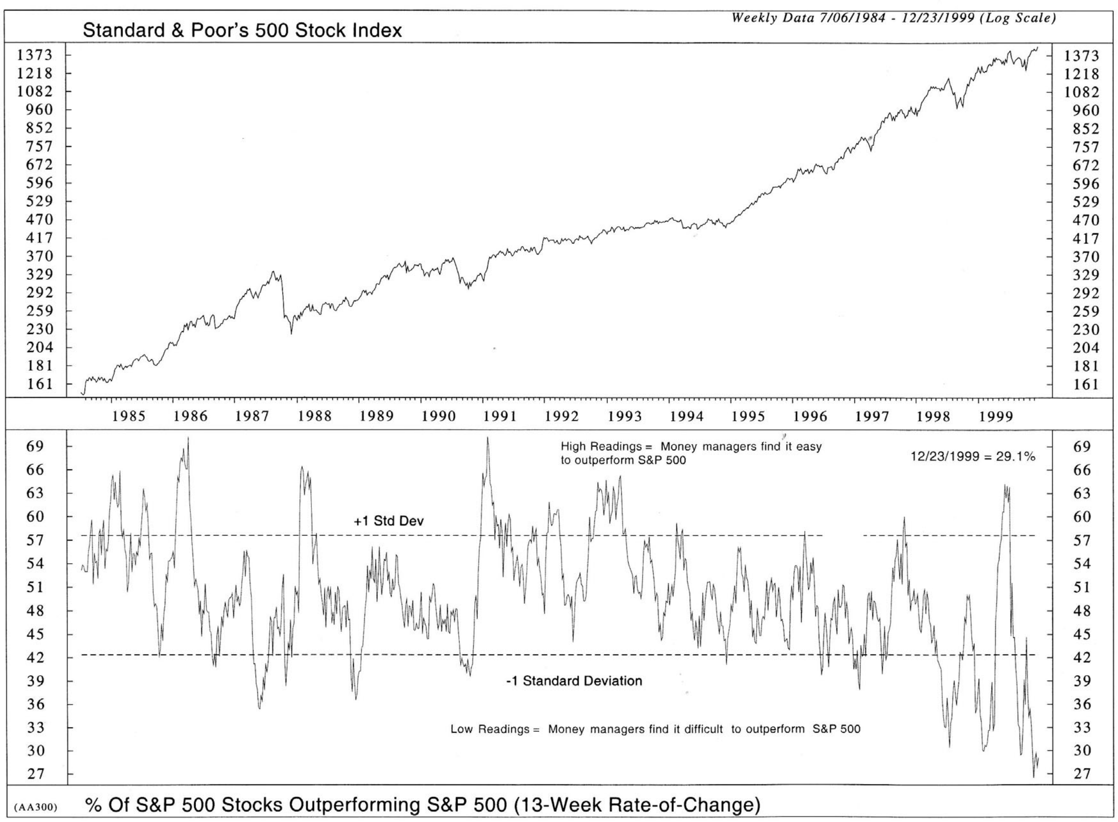
5. This past quarter, for fear of being rendered obsolete, Dow Jones decided to alter the thirty stock makeup of the DJIA by booting-out Chevron, Union Carbide, Sears and Goodyear in favor of Microsoft, Intel, SBC Communications, and Home Depot at a 50% increase in P/E ratios. One replacement per year in a 30 stock index might be justified, but the wholesale change just described can only be attributed to the fear of losing influence to its historically junior and turbocharged competitors, as they report index "performance" vastly different from the stodgy Dow. Since the replacement stocks are mostly technology related, this is further evidence of a capitulation to "group-think".

6. *The Wall Street Journal* informs us that lawmakers are putting campaign cash into the stock market. Concepts of safety and a short-term investment time horizon are not deterring elected officials from succumbing to the temptation to go for the big score. Conflict of interest concerns, of course, have been swept aside.

7. **In the past five (5) years the broker population has surged from 490,000 to 620,000, a 28% increase versus a general population increase of 8%. Although on-line trading now represents 15% of all trading, wealthier investors are apparently more inclined to seek advice than go it alone. Moreover, high exchange volumes and general euphoria allow for less productive brokers to temporarily succeed… until the next downturn.**

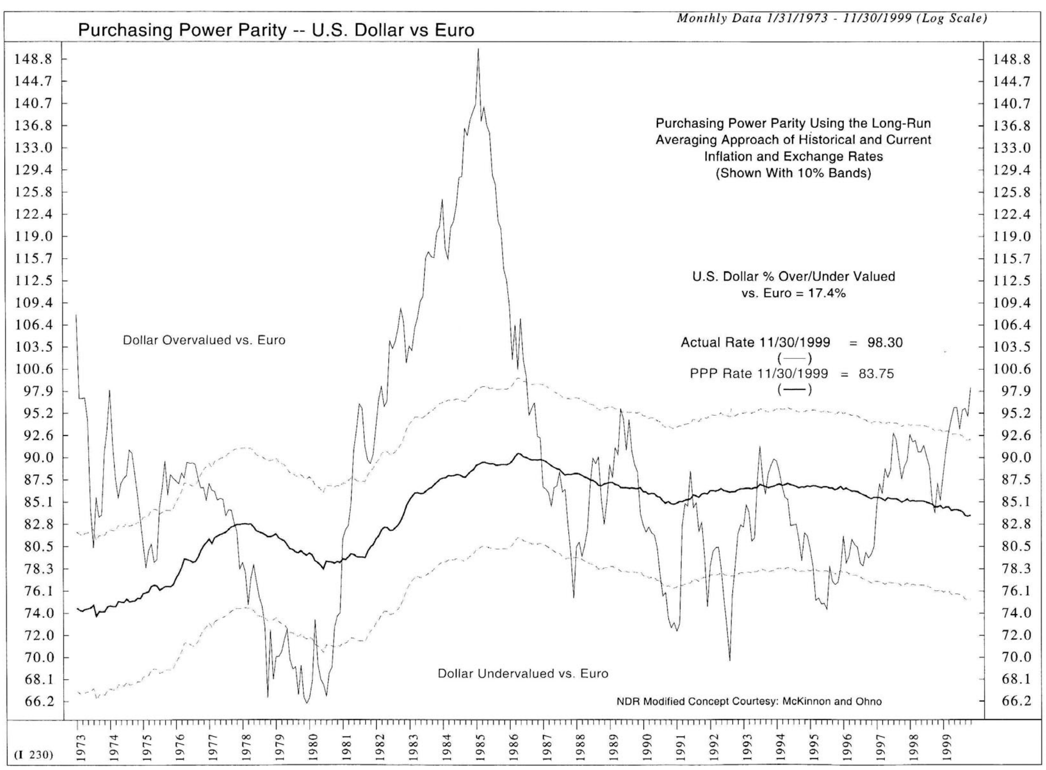
We believe the foregoing seven (7) observations increasingly point to a risky U.S. equity climate. From a portfolio construction standpoint, we continue to tilt toward Asian markets, cash, and, in balanced accounts, bonds.

Subsurface breadth deterioration is remarkable. For example, on Friday December 3rd the S&P 500 went to new highs. Yet only 100 of 3554 stocks made new highs, and 201 hit new lows. In fact, as the following chart shows, only 28.9% of stocks as of December 23rd were outperforming the S&P 500 itself, the smallest percentage in at least 15 years.

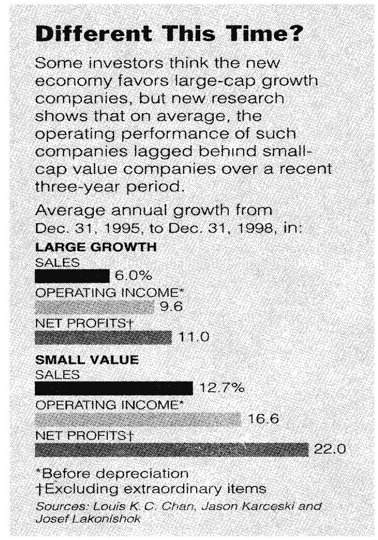


1999 could be characterized as a year of extremes. Our macro-economic outlook is that there will be further Fed rate hikes in early 2000 and this does not bode well for the U.S. equity market in general. It is true that "the market" so far has shrugged off a move on thirty year treasuries from 4.75% to 6.55%, a 180 basis point move. Although we expect more short-term rate hikes to further flatten the yield curve, we do not expect too much more on the long end. Therefore, where appropriate, we are buying longer dated corporates.

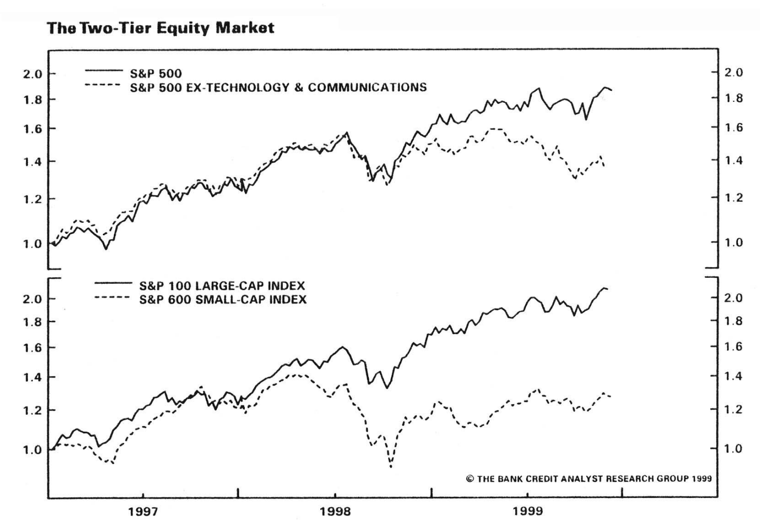
Mounting trade imbalances, coupled with a low savings rate domestically, create strong demands for foreign capital. This comes at a time when Asian and European economies are strengthening, and there is increasing competition for this capital. Since the price of capital is interest rates, we are witnessing a progressive inching-up of rates. We believe this situation bears watching closely as the Fed conceivably could be required to respond with higher rates to defend the dollar. Therefore, one should not necessarily assume that quiescent inflation portends lower interest rates in all circumstances. The euro looks undervalued, and in fact, on a purchasing power parity basis shows up to be about 10% undervalued versus both dollar and yen.



The superior performance of large-cap growth stocks over small-cap value stocks has been heavily chronicled. Implicit in discussions of this phenomenon is the generally accepted idea that this is due to superior returns on equity and non-cyclical profits generated from mostly consumer disposable type companies. This paradigm is well entrenched… and apparently wrong! Research shows that in the three year period from 12-31-95 to 12-31-98, small-cap value companies had twice the top-line growth in sales and twice the growth in net profits than their more highly regarded large-cap growth brethren.



Furthermore, the last two years have seen a widening disparity in relative investment returns between "technology" stocks and everything else. Believers in the new paradigm offer a justification based upon superior revenue growth and profits that are assumed to be following. We question this logic. We believe that until such time as it begins to be demonstrated that profit growth will in fact follow revenue growth, that many of the current valuations (based on multiples of sales rather than multiples of profits) are not justified! So far we fail to see significant protective barriers to entry, technological or otherwise, that would shield these companies from the eventual effects of severe price competition.



A stock market inspired "wealth effect" has unfolded. This in turn has given rise to a consumer response resulting in negative saving rates and record consumer confidence. In such a battle, the Fed has superior firepower. Even though the equity market has shrugged off Fed moves to date, and a brief respite was provided by Y2K concerns, Fed goals have yet to be accomplished. Therefore, we believe the risks of a decline in the U.S. market remain high.

We recently added Teledyne Technologies (TDY) to our portfolios at about $8 1/4 per share. Having the word "technology" as part of the corporate name is not helping the valuation yet; TDY is trading at a low 6 times expected 2000 earnings of $1.35-1.40. Originally founded by Henry Singleton, Teledyne was subsequently merged into Allegheny Ludlum and is now being spun-out. Forty percent of $800 million/yr. in business is with the U.S. government. TDY manufactures such things as cruise missile engines and microelectronic modules for fiber optic systems aboard the NASA International Space Station. At 2.5X EBITDA and 6X EPS, we believe this stock is too cheap. Defense contractors Lockheed Martin and Raytheon have been badly battered in the U.S. market, down some 65% or so from peak valuations. Furthermore, TDY did a $100,000,000 dividend up-stream to their parent Allegheny Teledyne just prior to the spin-off and this money will have to be replaced eventually with fresh equity money. Nevertheless, we believe that TDY is worth substantially more, and has some business in commercially sexy areas such as broadband communications, etc. As investors become more familiar with the story, we believe a higher price to earnings ratio will be justified. Executives received their stock options at a formulaic price that is the average of the first 20 days of trading, about $9 per share. We purchased in the middle of this period at slightly lower prices.

All things considered, it was a difficult year. Genesis Health Ventures was a disaster as we underestimated the negative affect of the implementation of fixed rate reimbursement from Medicare. SK Telecom was more spectacular than we would have imagined in our wildest dreams. SK Telecom acquired their second largest competitor thereby expanding their share of the wireless phone market from 40% to 60%. The PennzEnergy acquisition by Devon Energy has done us no favors yet, and Korea Electric Power suffered from Y2K worries as well as Korean political machinations preventing them from spinning off

their fiber optic cable business. M.S.D.W. Asia Pacific is doing well. Newmont Mining looks promising, and is up moderately. Teledyne Technologies is up as well. We maintain a conservative posture and are mindful of preserving capital. We do not think the U.S. equity market will be a safe place in which to be fully invested until such time as there is a significant change in the investor attitude toward IPOs, technology stocks and the like. Unfortunately, that kind of an attitude adjustment probably requires some nasty downside action in the technology sector in order to regain a firmer foothold.

We thank you for your trust, faith, sponsorship, and referrals in 1999. We look forward to serving you in the new year.

Very truly yours,

Alan T. Beimfohr **John G. Prichard, CFA**

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