January 18, 2002

Dear Client,

Enclosed are the 2001 return calculations for your account. Where applicable, also enclosed are three and five-year return calculations for your account.

Since very often the only regular contact with clients is a monthly account statement, or an occasional trade confirmation, we thought it would be worthwhile to review our investment approach.

The obvious objective of any investment account is to grow in value over time. One of the best vehicles (although by no means the only one) for accomplishing this objective has been through the purchase of common stocks. While many people have come to embrace this concept over the past decade, the last few years have been pretty rough on many investors' portfolios. Indeed, the last few years have seen many recent common stock investors plunge head first, almost exclusively into technology stocks or technology related mutual funds. Technology stocks, which after several years of strong performance in the mid 1990's, had become the darlings of the investment community in general and many mutual funds in particular. The excesses that ended in a mania have been fairly well chronicled by most financial media outlets- ironically those very same media outlets who in many cases were the biggest advocates and cheerleaders of overpriced tech shares- so there's no need to go into great detail about the causes or reasons behind it. What's worth noting however, and what in retrospect has become painfully obvious to many, is the following: when stocks are priced at very high levels in relation to current earnings, cash flow, or asset values, and when extremely optimistic assumptions about future growth rates are required in order to justify the current stock price-let alone a higher one-little "margin of safety" exists and any business outcome short of perfection usually results in a disastrous outcome for the stock. As Warren Buffett likes to point out, a stock cannot indefinitely outperform the underlying business.

Our investment approach is value driven. We approach the purchase of common stocks in much the same way any person might evaluate an investment in, or purchase of a private business, or rental property. These types of decisions usually begin with two important components: an asking price and an income statement and/or balance sheet. Most rational investors would make an offer that incorporated some sort of reasonable relationship between the asking price and the income generated by the business or property, with the expectation of earning a satisfactory return on their capital. It's a peculiarity of the stock market that normally rational people ignore common sense approaches to business valuation and often throw caution to the wind when it comes to investing in common stocks. Thrilling tales of enormous contracts to come, stunning product breakthroughs, dazzling growth rates from now till the hereafter, have all been the hallmark of the advice peddlers on Wall Street. Unfortunately, many investors respond to this siren song and often wind up with shipwrecked portfolios.

We try to buy stocks below their calculated "intrinsic value". As a yardstick, we are interested in price level below what a buyer, typically with cash, would be willing to pay for a business. This process generally involves looking for a specific combination of attributes. Among those attributes: 1) A stock price that's low relative to current earnings or cash generating capabilities. 2) A business where one feels reasonable comfortable with a five year outlook (no rapid product cycles or the risk of technological obsolescence). 3) A management that's capable and honest, with a history of acting in the best interests of all shareholders. In essence, we are looking to buy $1.00 worth of business value for $.60. Our expectation is that by employing this approach- patiently buying dollars for sixty cents-over a variety of companies, it's likely, even probable that we'll have a satisfactory outcome.

One final item to note; this value based approach frequently leads us to common stocks or industries that are out of favor and sometimes surrounded by negative headlines: think of pharmaceutical stocks during President Clinton's proposal for a national heath care plan. That's OK. We can live with owning stocks that are temporarily out of fashion because that usually means we are purchasing them at very reasonable prices. But it does require patience and a willingness to be temporarily "out of step" on the part of the investor. We have found this to be a very successful long-term strategy.

We appreciate the trust you have placed in us. Should you have any questions or comments, please don't hesitate to call us.

Very truly yours,

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