



ASSET MANAGEMENT COMPANY

FOURTH QUARTER 2001

THE YEAR IN REVIEW

We are pleased that 2001 is behind us and look forward to better times in 2002. The combination of a slowing economy, a falling stock market, and the events of September 11th and its aftermath all conspired to make this a difficult year for investors. We are ready for a return to normalcy.

Not all of the outcomes in 2001 were bad. Clearly, our country has rallied and our national spirit has risen to new challenges. There seems to be a greater emphasis on family, friends and neighborhood; and some healthy reassessments of geopolitical relationships are underway.

On the economic side, things were tough for most businesses across most industries. However, here too, some benefits lie in the weeding out of less productive enterprises and flawed business models, and in restoring a more rational approach to the allocation of capital. Moreover, with fewer dollars chasing stocks, prices are gradually coming down to more reasonable levels. This, of course, will make for better returns once the economy recovers.

FUTURE OUTLOOK

At the broadest level, we see three trends playing out in the U.S. equity market: 1.) The market has shifted from a focus on *Growth* to a

focus on *Value*. This should continue for the near to intermediate term. The high multiple/“consensus” stocks are being beaten down and the more mundane but less expensive stocks are faring better. 2.) This shift is taking a while due to nostalgia and wishful thinking on the part of investors. Today’s investor has been taught to “hold on” in the face of volatility and await the inevitable recovery. While this is generally good advice, prices of many stocks were so ridiculously high that a recovery could take years, or, for some issues, not come at all. Additionally, there is a natural tendency to think that if a stock traded at a certain price, it must have been worth that price, at least at the time it was purchased. It takes a while for reality to set in. 3.) Finally, we’ve entered a period in which we forecast lower returns for the market as a whole. This is partially due to the market still being expensive. For example, the P/E ratio of the S&P 500 is now about 26 versus a long-term average of about 19. Sun Micro Systems, while trading down 81% off the high reached in September 2000, is still priced at 46 times estimated 2003 earnings. Additionally, as Warren Buffett pointed out, the previous bull market was bolstered by a long trend in declining interest rates. (Recall Prime being 21% under the Carter Administration?) Obviously, with Prime at 5% now, it doesn’t have far to fall. Thus, we will not have the benefit of a long-term secular trend of strongly declining interest rates to bolster our market valuations going forward. Buffett

anticipates equity markets to return around 7% annually over the next decade.¹

PORTFOLIO POSITIONING

In light of these trends, we have positioned the equity portion of our accounts to have a value orientation and to use alternative asset classes such as real estate and convertible bonds to reduce risk and enhance returns. Furthermore, we believe that while the stock market as a whole will return far less than it did in the past decade, above average returns are still possible through disciplined security selection and sector allocation. We believe the current market environment will particularly reward our bottom-up analytical modeling and value-driven approach. Despite a market that is still somewhat overvalued, we are finding good businesses at attractive prices.

For fixed-income securities, we anticipate that the combination of costs from higher government spending (e.g., homeland security, the war on terrorism, higher unemployment benefits) and lower government receipts (e.g., lower payroll taxes, lower corporate and personal income tax revenue) will lead to deficit spending and inflation. Inflationary expectations cause us to shy away from long-term bonds. At the same time, with short term

rates so low (the Federal Reserve cut rates 11 times in 2001), we are exploring alternatives to cash with high current yield and acceptable risk-reward characteristics. We reevaluate our outlook and reposition portfolios on an ongoing basis.

If you feel that your investment strategy could be improved, or there are aspects of it that you have questions about, please stop by our office or call us to make an appointment. Our telephone number is (970) 925-8747 and our web address is www.obermeyerasset.com. We can show you how we would develop and implement a cohesive investment strategy for you to better meet your financial goals and objectives, and give you the peace of mind that you are on a sound financial path. We perform these evaluations on a *no obligation* basis and keep all information completely confidential.

¹ An interview with Warren Buffett on the stock market is included in *Fortune*'s 2002 Investment Guide and is available at www.fortune.com