

MARKET OVERVIEW

Time present and time past
Are both perhaps present in time future.
And time future contained in time past.

—T.S. Eliot

The Four Quartets

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.

ABSOLUTE VALUE

An absolute return strategy designed to restrict downside volatility and enhance returns from a portfolio containing high-yielding, high-quality stocks. Layered below and above the base portfolio are hedge and leverage tools intended to prevent drawdowns and amplify gains.

Whether our investment decisions are focused on selecting individual stocks or on creating managed accounts (or funds) in particular strategies, we are always considering what the future will bring, and always influenced in that consideration by what we have experienced in the past. In that sense, investing is a kind of simultaneous inner dynamic of projection tainted by memory. We imagine what the future will bring, but the plausibility of that imagination is constrained by the past we've experienced directly, or studied second-hand. We envision an outcome for our decision-making, even though we can't possibly know all the details of what the future holds.

In life generally, we picture the future. We commit to (or invest in) studying a subject, with the view in mind that we will learn it. We may marry, and even amidst the charge of wedding-bell energy we see ourselves growing old with our partner. We buy a house because we can picture ourselves living in it. We travel to France with a snapshot of ourselves below the Arc de Triomphe developing even before the plane has landed. Wherever we are in the present, we're also looking ahead.

By definition, investors invest for the future. The "return" investors seek is the return of a vision, from the future to the present, one that can be marked in a discrete period. Or is the "return" more of a transport of the future into the present, which immediately becomes the past? And isn't the "return" a memory—since you never "will have" a return but only "have had" a return—a memory which can only exist because there is a memory-reader in the present?

Who is this memory-reader, and what does he or she read? What goes on in the decision-making process when the goal is maximizing returns and minimizing risk? We have thoughts on this, and we're also interested in the ideas of some specialists in the field of behavioral finance, who've suggested that the most potent force in investor behavior is *prospective regret*.

We all know what regret means. It's about being sorry for something that's already happened, wishing at the same time it hadn't happened, or that you hadn't

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“The bet you make is that life does not change in an instant, that successful companies with consistent businesses are there for a reason, and that over time these businesses will grow along with the economy.”

done what you did, or said what you said. But prospective means something that will occur in the future. How can you be sorry for something that hasn't happened yet? How can you wish that what hasn't happened yet hadn't happened?

This strange state arises because you live, at least in part, in your imagination. For investors, that decision you haven't yet made but which you still regret having made is in fact a fantasy which exists in your imagination. Let's say you are an absolute return investor who just wants to make some money with a buy decision, you couldn't care less whether your buy outperforms an index or not, you just want a positive profit. But you are aware that there are many factors involved in whether or not a stock goes up within a given time frame, and perhaps the most important is whether or not the market environment is favorable. You want to buy XYZ stock, but in reviewing all the factors you find that you're nervous about the overall market and think it could go down sharply, taking most stocks down with it. In that moment you believe you're avoiding risk (risk-avoidance being another significant psychological imperative of investors, according to behavioral finance theorists), but in fact what you're doing is imagining a market decline, one that sucks XYZ down with it, and the regret that you will feel for having bought XYZ today even though you recognized the possibility or even probability of a market decline. “Prospective regret” might also be called *imagined regret*, and it is this imagination of the future, and the quality and contents of the imagining, which dictates how you will make decisions in the present.

Isn't this how all important decisions go? You decide to do or buy something because it will bring you happiness, or riches, or fulfillment, or approval—but in the future, after you have acted in the present. Your decisions, especially

your investment decisions, which are as oracular as decisions can get, are an imaginative projection into the future.

Often, you can have some control over the outcome of an imagined future. You can sign up for an advanced degree; if you work hard and go to classes chances are you'll get that degree. Paying your money for tuition and putting in your time for the coursework is a pretty good wager. The probabilities of success are high, and the factors which generate those probabilities are known and mostly under your control.

Investors face a different reality for their imagined future. Only some of the factors that will create the future reality are known. Some are completely unknown. Many if not all are out of the control of the investor (thus the phrase “passive investor”). This lack of certainty about the unfolding of the future and lack of control in determining the outcome produces stress, and in a state of stress, as we all know, the imagination runs wild. All the bad things that can happen! How I will regret my loss!!!

And yet we persist in investing our finite resources in a wavering future. Why is this? Because there is a flip side to prospective regret, and it is *fantasy success*. Once again, the imagination is the ruler of decisions, conjuring a future in which the end of the narrative shows the investor living happily ever after. Is the story strong enough to overcome an investor's natural loss-avoiding tendency reflected in the inner projection of prospective regret? Are investments no more than the conflict between prospective regret and fantasy success? Are your views of the future as rational as you'd like to think, or is that future a picture generated from your own particular character frailties?

This is the investment battle, then, to remain aware of the subtle and not-so-subtle psychological forces that are affecting our decision-making, and to find ways to act that

SELECTED INDICES

	3 rd Qtr'05	12 Mo
S&P 500	3.6	12.2
Equity Inc	3.1	12.8
Util Fund	8.3	33.6
R3UTIL	7.6	25.2
LB Long	(2.7)	6.9
LBGC	(1.0)	2.6
S&P 400	4.9	22.1
Wilshire 5K	3.9	14.6

S&P 500 = Standard & Poor's Index
 Equity Inc = Avg Equity Income Fund (Lipper)
 Util Fund = Avg Utility Fund (Morning Star)
 LB Long = Lehman Long Government
 LBGC = Lehman Bros. Gov/Credit Bonds
 R3UTIL = Russell 3000 Utilities
 S&P 400 = S&P Mid Cap Index
 Wilshire 5K = Wilshire 5000 Market Index

are not distorted by secret fears. It is simply not good enough to buy into some salesman's strong case for an investment idea: accepting credible stories without considering the dark side has been at the root of most investors' past losses. And it surely isn't good enough to pile on to a concept once it has already been "proven" by the provision of superior past returns. (There are many sad statistics showing how little of mutual funds' strong returns have been obtained by investors, due to poor timing—caused by the prospective regret motivation that a winner will be missed.)

There is only one way that we know of to circumvent the all-too-human elements of prospective regret or fantasy success, and that is to invest in real companies that provide real and necessary products and services. The bet you make is not on a stock price or a sector movement. The bet you make is that life does not change in an instant, that successful companies with consistent businesses are there for a reason, and that over time these businesses will grow along with the economy. The resultant stock price and investment gains become a side-effect of a much deeper position, one that comes from insight rather than decision-making. □

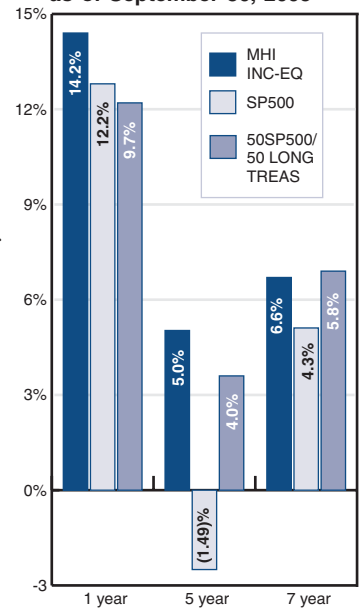
In our second quarter report we suggested that dull is good, and that a measure of stability helps cushion the markets against unforeseen developments—like \$60 oil and long-term interest rates of 4%...at the same time. This past quarter trading slowed to a crawl, but even with many on the sidelines the low-volatility environment once again provided the kind of circumspect background necessary to generate moderate gains against a backdrop of even worse energy pricing and an ominously shrinking spread between long and short-term interest rates.

Are equity investors whistling past the graveyard of a potentially inverted yield curve, a tightening noose of gas and oil prices, federal deficits ballooning yet more due to the natural disasters, a growing feeling of failure in Iraq, disenchantment with the administration, neglect of the looming fiscal stresses from Social Security and Medicare, and the potential for the end of the housing boom which has generated some 25% of new jobs in the past few years? Or do we need to give the market (investors) some credit for hanging in there despite problems that are all too visible, fading these in favor of a brighter future or at least in favor of the deep piles of cash building up in the coffers of corporations that are themselves reluctant to invest in new capital spending?

Unfortunately, we're not smart enough to know. We are, however, smart enough to understand that if we invest in solid companies that provide products and services necessary for life—whatever life turns out to look like in the future—and which provide high levels of cash now plus rising payouts to compensate us for the risks we are taking,

"Are equity investors whistling past the graveyard of a potentially inverted yield curve, a tightening noose of gas and oil prices..."

**Annualized Returns
as of September 30, 2005**



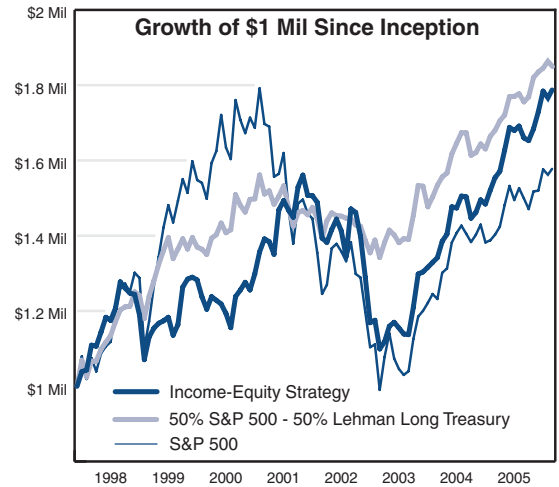
“Few other stocks are in any way over-extended, valuations continue subdued, and for the most part earnings and other fundamentals remain robust.”

things will more than likely work out in the end. In the meantime, we review the generally modest developments in a quarter that quietly provided decent returns (similar to the broad market and outperforming our 50-50 benchmark).

PORTFOLIO HIGHLIGHTS

Our top performer this quarter was title insurer Fidelity National Financial Corp., up almost 25%. You may recall we bought this issue earlier in the year and received a special dividend of \$10 (about 25%), in addition to the regular dividends. At this point the stock is now trading at about the same level as our purchase, meaning that we have locked in the gain from the special dividend and still own the stock. This is a good thing, since the company is about to IPO its high-growth information services division, while retaining a 50.31% interest, which should unlock yet more value. We had slightly larger gains in Tidewater—also purchased this year—as the supplier of oil service boats rose from both the natural buoyancy of the energy markets and the increased maritime transportation needs in the aftermath of two major hurricanes. Our other direct energy participations, BP and Enerplus also delivered mid-teens gains, in addition to their dividends. But it wasn’t all energy, we also had similar gains from Nam Tai Electronics, and more modest gains from UnumProvident, RR Donnelley, Southwest Gas, Schering-Plough, and ING, to name a few—touching most sectors of the market.

Bringing portfolio returns back down to earth were utilities Energy East and Keyspan, both dragged down by disappointing earnings.



Still, both companies remain prime consolidation prospects in our view, and we think little more than “fluctuations” are at work. Last quarter’s winner Urstadt Biddle was also re-rated down on disappointing earnings, perhaps feeling the bloom coming off the rose in the world of retail (UBA is a mostly retail area REIT). As a group, though, the most negative area was in banking. Here there is a notable problem, as the shrinking of spreads between short and long rates (banks borrow short, whether from the Fed or from depositors, and lend long) is hurting earnings, and relief is not in sight. We sold Community Bank System early in the quarter at a substantial profit (though we hated to part with it since it seems a likely consolidation candidate), and were dragged a bit by Regions Financial and Key Bank. We also suffered one casualty from the hurricanes—Montpelier Re, whose exposure to once-in-50-year risks resulted in a big dent to their capital structure. There are some opportunities going forward in insurance and re-insurance as a result of the hurricanes, but we’re waiting for the dust to settle, or the basements to dry, as it were.

Quarter Composite Net of Fees*

Income-Equity (Prelim)	2.7%
50/50 SP500 & Long Treas	0.5%
Russell 1000	3.9%

12-Month Composite Net of Fees*

Income-Equity (Prelim)	14.2%
50/50 SP500 & Long Treas	9.8%
Russell 1000	14.2%

5-Year Composite Net of Fees*

Income-Equity (Prelim)	5.0%
50/50 SP500 & Long Treas	4.1%
Russell 1000	(1.3)%

Included are all unrestricted portfolios that have been managed for one full quarter. As of 9/30/05: 424 accounts in composite, representing 54% of total assets in the strategy with a dispersion of 0.19. Inception: 5/97. We offer a customized version of Income-Equity that excludes Master Limited Partnerships. These accounts are not included in the composite and represent 31% of the total assets in the strategy.

We added some positions during the quarter, increasing our diversification. It is not often that you get to buy a great leadership company like Proctor and Gamble both at a modest historical valuation and on the cusp of a transformational change—its purchase of Gillette—at the same time. So we accepted a slightly lower yield than we normally would for this portfolio. The buy has worked out well almost immediately, and we expect much more in the coming years. We also added convertible preferred shares in General Mills, acquiring a position in this fine food company along with a 5.961% current yield. This replaced Conagra, which we sold in anticipation of a reduced dividend as a new president attempts to restore a growth trajectory.

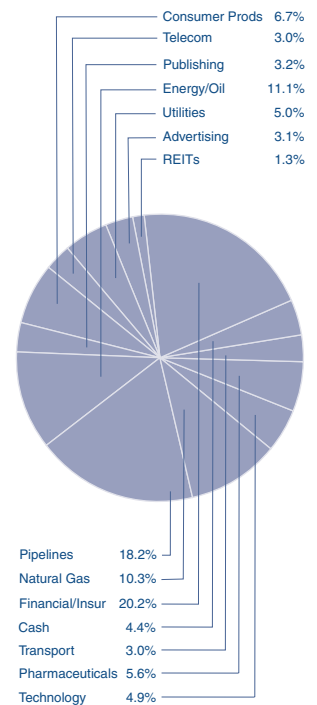
Surprising even ourselves, we also added a position in SBC communications, about which you can read more in the BTB-Utilities review. In a nutshell, despite the competitive threats in the telecommunications area the company simply has too much going for it to sell at such a cheap price with such a high yield.

LOOKING FORWARD

Though the performance of some of our energy-related companies inspires a touch of vertigo, we find the portfolio in general well-positioned. Few other stocks are in any way over-extended, valuations continue subdued, and for the most part earnings and other fundamentals remain robust. The fourth quarter has historically been the strongest of the year, so there's reason for optimism—though a yield-curve inversion seems imminent, and that is a cloud. Strategists will be saying “this time it's

different” about the normal message of a yield-curve inversion (“recession upcoming”) because the tightening was actually only a “normalizing.” We can't really say this time it's different, because we've never seen such a set of circumstances before...

Our portfolio currently yields 5.3%, with a projected growth of yield of 7.0%. This understates matters somewhat, as earlier in the year we gathered in several substantial special dividends, and we expect one or two upcoming in the current quarter (our 12-month rolling current yield is 6.5%). Bear in mind also that certain reporting databases are unable to account for special dividends, so the yield quotations are often incorrect except in retrospect. □



FUNDAMENTAL CHARACTERISTICS

Yield	5.3%
Proj Dividend Growth	7.0%
Payout Ratio	48%
Market Cap	\$29.8 Bil
Price/Book	2.8
P/E Ratio**	14.7
S&P Rating	BBB+
Beta*	0.6
R-Squared*	0.6
Standard Deviation	12.4

*Relative to S&P 500, 9/30/00 - 9/30/05

**REITs use P/FFO ratio

Disclosure: Gross of fees performance is based on actual results calculated by using Checkfree Security APL's portfolio accounting software, which uses the BAI method of calculating performance. Contributions are time-weighted to the day and performance is linked to monthly calculate cumulative performance consistent with FAF (Financial Analysts Federation) guidelines. A complete list of all composites is available. Net of fees performance is calculated by deducting an annual fee of 100 basis points from gross of fees performance. 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.

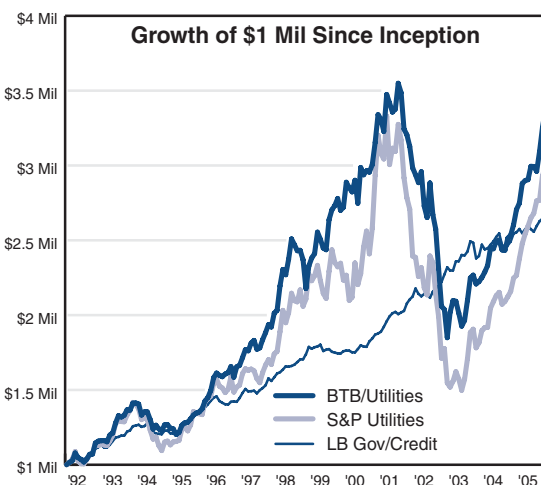
“...we think the portfolio is increasingly demonstrating how diverse you can be and still be a utilities portfolio, benefiting from the steady market of essential services even without participating in the small group of large-cap electric stocks that drive most indices.”

It was a heck of a quarter for our portfolio by any measure, but we’re particularly pleased that the groups we thought had high potential (energy producers and foreign telecom) and low risk (distributors in both gas and electricity) fulfilled their potentials in full. The general utilities environment was strong, but as the quarter wore on the sector became spotty and not nearly as robust as has been the case in recent quarters. With our unusual mix we were able to deliver almost twice the gains of the broad-based Russell 3000 Utilities as well as the large-cap S&P Utilities.

Speaking of unusual mixes, we think the portfolio is increasingly demonstrating how diverse you can be and still be a utilities portfolio, benefiting from the steady market of essential services even without participating in the small group of large-cap electric stocks that drive most indices. We’re doing this with:

- Mid-cap utilities with commodity exposure
- Mid-cap distribution utilities that are takeover candidates
- Natural gas producers
- Foreign telecom companies
- Domestic and foreign water companies
- Enablers and equipment makers
- Selected MLPs
- Special situations

As you may read in more detail in the “Distribution/Merging Utilities” section, at long last the Energy Bill was passed, and with it came repeal of the Public Utility Holding Company Act (it will be a relief for us to stop saying “PUHCA” every quarter!). So far that hasn’t meant too much to utility M&A activity, but the drums are beating, and the targets include telecom companies, cable companies, and even generating companies. Corporations have



substantial war chests, and we expect the pace of deals to be consistent, as the businessmen of the world continually wend their way toward the unattainable dreams of dominance and monopoly.

An important issue for most utility investors are the valuations of the large-cap electrics. This is not so important in and of itself for our purposes, but it is important from the standpoint of the popular indices setting a tone for non-index members. That we have outperformed the average mutual fund and the S&P 500 for the last ten years (even including the post-Enron troubles of 2002) is at least in part a function of the last few years of generalized ravenous appetite for these boring old companies.

While the recent momentum clearly can’t persist, there are reasons why utilities in general can continue to provide robust performance. First, the industry has gone through a “back to basics” sea change, and the companies now have solid balance sheets, focused business models, and a chastened attitude that will provide discipline for any future growth initiatives. Second, investors have returned to sanity and are placing higher value on reliable, sustainable business models, as well as asset-based businesses and companies that offer

Quarter Composite Net of Fees*

BTB/Util (Preliminary)	11.7%
Russell 3000 Utilities	7.6%
S&P Utilities	7.3%
LBGC	(1.0)%

1-Year Composite Net of Fees*

BTB/Util (Preliminary)	34.3%
Russell 3000 Utilities	25.1%
S&P Utilities	38.6%
LBGC	2.6%

10-Year Composite Net of Fees*

BTB/Util (Preliminary)	9.8%
Russell 3000 Utilities	4.1%
S&P Utilities	8.2%
LBGC	6.6%

Included are all unrestricted portfolios that have been managed for at least one full quarter. As of 9/30/05: 156 accounts representing 96% of assets in the strategy, with a dispersion of 0.16. Inception: 9/91.

cash dividends rather than just promises of growth. Third, there is a great need to deploy capital to improve our nation’s infrastructure—the Energy Bill also added incentives for this—and these companies will get paid either in a regulatory or merchant context. Fourth, consolidation is a continuing theme that supports valuations and encourages holders. Eventually this will resolve into a premium for scarcity value as well. Fifth, there is a built-in earnings opportunity for merchant providers as most long-term generation and fuel-supply contracts are rolling off in the next five years.

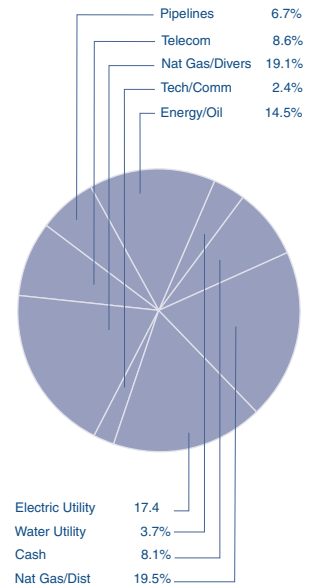
That said, the large-cap electrics of the world, the FPLs and Exelons and Dukes and Southerns, are pretty pricey. We think an investor’s best defense—an investor who wants to be involved in essential services and is committed to the outstanding long-term returns and risk-reward profile utilities have always provided—is to avoid these stocks and stick with higher-potential, cheaper-valued merchandise, as we believe we do. People will surely be lighting their offices and heating their homes and making phone calls, and there are plenty of modestly valued companies here and abroad who will serve them. Perhaps we’ll be surprised by continuing strength in the large electrics along the way, as most investors have been since early 2003, when the indices were half as high (gasp) as they are today—but there are plenty of opportunities well outside the spotlight.

PORTFOLIO HIGHLIGHTS

We again added to Sierra Pacific early in the quarter, bringing it to higher weighting. The stock rewarded us with a nearly 20% gain, and substantial bragging rights since we’ve been insisting on a higher value for it since our first

purchase in October 2004 at 9 and change and now sit on a 60% gain from that entry. We added a small position in Dynegy at below book value, after announced asset sales basically solved its financial stresses and positioned it to thrive, while, we think, awaiting an acquisition offer. We raised cash for these purchases by selling Cinergy, which will be taken over by Duke Energy, and lightening our gas exposure a bit by taking substantial profits in Burlington Resources and EOG Resources. We still love natural gas, even at \$14+ in October, but it’s simply a discipline with us to cut back somewhat after such a mighty run.

Perhaps the most interesting portfolio change was that after years of badmouthing the Baby Bells, we added a stake in SBC Communications. We like to think this shows fair-mindedness and flexibility, but more likely it’s simply another case of a twitchy nose for low risk. This could be a value trap, as apparent low-risk often is, but we think there’s a good case to be made that SBC could easily sell 30% higher—and we receive a 5+% dividend along the way for testing this theory. With the addition of AT&T the company becomes the leading player in enterprise communications for large businesses—a position that we definitely do not see reflected in the stock price—and their strong fiber-optic initiative finally makes them a true competitor to cable in both broadband and entertainment. Through Cingular they remain a major factor in wireless, and can offer a variety of “bundles” for every configuration of service. Unlike the situation in past years, revenues have been rising in each of the past four quarters, and earnings began to rise last quarter as well. Indeed, the dividend, currently



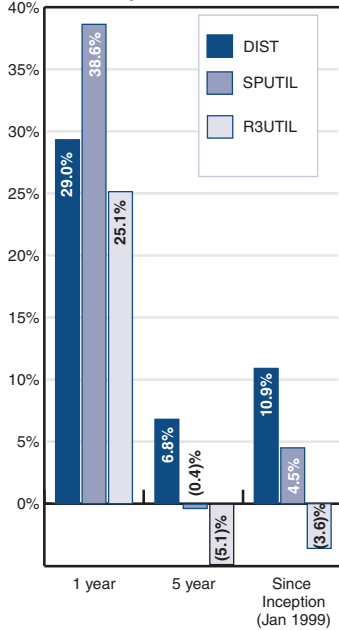
FUNDAMENTAL CHARACTERISTICS

Yield	3.1%
Proj Dividend Growth	5.7%
Payout Ratio	53%
Market Cap	\$13.7 Bil
Price/Book	1.8
P/E Ratio	15.9
S&P Rating	BBB+
Beta*	0.7
R-Squared*	0.5
Standard Deviation	15.3

*Relative to S&P500, 9/30/00 - 9/30/05

continued on page 11...

**Annualized Returns
as of September 30, 2005**



Quarter Composite Net of Fees*

Distribution (Prelim)	5.3%
Russell 3000 Utilities	7.6%
S&P 500	3.6%
S&P Utilities	7.3%

1-Year Composite Net of Fees*

Distribution (Prelim)	29.0%
Russell 3000 Utilities	25.1%
S&P 500	12.3%
S&P Utilities	38.6%

5-Year Composite Net of Fees*

Distribution (Prelim)	6.8%
Russell 3000 Utilities	(5.1)%
S&P 500	(1.5)%
S&P Utilities	(0.4)%

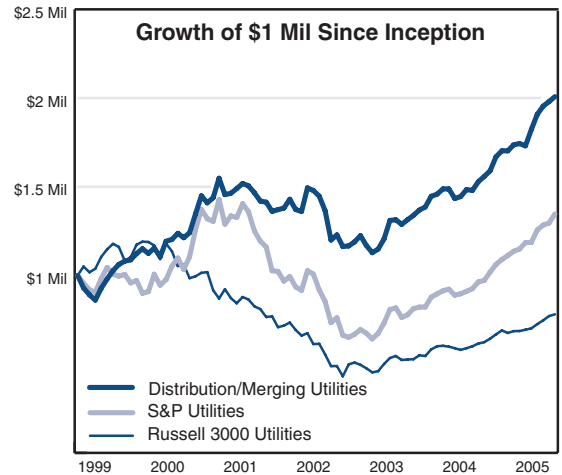
Included are all unrestricted portfolios that have been managed for one full quarter. As of 9/30/05: 190 accounts, representing 94% of total assets managed in the strategy with a dispersion of 0.15. Inception: 1/99.

Despite its plain vanilla character, this portfolio continues to show its heels to nearly all other strategies and indices over the year to date and over the past three and five years, both on an absolute and risk-adjusted basis. This past quarter wasn't as impressive as some, but still managed to outperform all the broad-market indices and hang in with much more aggressive (and much more volatile) utility indices.

We're very happy to stop handicapping the odds of getting an Energy Bill through Congress and the prospects for repeal of the Public Utility Holding Company Act. It took an energy crisis for both houses to "look busy," but now it's done. PUHCA is relegated to the dustbin of legislative history, and the Federal Energy Regulatory Commission has become the arbiter of merger appropriateness, with geography no longer a factor. You may recall that PUHCA determined that electric utilities (those with generating capacity) could only buy other utilities that were geographically contiguous, and non-utility companies like banks (and, let's say, oil companies) could not buy utilities at all. These restrictions are gone.

The news was not greeted with a roar of deals out of the starting gate, though a couple were made seemingly in anticipation of passage (Duke purchasing our Cinergy, Warren Buffet's Mid-America purchasing PacifiCorp from Scottish Power). We'd hoped a few deals were imminent, but we're hardly daunted given the performance of the portfolio and the inexorable array of factors which point to more consolidations.

Outside of a few stocks with gas exposure that have really flown, our valuations are as modest as you can find in the equity markets.



We own many companies that sell at or near book value, which is a bit astounding when you realize their assets are irreplaceable and their internal returns are essentially guaranteed by the local regulators, if not by the mandatory nature of the services they provide. Plus, nearly all exhibit at least moderate growth in revenues and earnings. In sum, any acquirer can earn a reasonable rate of return after buying these companies at a solid premium to market prices. And that is a prescription for consolidation, especially in a world in which the potential acquirers are flush with cash.

With current valuations up the premiums may not be in the 50%-plus range that we assumed a few years ago, but premium potentials are still much higher than expected returns anywhere else we can think of in the market. Our estimation is that the private market value of our stocks is at least 30% higher than current pricing, though that is, to be sure, an estimate. The companies with gas exposure have boosted overall portfolio valuation metrics some, but these also have appeal as acquisitions for larger gas companies, at correspondingly higher valuations.

PORTFOLIO HIGHLIGHTS

While companies with gas production such as Western Gas Resources, Questar, and Energen, led our list this past quarter, we had some strong performances by other names as well. Our highweight Sierra Pacific continues to make financial progress and work its way through potential liabilities to Enron. The company may have to pay something, but it's unlikely to be anywhere near what Enron is suggesting. Should payment be required, a substantial amount has already been reserved, and the complexion of regulation in Nevada now suggests that the company would be made whole in fairly short order through rate mechanisms. We trimmed a little Sierra Pacific at the high to pay for some new positions, with the stock up over 60% from our original purchase, though it remains a highweight.

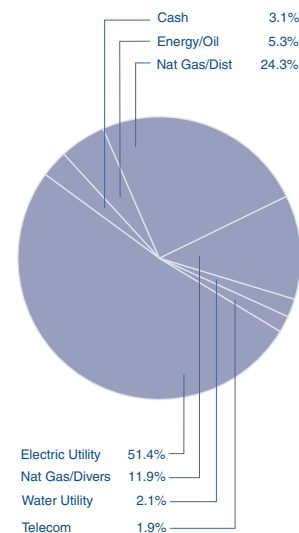
Relative newcomer Centerpoint Energy, a Texas electricity distributor, is also setting its financial house in order, and provided double-digit gains. Southwest Gas rose after weakness earlier in the year. Here is a stock at 27 that had offers in the 32-34 range just a few years ago. We assume the private market value established in those offers by two industry participants is more realistic than current market prices. Southern Union also turned in a good performance. This former pipeline and utility roll-up company has turned out to be a solid operator with double-digit growth. At about 2 times book it's a bit pricier than most in our portfolio, but the growth here is nearly twice the norm.

We added IdaCorp, the former Idaho Power. This is an odd electric utility since a substantial portion of its profitability comes from hydropower and is therefore subject to the

vagaries of weather (snowpack in particular). But we've always been drawn to the company in part because of its IdaTech subsidiary which is involved in industrial-strength fuel cells. Their product is solid, and has passed a number of beta tests with Bonneville Power Authority and most recently with the US Army (as part of a system from Hoku Scientific). But it's been a long slog to get the business off the ground, with full testing and approval from the institutions who matter taking a little longer than forever. Still, that makes for a higher barrier to entry for competitors, and we do think that one day it will turn out that we bought a high-end fuel cell company for nothing, considering the low valuation of the overall company. We also bought some Dynegy. This relic of the brief energy go-go years has cleaned up its financial house and now offers a substantial energy company with 13,000 megawatts of generating power in a size and condition that should be appealing, especially now that generation deals have the bankers buzzing.

LOOKING FORWARD

These stocks are not expensive, not overbought, and are likely targets of acquirers. In the meantime, moderate revenue and earnings growth are prevailing characteristics of the group, and the current yield remains competitive with shorter-term fixed income, with a projected growth of yield of 3.7%. The portfolio has well rewarded the patient investor, even without a plethora of deals in recent years. Now we're looking for more of the same, and a much higher likelihood of transactions in the wake of the new legislation. □



FUNDAMENTAL CHARACTERISTICS

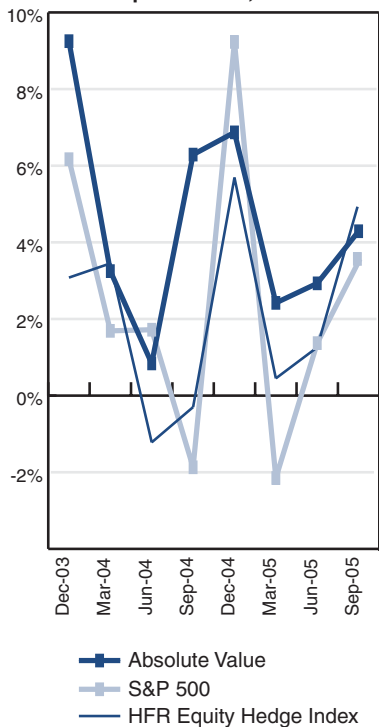
Yield	3.0%
Proj Dividend Growth	3.7%
Payout Ratio	50%
Market Cap	\$3.7 Bil
Price/Book	1.7
P/E Ratio	16.2
S&P Rating	BBB+
R-Squared*	0.3
Beta*	0.4
Standard Deviation	13.4

*Relative to S&P 500,
9/30/00 - 9/30/05

“The strategy hopes to capture all of the upside and diminish the downside over both short and long terms. It is, in effect, a classic hedge strategy.”

The narrow volatility and trading range quality of the equity markets limited our ability and willingness to make creative changes to our portfolio this quarter—we still outperformed the underlying Income-Equity portfolio, the S&P 500, and the HFRI Equity Long-Short index, recording our eighth consecutive profitable quarter (including a two-month inception “quarter”) with a return of 4.3% net of all fees. For the year to date we have returned net 10.2%, and net 17.6% for the trailing twelve months. Our hedge coverage levels ran between 30% and 60% with index products during the quarter, with between 10 and 20% in individual short positions; our returns were not only better than those available in the markets generally, they were also achieved at substantially less theoretical risk as well as less actual volatility.

Net of Fees Quarterly Returns* as of September 30, 2005

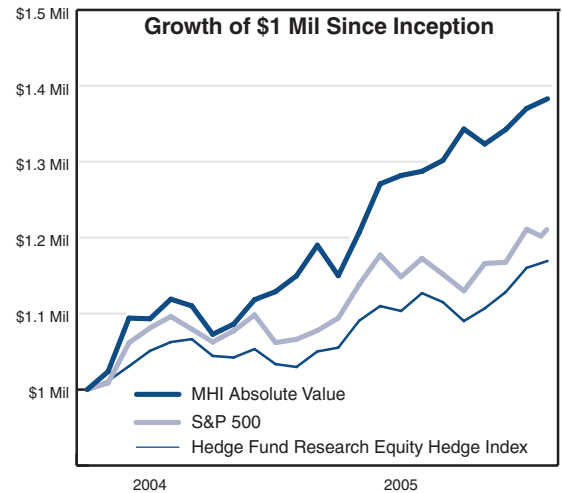


*First quarter was a partial quarter (Nov. and Dec. 2003)

PORTFOLIO HIGHLIGHTS

We noted last time that recent quarters have been difficult for both hedging and enhancement trades, though we’ve been coming through with quite respectable returns. This period we lost a small amount on our index hedges, and nearly all the alpha was added through relatively short-term long trades as well as a significant short in Sears Holding. We undertook a substantial short position in Sears not only because it was undervalued and negatively timely, but also as a play on the waning fundamental and technical momentum in the retail sector generally. We shorted around 150 and took partial profits on the last day of the quarter at about 125. We also shorted ArvinMeritor profitably, though briefly.

Our trading long positions were various, and most were special situations. We traded in



favor of stronger energy prices with Toreador Resources and Global Industries, traded Central Parking at a technical bottom with thoughts of M&A for a 12% gain and did the same with Maytag (putting ourselves, in effect, inside the bidding war). We added weight to two stocks in the underlying portfolio at technical bottoms, Suburban Propane and Enterprise Products. We held SPH fairly briefly for a 6% gain and still hold EPD overweight at a profit. Meanwhile, the underlying long portfolio in high-yielding stocks gave a credible performance. It seemed like a hard-working quarter at the time, but looking back at the actual transactions perhaps it was more hard-looking than hard-working.

LOOKING FORWARD

We’re beginning to think that the low-volatility period which has limited opportunities may be drawing to a close. There has been plenty of volatility elsewhere, notably in commodities and housing, and we think these “animal spirits” may soon return to the equity markets. This change is more likely to be on the downside than the upside, since the structural problems

at the macro-economic level have not improved and corporate profits are likely to slow the quick pace of the past few years. Supporting prices, though, may be a heightened level of stock buybacks and merger activity, as a consequence of the high levels of cash held by corporations and accompanying modest levels of capital spending. Time will tell, and in the meantime we continue our killing for stocks to buy and short, and we remain alert to any threat from the broader market to motivate our index-level hedging.

As this is a relatively new portfolio, we re-iterate the talking points: Absolute Value is a dynamically hedged and enhanced strategy based on our Income-Equity portfolio. Layered above and below the Income-Equity long-only portfolio are hedge and leverage tools intended to amplify gains and prevent drawdowns. The goal is to maintain a high level of current income, permit the portfolio to participate in positive market periods, and hedge to prevent portfolio declines during negative broad market phases. In a nutshell, this strategy adds a layer of dynamic active manager skill to the proven effective long-term buy and hold approach of the Income-Equity portfolio. The strategy hopes to capture all of the upside and diminish the downside over both short and long terms. It is, in effect, a classic hedge strategy. □

For further information, please contact Helen Hamada for a brochure and performance information (Helen@mhinvest.com, phone 888-282-8845). Please bear in mind that this strategy is offered in individual accounts, and is open only to qualified investors (similar to hedge fund qualifications).

BTB/Utilities - continued from page 7

at a hefty 5.4% yield, was increased in the last year as well. We remain cognizant of the various threats to telecom services, but think the company has been re-invented to some extent, and at 2 times book offers substantial upside in a sector that has been perhaps rightfully shunned by investors in the past few years. Our bet, as it were, is that investors have been too focused on the past.

LOOKING FORWARD

We think the gas and foreign telecom stocks that drove our portfolio this past quarter and year to date can continue to do so. The foreign phones are still cheap and still growing very nicely in their more congenial environments. The natural gas situation, already tenuous, was knocked into shortages of indefinite duration by the twin hurricanes. Cash is rolling in, and there aren't enough prospects to put it to use out in the field. This always means putting it to use on Wall Street, through buybacks, dividends, and M&A. In addition, our distribution stocks have been slow. Slow enough, we think, and at low enough valuations, to attract the interest of the many prosperous participants in the utility and energy industries. Enormous multitudes of monthly customers are a good thing, we think. □

Quarter Net of Fees*

Absolute Value	4.3%
S&P 500	3.6%
HFRI Equity Hedge	4.9%

1-Year Net of Fees*

Absolute Value	17.6%
S&P 500	12.3%
HFRI Equity Hedge	12.8%

Cumulative Return

Since Inception Net of Fees*

Absolute Value	40.0%
S&P 500	21.0%
HFRI Equity Hedge	18.5%

Past performance is no guarantee of future results. Gross performance is based on a representative account commencing 11/1/03. The strategy employs, in part, a portfolio of stocks similar to or the same as the sub-advisor's Income-Equity strategy, which has a track record commencing in 1997. There is no guarantee that this portfolio will continue to provide return and risk characteristics similar to those in the past. There are additional risk factors not found in strategies that hold portfolios solely of stocks owned for cash payment. Efforts at hedging the portfolio against market declines may incur a cost. Stocks bought on margin may not provide absolute return. Stocks sold short may rise, producing losses. The strategy may show a loss over any given time period, and there is no guarantee that such a loss will be recovered. Extreme market conditions may produce losses greater than contemplated by the manager or an investor. The use of leverage may generate losses that are greater than would otherwise be the case, or losses that may not have occurred without the use of leverage. Net of fees performance is based on a non-fee paying account. It is proforma and calculated by deducting an annual fee of 100 basis points from gross of fees performance accrued monthly. A 20% annual performance fee is applied quarterly in arrears. Returns are total returns, dividends are assumed to be reinvested.



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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	5.3%	7.0%	0.6	14.7	14.2%
Better Than Bonds/Utilities	Utilities sector: natural gas, electric, telecom, and water	3.1%	5.7%	0.6	15.9	34.3%
Distribution/Merging Utilities	Local distribution utilities, takeover candidates	3.0%	3.7%	0.4	16.2	29.0%

as of September 30, 2005



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