

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.

RISING DIVIDEND PLUS

A portfolio of large- and mid-cap companies in which dividend growth is the key variable, focusing on companies with proven long-term success or special current opportunities.

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.

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We've heard lots of talk about opportunities in the beaten down large-cap financials lately, in a kind of knee-jerk response to prices that are much lower than they were last year. After all, the financial sector managed a double-digit decline last year, and how often do you see that kind of a fall? But we spent the quarter combing through earnings statements and balance sheets and came up empty in terms of large banks or brokers that we want to buy now. Two key points kept gnawing at us.

First, the companies themselves don't seem to have a very good handle on the level of their liabilities, either in terms of write-downs or the more important write-offs. That information won't be in until at least the middle of this quarter—and thanks to Sarbanes-Oxley it's likely to be far more accurate than it would have been in the absence of that legislation, which dictates stiff penalties for CEOs that deceive investors. The possible “final” tallies of losses (and we put “final” in quotes because there are potential events and trends yet to emerge which could easily change the numbers over the next year or two) may provoke a relief rally among some stocks, a relief from severe uncertainty if nothing else.

But our second misgiving is much more important for long term investors, and we have a name for this one: Marsh Mac Syndrome. What's MMS? Let us quote from the Marsh MacClellan quarterly report, in the section titled “risk factors.” (You may recall that Marsh Mac has suffered mightily in recent years subsequent to former New York Attorney General Elliott Spitzer's investigation of the company's practices in receiving undisclosed payments—kickbacks and bribes, in other words—from the insurance companies they recommended as insurance brokers). In the “risk factors” section the company cites reputational damage, risk from lawsuits, distractions of management in dealing with legal problems, and—

“the extent to which we are able to negotiate compensation arrangements with clients or insurance carriers to replace the revenue stream historically associated with contingent commissions, which we have eliminated under Marsh's new business model.”

The quarter report and conference call confirmed it: they just haven't been able to find a revenue stream as attractive and appealing and lucrative as their previous complex system of bribes and kickbacks!

But we shouldn't pick on Marsh Mac (and indeed we don't mean to imply the company will never regain its former glory we think it can). They're simply the most overt case of a problem that has become pandemic in the financial world, and which gives the lie to a current widespread appearance of cheapness. The problem is this: what will these banks and brokers do in the future to recover and return to past earnings levels, earnings that they are now

“The whole beehive of useless financial activity results in the empty wax cubicles of former drones instead of the honey that flowed from global cross-pollination of the liquidity bloom. It is winter.”

handing back as the free market plays the role of district attorney? Yes, many companies seem cheap based on prior stock prices, but those prior stock prices were based on prior earnings, and those prior earnings were derived from all manner of bad loans and bad business—ranging from loosely extended credit to financial derivative products that were certainly unethically, if not illegally, presented to investors who are not likely to take the bait again any time soon.

As the residential real estate market implodes and overall growth slows, the need or demand for loans declines. The buyers of derivative packages back off. IPOs don't IPO. The whole beehive of useless financial activity results in the empty wax cubicles of former drones instead of the honey that flowed from global cross-pollination of the liquidity bloom. It is winter.

One day these companies will surely find the equivalent, in Marsh Mac's words, of a “revenue stream historically associated with contingent commissions,” but that day is not simply the day after all the losses (previously reported as earnings) are tallied. That day comes after the long slog of right-sizing and re-thinking, and perhaps a good deal of consolidation. We're not concerned, though. Many companies may have sold off an arm at a discount to sovereign wealth funds from various countries, but they still have another arm—and they have the ability to regenerate!

Seriously, while we find Marsh Mac syndrome an important neutralizer to some of the drooling going on in the value camp, there is also precedent for optimism, amidst the still-smoking rubble, regarding the economy, the overall market, and even the financial sector. It wasn't that long ago, after all, that the country was mired in the Savings and Loan crisis—whose accumulated losses were, as economist Michael Darda has pointed out, roughly twice the size of the expected losses from the

current turmoil—which also drove down the banking and financial sector. At that time it seemed that the economic and stock market gains of the late 1980's were destined to an ephemeral pause.

Then, in 1990, the real (inflation-adjusted) Fed Funds rate was 4.5%, nearly twice what it is today. There had been no consumer buying binge based on use of home-equity-as-ATM-card, real estate was on the decline and would stay that way for some years. Indeed, a Democrat president was taking up residence in the White House. And the dollar had been weak, compelling pension funds and institutions of all kinds to go “international” in their investing. Conditions in the 1990-91 period were uncannily similar to those of today, and formed the murk and mud from which one of the great periods in the annals of economic prosperity and equity bull markets emerged. Now, one may argue that the forces of destiny—in the form of technology hardware and later the Internet—arose to save the day. And one may ask who or what will arise to save the day this time? That's a known unknown. It might be breakthroughs in renewable energy, or medical science, or peace on earth. One doesn't know. But the almost universal pessimism expressed in both quantitative sentiment measures and anecdotally among talking heads is likely overdone, and likely wrong, just as it was during the S&L crisis and just as it usually is when the consensus view is extreme and monolithic. What we can say with 20-20 hindsight is that the apparent end of the world in 1990-91 was actually the beginning.

Today all the talk is about recession, as if a recession were easy to predict and “obvious.” Yet all the scary doings in the financial sector and all the palpable long-term imbalances in the domestic economy can't argue away the fact that the hard economic numbers so far display a slowdown in growth and no more. Most recently, industrial production

SELECTED INDICES

	4 th Qtr07	12 Mo
S&P 500	(3.3)%	5.5%
Equity Inc	(3.5)	3.6
Util Fund	5.2	20.2
R3UTIL	(1.4)	9.1
Long Bond	5.6	9.8
R1000	(3.2)	5.7

S&P 500 = Standard & Poor's Index
 Equity Inc = Avg Equity Income Fund (Lipper)
 Util Fund = Avg Utility Fund (Morning Star)
 LB Long = Morningstar
 R3UTIL = Russell 3000 Utilities
 R1000 = Russell 1000

has been firm. Purchasing managers surveys have been firm nationally, though the December ISM number was a downside surprise and concerning (though the Chicago ISM was actually “strong.”). Real interest rates are about 1.5%, a level not associated with incipient recession. If you’d asked an economist ten or twenty years ago if current employment levels were characteristic of recession, you’d have received a smirk in response. Consumer sentiment is down, as are sales of discretionary items, but consumer sentiment is not very well correlated with actual consumer future behavior, and discretionary purchases are actually a very small percentage of consumer spending. The last time consumer sentiment was this low proved, in 2005, to be an excellent buying opportunity.

Export-related companies are taking up a good deal of the slack from weak real estate and related business, and there are obviously many companies that can take advantage of the global need for infrastructure as well as consumer products to serve the needs of a rapidly growing global middle class. Indeed, the rest of the world is mainly booming in reality (though some global stock markets may be reflecting fantasy), giving them funds for our goods and services, and to buy US assets. Inflation is a concern judging by recent numbers, but our Fed and the developed world’s Feds are in no position to raise interest rates in the face of slowing growth, and, relative to history, equity prices are extremely low when measured against interest rates.

Importantly, after a first flush of relief when finance sector reports are in and all the losses are tallied, we think Marsh Mac Syndrome will set in for many companies in finance—including most of the biggest. Since financials are still the most heavily weighted in the market (17.6% in the S&P 500, 20.3% in Russell 1000, 32.3% in Russell 1000 Value) they’re likely to be a

drag on the indices, so we may not see nearly as much satisfaction at the index level as we do in individual stocks and sectors. There may even be some very good performers in the financial sector—and we believe we already own some of these—but they will not be the companies that need to “replace their previous stream” of ultimately bogus earnings with...something new.

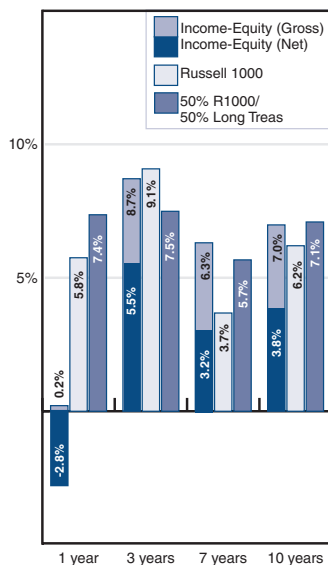
GIPS Performance Disclosure

Miller/Howard Investments Inc. is an SEC registered investment advisor specializing in multi-cap, core equity management and dividend strategies. The annual investment management fee for the met composite is an assumed fee of 3%. Actual investment advisory fees incurred by clients may vary. Actual returns will be reduced by investment advisory fees and other expense that may be incurred in the management of the account. Other than brokerage commissions, this fee may also include portfolio monitoring, consulting services, custodial services and investment management fees.

Miller/Howard Investments Inc. has prepared and presented this report in compliance with the Global Investment Performance Standards (GIPS®). The firm is currently undergoing a firm wide verification being conducted by Ashland Partners & Company LLP. To receive a complete list and description of Miller/Howard Investments’ composites and/or a presentation that adheres to the GIPS standards, contact Marilyn Marecek at 845-679-9166, or write Miller/Howard Investments, PO Box 549, Woodstock, NY 12498, or marilyn@mhinvest.com.

“Importantly, after a first flush of relief when finance sector reports are in and all the losses are tallied, we think Marsh Mac Syndrome will set in for many companies in finance—including most of the biggest.”

Annualized Returns
as of December 31, 2007*



While the quarter’s healing activity often had a feverish feel to it, by the end of the quarter we began to see evidence that the natural constituency for dividend stocks was beginning to return—after seeing the highest-yielding of these batted around in a frenzy by traders during the third quarter. The quarter and second half of 2007 weren’t the most satisfying we’ve had, but for the year we managed to finish about flat, which was a long ways better than comparison strategies and indices, though below the broad market indices (which were helped by technology and energy producer weightings). For example, the financial sector indices were down nearly (20)%, REIT indices were down more than (16)%, dividend-oriented ETFs and closed-end funds were down anywhere from (1)% to (20)% with the majority down (5)% to (10)%. So there were many yield-oriented ways to lose in the equity markets this past year, and despite some disappointments we did well to live to fight another day.

PRELIMINARY RETURNS*

Quarter Composite

MHI Income-Equity Gross	(3.0)%
MHI Income-Equity Net	(3.7)%
50/50 R1000 & Long Treas	1.2%
Russell 1000	(3.2)%

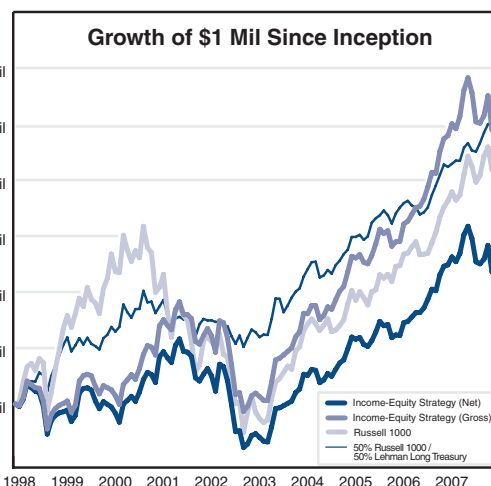
12-Month Composite

MHI Income-Equity Gross	0.5%
MHI Income-Equity Net	(2.5)%
50/50 R1000 & Long Treas	8.0%
Russell 1000	5.7%

10-Year Annualized Composite

MHI Income-Equity Gross	7.0%
MHI Income-Equity Net	3.9%
50/50 R1000 & Long Treas	7.2%
Russell 1000	6.2%

*Net returns assumes a 3% annual advisory fee. See full disclosure presentation on page 5.



The above data is shown as supplemental information and complements the disclosure located on page 5.

yields. Recent and projected dividend growth results in higher returns. Return and risk from dividend-paying stocks is a stronger factor than the complicated ranking systems we reviewed. Financial safety and historic price persistence ranks add more value than future performance ranks. The addition of technical factors, especially for stocks that have declined, adds to returns and diminishes risk. Evaluation of relative strength and insider buying can add incremental value. Longer-term earnings estimates are unreliable, and less reliable as indicators of future performance than recent cash flow growth. We could not uncover strong conclusions from book value growth, or from historical growth more remote in time. Low valuation is better than high valuation, but isn’t prima facie dispositive. Analyst consensus price targets do not appear to contain useful information.

One of the things money managers do when times are tough is to put in long hours trying to improve process, strategy, and knowledge. Apart from lagging the tech bubble in 1998-99, which hardly counts, and participating in the declines of 1990-91, we were hard pressed to recall a time when dividend-oriented stocks did not at least display dampened volatility in the face of difficult markets. So we spent considerable time this quarter studying historical data, using, for the first time, a new database from a respected vendor—which we thought would provide an extra measure of objectivity.

The results, we think, helped sharpen and refine tenets that we’ve held for many years, and they also confirmed what we’ve known from both prior historical research and from our own real-time experience. Some conclusions: we were unable to find any way to achieve below-market volatility and above-market returns other than by using dividend-paying stocks. Higher yields are coincident with lower volatility, except in the top decile of

We were seeking strong predictive factors, not just a positive re-inforcement loop for our philosophy of investing, and we looked at many factors we don’t normally use—but the end result was a re-affirmation of what we have always done, an increasing quantification of our principles, and a strengthening view that the second half of 2007 was an anomalous period. There’s no rule that says such a period can’t continue, but by definition an anomaly is unlikely to persist.

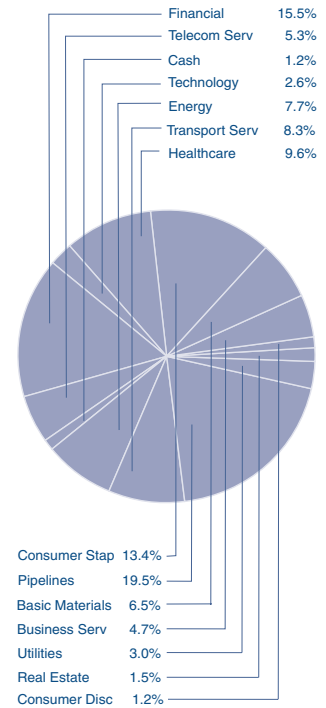
PORTFOLIO HIGHLIGHTS

We'd been waiting for some time to catch Alliance Bernstein (AB) at a good price, and the shakes in the market provided just that moment. Yielding 6.3%, the company reported earnings \$.05 better than expected on assets under management that was also better than expected, the result of strong inflows. AB is well positioned, with growth, value and international offerings, and we think large asset managers will benefit for many years from the shift to defined-contribution retirement plans, as well as the management help that a huge wave of retiring baby boomers will require. We added McCormick & Co (late in the third quarter, actually)—the spice and seasonings company that's surely well represented in your kitchen cupboard—also during an uncharacteristic lull in valuation. This one has extensive foreign operations which will benefit from a weaker dollar, and simply dominates the market here at home—a dominance that allows it to pass on higher costs (think of it as “the spice utility”). The company is financially strong and trades at a discount to previous valuations, though in today's world we think it should trade at a premium. In a similar vein we added major food distributor Sysco, selling at a 20% discount

to its historic valuation, though its reliable growth should be near the top of the heap of large-cap consumer non-durables for 2008 and beyond. This, like MKC, is a solid steady-eddy kind of company that is a classic buy in our approach when its historic valuation is severely discounted.

We also increased our position in CapitalSource (CSE), for the second time. As noted in the Overview, we searched through the finance sector long and hard for babies thrown out with the bathwater, but came up against what we call Marsh Mac Syndrome (the problem of replacing a revenue stream from a business model that has been discredited) time after time, concluding finally that we already owned the babies that had been tossed. Our specialty financials don't rely on residential real estate, don't rely on the interbank funding market, aren't involved in derivatives, and are now benefiting from reduced competition and increasing margins. In the case of CapitalSource there is also an agreement for them to buy Tier One, an upper midwest bank that will give them a low-cost source of capital—if the deal goes through as planned (it may not, due to declines in CSE's stock price since the announcement, but the company would still be fine without it).

Continued on back cover...



Income-Equity Strategy Composite Performance—GIPS composite disclosure shown in US dollars

Preliminary	Income-Equity Strategy Composite Includes MLPs		Income-Equity Strategy Composite No MLPs		Russell 1000
	Gross	Net	Gross	Net	
Period to Date (3 mo's to 12/31/07)	(3.0)%	(3.7)%	(5.3)%	(6.0)%	(3.2)%
1 Year (ending 12/31/07)	0.5%	(2.5)%	0.1%	(2.9)%	5.7%
3 years per annum (ending 12/31/07)	8.8%	5.6%	8.1%	5.0%	9.1%
5 Years per annum (ending 12/31/07)	13.6%	10.3%	Not Enough Data	Not Enough Data	13.4%
7 Years per annum (ending 12/31/07)	6.4%	3.2%	Not Enough Data	Not Enough Data	3.7%
10 Years per annum (ending 12/31/07)	7.0%	3.9%	Not Enough Data	Not Enough Data	6.2%

The Income-Equity Strategy Composite focuses on multi-cap, high-quality, high-yield dividend-growth investments across the broad market, including American Depositary Receipts. The No MLP portfolio excludes exchange traded Master Limited Partnerships. The Russell 1000 Index offers investors access to the extensive large-cap segment of the US equity universe representing approximately 92% of the US market. See full disclosure on page 3.

FUNDAMENTAL CHARACTERISTICS

Yield	6.0 %
Proj Dividend Growth	9.5%
Payout Ratio	58%
Market Cap	\$36.3 Bil
Price/Book	2.8
P/E Ratio	14.5
S&P Rating	BBB+
Beta*	0.6
R-Squared*	50.9%
Standard Deviation	11.7%

*Relative to S&P 500, 12/31/97 - 12/31/07 (Weighted Averages)
Sector pie chart is taken from a representative account. Information is supplemental to the performance disclosure on page 5.

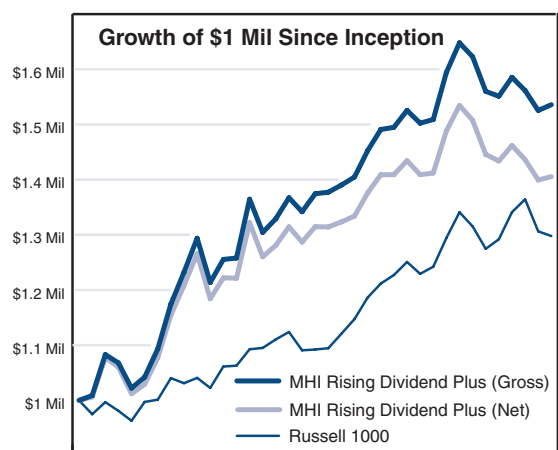
“Our studies and the studies of others have shown that both high dividends (if not the highest) and rising dividends are important factors that can exert a strong positive influence on stock price absolute and risk/adjusted performance.”

This quarter marks the third anniversary of Rising Dividend Plus, and it has been a very good three years. While for 2007 we were merely close to the broad indices in returns, for the three years our gross returns were about 60% greater than the market, as measured by the Russell 1000 or the S&P 500.

There are several ways for an investor to make use of dividends. Dividends can be the basis for a financial compounding machine: as the dividend for a stock grows, it can make the stock producing that dividend commensurately more valuable. This feature of course has greatest application in higher yielding stocks, where the dividend constituency is more committed, and where the rising yield impact on a stock is more direct since it enhances its competitiveness relative to other income instruments. But dividends also contain other information: the growth of a dividend is management’s way of saying “we’re doing fine and business is good.” It is also a way of saying “our reported earnings are real because we have the cash to pay you.” Our studies and the studies of others have shown that both high dividends (if not the highest) and rising dividends are important factors that can exert a strong positive influence on stock price absolute and risk/adjusted performance.

In Rising Dividend Plus we emphasize the value of dividend growth as information about a company’s future prospects. At least 80% of the portfolio is populated by stocks demonstrating high recent and expected dividend growth. But which stocks? Which stocks will sustain their dividend growth going forward, and at the same time compose a portfolio that has the highest likelihood of success no matter what the market is doing?

We use a variety of tools and considerations to arrive at our quite concentrated large and mid-cap holdings,



12/04 3/05 6/05 9/05 12/05 3/06 6/06 9/06 12/06 3/07 6/07 9/07 12/07

The above data is shown as supplemental information and complements the disclosure located on page 7.

typically using stocks that not only offer rising dividends but also a “plus.” We enter a position with the idea that we may hold it forever, but most of our stocks also have a nearish-term catalyst that may or may not persist. The catalyst might be a rise in commodity prices, change in legislation or background politics, a new product, market dominance in a segment showing substantial growth, or especially attractive valuation due to transient factors. We identify the “plus” factors through rigorous research, including deploying the quantitative and technical skills which originally formed the foundation of our firm and which we’ve honed for over thirty years. Increasingly, we also use quantitative fundamental historic research as a selection guide. All other things being equal, we will choose a stock with the better statistical profile, and we will occasionally select a stock with an extraordinary technical profile. We seek an information or inference edge from an array of tested factors, including balance sheet changes, insider activity, stock buy-backs, revenue and cash-flow changes, and actual price activity, to build a portfolio of high absolute and relative potential.

When we review stocks in our quarterly reports, we always try to illuminate the “plus.” Bear in mind, though, that a standout company with strong past and present dividend growth doesn’t really need more than that.

PRELIMINARY RETURNS*

Quarter Composite

Rising Dividend Plus Gross	(3.2)%
Rising Dividend Plus Net	(3.9)%
Russell 1000	(3.2)%
S&P 500	(3.3)%

1-Year Composite

Rising Dividend Plus Gross	2.8%
Rising Dividend Plus Net	(0.3)%
Russell 1000	5.7%
S&P 500	5.5%

**Since Inception (12/31/04)
Annualized Composite**

Rising Dividend Plus Gross	15.4%
Rising Dividend Plus Net	12.0%
Russell 1000	9.1%
S&P 500	8.6%

*Net returns assumes a 3% annual advisory fee. See full disclosure presentation on page 7.

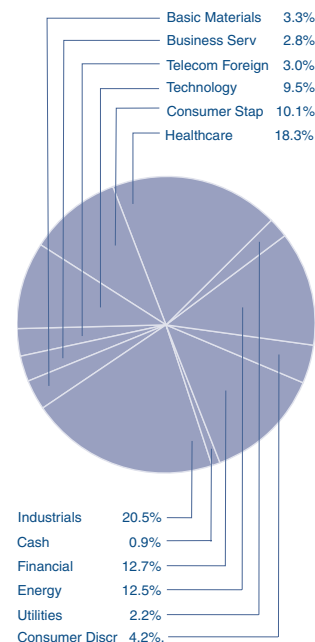
PORTFOLIO HIGHLIGHTS

Turkcell, “borrowed” from our BTB/Utilities portfolio led the portfolio this quarter, rising over 30%, as did many foreign telecoms. Here, a peaceful election favorable for business was the catalyst that helped the stock emerge from relative undervaluation, on very busy trade. Although gas prices had trouble getting off the mark, the portfolio was helped by gas producers Anadarko, Devon, and Pioneer (the three averaging over 10% in gains), as well as deepwater drilling specialist Ensco in a strong energy group. But the stronger-stock side was diverse, with contributions from new buy Best Buy (strong electronics sales), Abbott, Teva Pharmaceuticals, Intel, Emerson, and Staples (on a strong earnings report that implied that the company is even more undervalued than we’d thought).

Corning was surprisingly flat considering the prospects and current business in each of its major segments. We added Alcoa on news that the company was buying back 25% of its shares, which we thought in combination with still-strong aluminum business would boost the stock price—but that hasn’t happened yet, in any event. Medtronic delivered a temporary disappointment with news that a key wire lead product had

too many failures and was coming off the market. Investors over-reacted, we think, and the stock has worked higher after an initial sell-off. 3M reported what we thought was a good quarter and offered reasonably good guidance, but investors must have been expecting much more, and the stock dropped some 15%, again working back up at the end of the quarter as cooler heads prevailed. American International Group suffered from suspicions that it will sink in the current financial quagmire, but there isn’t any real evidence of this, and the stock remains among the cheapest of quality large-caps. New buy DeutscheBank, a developed-market bank that also serves emerging New Europe, met a similar fate.

We also added Ambac Financial, the bond insurer, which fits our dividend-growth model but which is clearly in the “special situation” category at this point in time. We could fill a quarter report with the facts and our thoughts around the company and the overall bond insurance industry situation. For now we’ll say that we strongly believe they will keep their triple-A rating, and that the stock would be historically cheap even at half its expected earnings (or at 50% dilution through new equity). It’s controversial, but we think the risk/reward tradeoff is extremely favorable.



Rising Dividend Plus Composite Performance
GIPS composite disclosure shown in US dollars

Preliminary	Rising Dividend Plus		Russell 1000
	Gross	Net	
Period to Date (3 mo's - 12/31/07)	(3.2)%	(3.9)%	(3.2)%
1 Year (ending 12/31/07)	2.8%	(0.3)%	5.7%
3 Years per annum (ending 12/31/07)	15.4%	12.0%	9.1%

The Rising Dividend Plus Composite is a mid- and large-cap core strategy focusing on companies in which dividend growth is the key variable. The Russell 1000 Index offers investors access to the extensive large-cap segment of the US equity universe representing approximately 92% of the US market. See full disclosure on page 3.

LOOKING AHEAD

It’s an emotional market now, subject to swings and overshoots both at the index level and in individual stocks. But there’s no question in our minds that there are many stocks with excellent near and long-term prospects, and, as noted in the Overview, there will be good opportunities to deploy capital even if the broader indices provide little satisfaction.

FUNDAMENTAL CHARACTERISTICS

Yield	1.7%
Proj Dividend Growth	13.2%
Payout Ratio	22.4%
Market Cap	\$45.4 Bil
Price/Book	3.5
P/E Ratio	16.2
S&P Rating	BBB+

(Weighted Averages)
Sector pie chart is taken from a representative account. Information is supplemental to the performance disclosure on page 7.

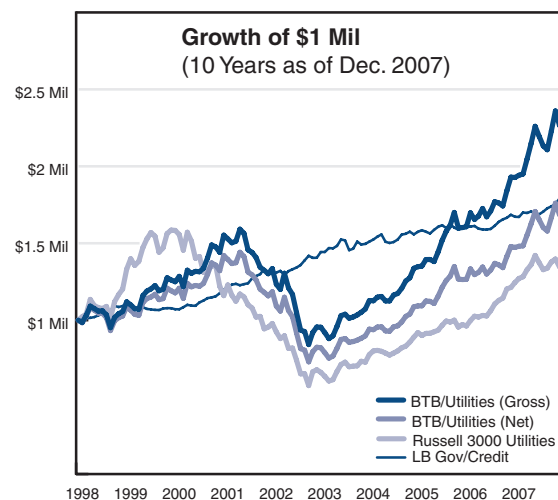
“Over the years we’ve heard many investing ‘experts’ say the sector is ‘too narrow,’ though life as we know it can’t go on without utilities, and they always participate in long-term economic growth.”

Last quarter we noted that the strong relative performance of utilities generally during the maelstrom of the third quarter suggested that investor confidence in the sector wasn’t seriously damaged by the troubles in the credit markets, and that utilities of various stripes would likely be on investors’ shopping lists as pressures on the general environment receded. We noted there may be an evolution in both investor thinking and in economic reality that places foreign companies—even in countries formerly thought of as “developing”—no higher on the risk thermometer than domestic issues. This is particularly true in the case of utilities and telecoms, which in general are treated more favorably and are more protected than our own counterparts, and which directly benefit on a relative basis from strengthening in their local currencies. Potential growth in the future is generally far superior to domestic companies, and that only adds to the appeal of “furriners,” especially if one accepts the notion that risks are no greater. That’s a rather large ‘especially,’ but so long as the dollar dawdles there is, at the least, a financial compensation for any greater potential political risk.

PORTFOLIO HIGHLIGHTS

Many but not all of our foreign companies continued to drive the portfolio higher. Too, as we suggested last quarter, some of the weak became the strong, and we benefited from positive movement in more traditional domestic utilities that had been a drag in the third quarter. (Yes, a wise geezer did say that “stocks will fluctuate”).

Turkcell found buyers after a peaceful and successful election established a more reliable environment for this country at the nexis of Europe and the Middle-East, a country with strong aspirations to join the EU and willing to take the economic steps necessary to do so. The stock was up about 30% for the quarter, and doubled during the year since we bought it. Also boosting returns was Telefonica de Espana, Philippine Long Distance, and China Mobile, all up in low double-digits. We note also that at the end of the quarter NTT, the dominant phone company in Japan, announced a nearly 20% ownership position in Philippine Long Distance. Last quarter we surmised it was time to take some profits in



The above data is shown as supplemental information and complements the disclosure located on page 9.

this area; we did reduce weights in China Mobile and Brazil Telecom. We also took profits in solar supplier MEMC Electronics after a large move up, and sold NRG on strength, perceiving the stock as fully valued as well as reacting to its plans to develop nuclear facilities. Energy East was sold as its price was sufficiently close to its announced sale price to Iberdrola, and that deal in addition may be facing delays.

Positive moves in the electric utility indices helped provide a buoyant environment for our more traditional utilities, which recovered after profit-taking and general turmoil last quarter. Sierra Pacific, Potomac Electric, and Northeast Utilities all helped pull the portfolio up. In the gas area, buyers produced gains in El Paso, Equitable Resources, Questar (so often on this list!) and Spectra Energy. Natural gas producers were mixed, but Kinder Morgan Energy Partners and Enterprise Products Partners reflected both stability and strength in an MLP sector that had been irrationally sold last summer.

Weak stocks were mercifully few and those that didn’t perform well were small positions. PT Telekomunikiasi saw profit-taking, and demonstrated that the foreign telecom area isn’t monolithic; it was joined by a small decline in America Movil as well as a notable drop in NI Holdings which we had added prior to news of slowing subscriber growth, and which we quickly sold (the stock subsequently declined much more; it’s at a valuation level where we’re once again interested). Southern Union didn’t perform well

PRELIMINARY RETURNS*

Quarter Composite

BTB/Util Gross	4.5%
BTB/Util Net	3.7%
Russell 3000 Utilities	(1.4)%
S&P Utilities	7.5%
LBGC	3.1%

1-Year Composite

BTB/Util Gross	20.9%
BTB/Util Net	17.4%
Russell 3000 Utilities	9.1%
S&P Utilities	19.4%
LBGC	7.2%

10-Year Annualized Composite

BTB/Util Gross	8.8%
BTB/Util Net	5.6%
Russell 3000 Utilities	3.1%
S&P Utilities	7.8%
LBGC	6.0%

*Net returns assumes a 3% annual advisory fee. See full disclosure presentation on page 9.

despite its incipient MLP offering, and ONEOK was the subject of profit-taking as well. Dynegy fell back on slow revenue progress.

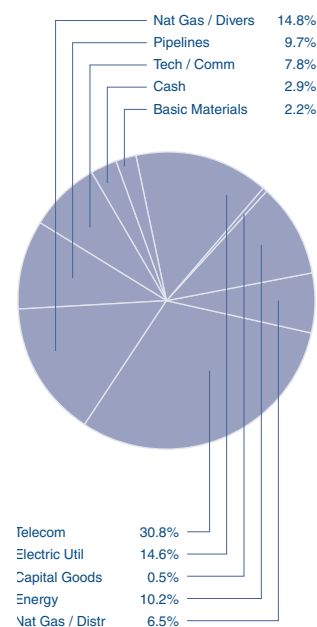
We added shares in Covanta, the leading waste-to-energy producer in the country. In a nutshell, the company contracts with municipalities to burn their garbage and create electricity. The result is the cheapest and cleanest form of solid fuel-based energy available, so they're solving a number of problems at once. This is hardly the least expensive stock in the universe, but their continuing success, lack of competition, and environmental contribution, warrant a position—a position already up about 10%, we might add. We also benefited from timely entries into two new telecoms toward the end of the quarter. When Leap Wireless fell apart on news a deal with Metro PCS would not happen arbitrageurs and event-driven buyers jumped out the window, pushing the stock way below fundamental value (as well as way below the Metro PCS offer which Leap had rejected). On news of better than expected earnings and revenues and massive insider buying we took the other side of what we perceived to be a temporary stock-price crisis that had no relation to fundamental values. The result was a fast move from the low 30's to the high 40's, and don't we wish we'd bought more(!). A deal is not likely imminent since insiders have been buying so heavily (typically insiders hold back if discussions are being held, to avoid insider-trading prohibitions), so we'll be weighing our current high annualized return versus a continuing review of underlying values.

A more measured flight of arbitrageurs and event buyers also opened up an opportunity for us in Canadian integrated telecom provider TELUS, as temperatures cooled around the BCE deal and any additional transactions that might eventuate, exacerbated by a regulator ruling on new spectrum auctions that favored new wireless entrants over incumbents. We'd considered TU in a favorable light some 20% higher, so when the technical gestalt indicated to us that selling pressures had given way to buying interest, we entered a position that rose nearly 15%—like LEAP, in the month of December. We also bought Quest, with no such subsequent fireworks, after the company re-instituted its dividend after, as Paul Simon might say, all these years. A new green shoot, we think,

which comes after the swamp has burned. That, and an attractive and growing service territory. They need cellular, of course, but we doubt they need us to tell them.

LOOKING FORWARD

Ever since the financial press insisted in 2002 that U.S. utilities were headed for mass bankruptcy, the group, along with telecoms (and MLPs, those utilities-without-borders) has provided the best returns and the best risk-adjusted returns of any domestic traditional sector. Over the years we've heard many investing 'experts' say the sector is "too narrow," though life as we know it can't go on without utilities, and they always participate in long-term economic growth. We have generated an average annualized gross return of 19.5% over the last five years, and have outperformed the broad market as well as fixed income over the past ten years and since inception. So there's been some compensation for the perceived "risk" of a single sector (admittedly, around 2002 that perception of risk was extremely palpable—for a little more than a year, in a unique and uncharacteristic moment). Plenty of opportunities remain as the world turns toward increasing broadband, decreasing carbon, and increasing reliance on both natural gas and electricity, but in the obverse of our comments on Quest, no swamp throbs forever without pause, so we see ourselves moving more cautiously in the year ahead.



FUNDAMENTAL CHARACTERISTICS

Yield	2.1%
Proj Dividend Growth	6.3%
Payout Ratio	31.4%
Market Cap	\$40.1 Bil
Price/Book	3.2
P/E Ratio	19.2
S&P Rating	BBB+
Beta*	0.63
R-Squared*	42.5%
Standard Deviation	14.1%

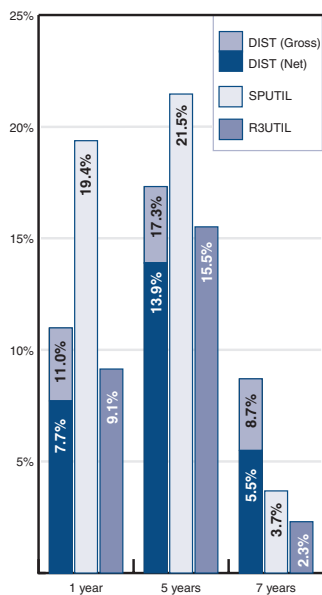
*Relative to S&P500, 12/31/97-12/31/07 (Weighted Averages)
Sector pie chart is taken from a representative account. Information is supplemental to the performance disclosure on page 9.

Better Than Bonds/Utilities Composite Performance
GIPS composite disclosure shown in US dollars

Preliminary	Better Than Bonds/Utilities Gross	Utilities Net	Russell 3000 Utilities
Period to Date (3 mo's - 12/31/07)	4.5%	3.7%	(1.4)%
1 Year (ending 12/31/07)	20.9%	17.4%	9.1%
3 Years per annum (ending 12/31/07)	20.0%	16.5%	13.9%
5 Years per annum (ending 12/31/07)	19.5%	16.1%	15.5%
7 Years per annum (ending 12/31/07)	6.0%	2.8%	2.3%
10 Years per annum (ending 12/31/07)	8.8%	5.6%	3.1%

The Better Than Bonds/Utilities Composite focuses on opportunities in the broad utilities industry seeking to provide growth and income for total return investors. Russell 3000 Utilities index is comprised of over 200 utility stocks that are included in the Russell 3000 Index. See full disclosure on page 3.

Annualized Returns
as of December 31, 2007*



Regulated utilities generally were once again considered the safe spot in the domestic equities market, and this generally benign environment helped our portfolio to another healthy quarter of gains, seemingly untouched by the angst surrounding companies more affected by economic and financing uncertainties. In addition, we had another takeover this quarter.

A number of investors have asked us about the impact of the recently-passed energy bill on our stocks. In truth, because the bill emphasized automobile fuel efficiency and an increase in biofuels, there's not much impact at all here on our primarily distribution-oriented utility companies. There are incentives favoring efficiency generally that, in a vacuum, could mean lower electricity sales. But these will have a relatively small impact in the face of a steadily increasing need for electricity (and the plants that produce it) for a society which increasingly runs on things that plug in or need a charge. The amount of increasing power demand simply dwarfs the power that may be saved by switching to new low-power lightbulbs—though we'd be the first to agree that every little conservation gesture can be a help.

PRELIMINARY RETURNS*

Quarter Composite

Distribution Gross	3.8%
Distribution Net	3.0%
Russell 3000 Utilities	(1.4)%
S&P Utilities	7.5%
S&P 500	(3.3)%

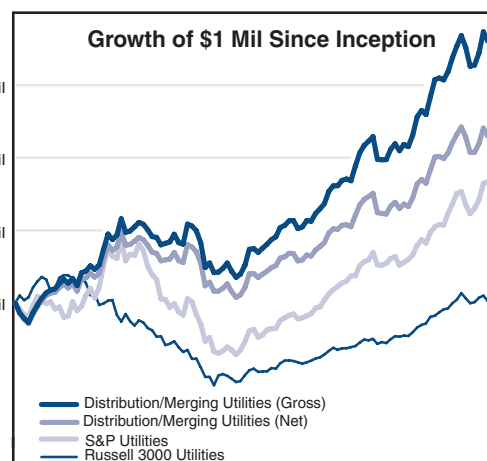
1-Year Composite

Distribution Gross	10.8%
Distribution Net	7.5%
Russell 3000 Utilities	9.1%
S&P Utilities	19.4%
S&P 500	5.5%

7-Year Annualized Composite

Distribution Gross	8.6%
Distribution Net	5.5%
Russell 3000 Utilities	2.3%
S&P Utilities	3.7%
S&P 500	3.3%

*Net returns assumes a 3% annual advisory fee. See full disclosure presentation on page 11.



The above data is shown as supplemental information and complements the disclosure located on page 11.

PORTFOLIO HIGHLIGHTS

There's one less electric distribution utility in town, as a group of infrastructure investors including Macquarie Infrastructure Partners and two Canadian pension funds agreed to buy Puget Sound Energy (Washington). We were hopeful about this kind of a deal, but also a trifle surprised, as the regulators in Washington don't provide a very agreeable environment. Nevertheless, the deal is a good one, and likely to complete, and helped push us over the decisional edge to add Portland General Electric to the portfolio. POR was the object of a failed takeover in recent times

by a financial buyer, as regulators refused a deal that would have presented the acquirers with nothing less than a cash cow to fund the payments on their leveraged financing, all on the backs of Oregon ratepayers. However, the company is clearly amenable to a sale, and we think the regulators would not object to a "real" deal that left the utility in competent and financially strong hands. That said, utilities in prosperous and growing areas are normally the best utilities to own, and we're satisfied that the regulators are sufficiently congenial on an operating basis (certainly more so than Washington's officials); so this is the kind of situation we seek—good potential for a deal, but fine on fundamentals as a standalone holding.

We sold two stocks in the portfolio with pending deals, Energy East and Alltel. In the first case the stock was fairly close to the deal price and it appears that the deal may be delayed somewhat by various state objections (EAS is multi-state in operation). As for Alltel, the events in the credit markets in recent months made us increasingly uneasy about the availability of financing for the deal at its current price. Since the closing was near, we exited rather than tolerating any last minute changes—which in fact never came to pass and AT has gone

private. We also reduced Sprint to a minimal weighting. The stock makes great intellectual sense—the last available wireless company of any scale for, one might ponder, a foreign carrier wishing to enter the market. But in reality few companies have ever made such a mess of what was a strong and valuable subscriber base. Even at low weight this is on our negative watch list, and it is a reminder to hold only stocks in which one would be happy to be an investor in the absence of a transaction.

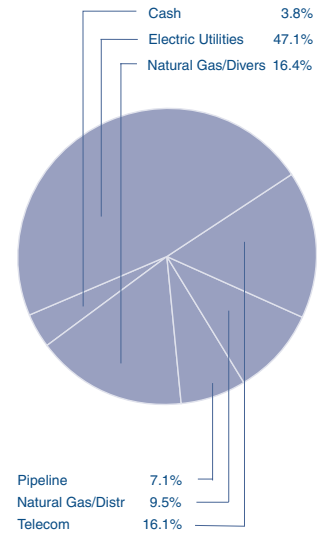
LEAP wireless is noteworthy in the drama of consolidation among the remaining wireless players that has been unfolding. Earlier this fall the company rejected an offer from Metro PCS, which precipitated a radical drop in the stock as deal players headed back to the clubhouse. After the company reported an upside earnings surprise insiders arrived to buy many millions of dollars in shares, and, at less than half the price of a few months prior, we were willing to take a chance on this category of assets which are increasingly rare and do not lack for buyers. So far so good, with a gain of over 20%, but we’re watching this egg closely.

Elsewhere, the portfolio was helped by traditional distributors that remain deal candidates in our view, stocks like Potomac Electric, Sierra Pacific, Northeast Utilities, Alliant, FirstEnergy, and the recovering CMS Energy. Sempra reported way ahead of expectations, but PNM Resources, which has been a disappointment, continues to struggle. We also got some positive push from Turkcell, which we’d originally bought as a potential object for one of the acquisitive Russian wireless companies, but which has become increasingly sound on its own merits after the supportive Turkish elections this fall.

LOOKING FORWARD

For some time we’ve had difficulty swallowing the valuations of the large-cap

electrics that dominate the indices. While we hold few of these in our portfolio, they do tend to set a tone for the sector generally. For that same “some time” we’ve felt there wouldn’t be help from the indices (though we underestimated that, to be sure) and have focused on individual situations and their valuations in order to drive superior risk/adjusted returns. We’ve also thought that increasingly rare U.S. investor-owned regulated utility assets should be appealing now to foreign strong-currency investors with a long-term investment horizon (such as the group that bought Puget Sound), and we’ve no reason to change that view. There is a huge constituency worldwide for infrastructure investments; there will continue to be deals until there are none left to buy. The overall relevant sector benchmarks are bound to fluctuate, but our underlying premise continues to experience positive feedback.



Annual ADV Update

If you would like a copy of our current ADV Part II, please contact Marilyn at:
 (845) 679-9166 or marilyn@mhinvest.com.
 The ADV will be mailed to you, free of charge.

Distribution/Merging Utilities Composite Performance
 GIPS composite disclosure shown in US dollars

Preliminary	Distribution/Merging Utilities		S&P Utility
	Gross	Net	
Period to Date (3 mo's - 12/31/07)	3.8%	3.0%	7.5%
1 Year (ending 12/31/07)	10.8%	7.5%	19.4%
3 Years per annum (ending 12/31/07)	16.1%	12.7%	19.0%
5 Years per annum (ending 12/31/07)	17.3%	13.8%	21.5%
7 Years per annum (ending 12/31/07)	8.6%	5.5%	3.7%

The Distribution/Merging Utilities Composite focuses on investments in public securities of undervalued small and mid-capitalization utility companies subject to acquisition. The S&P Utility Index is an unmanaged, market-value-weighted total return index of all utility stocks in the S&P 500. See full disclosure on page 3.

FUNDAMENTAL CHARACTERISTICS

Yield	2.8%
Proj Dividend Growth	6.3%
Payout Ratio	42%
Market Cap	\$9.8 Bil
Price/Book	2.2
P/E Ratio	17.4
S&P Rating	BBB+
Beta*	0.38
R-Squared*	16.9%
Standard Deviation	12.8%

*Relative to S&P 500, 1/31/99 - 12/31/07 (Weighted Averages)
 Sector pie chart is taken from a representative account. Information is supplemental to the performance disclosure on page 11.

Income-Equity Strategy continued from page 5...

We're not the only one's upping our stake—insiders continue to buy in large size with regularity.

To make room we sold Microsoft on a price spike. We'd waited long for a substantial change in dividend policy after their big special dividend some time back. While the company has been growing its payout rapidly, the yield is still on the small side for this portfolio, and our estimation of its capital appreciation possibilities doesn't compensate for that small yield, as it might in other cases. Pitney Bowes needs to re-work its business plan, after a move to sales of equipment from rentals has failed to improve the bottom line, and growth is slowing. We sold this one, a small position, but could come back after successful repairs, as it remains a financially strong company with a solid franchise. We began reducing Precision Drilling (PDS). We waited a respectable amount of time for activity in western Canada to pick up from its moribund pace, but this is obviously not going to happen now without much higher natural gas prices. Perhaps to add a nail in PDS's coffin the government of Alberta imposed new taxes on producers. We've still kept a bit—the company has managed beautifully through a perfect storm of difficulties not of their own making, and its assets are valuable, but we do have more timely uses for our funds that have good long-term prospects as well. We also had a small position since last spring in Citicorp—our only position with direct connection to the current crisis. We didn't like what was happening, but while we were awaiting an exit-bounce the CFO volunteered that the dividend was safe. Since no one had asked about it, we took that as an indication the dividend was not safe, and exited at an embarrassingly low price but still higher than it is now. No longer even a little involved, let us be blunt: the company should have cut the dividend rather than make that awful deal with the Abu Dhabi Investment Authority.

LOOKING FORWARD

Some of the higher-yielding stocks that dragged down performance in the third quarter were also problematic in this past quarter, but the good news is that some were not. Potlatch, most of our MLPs, Diana Shipping, Macquarie, and others provided healthy positive returns and helped the portfolio. Others are showing signs of bottoming. Chances of a near-term resumption in absolute and relative strength have increased, in our view. And relative performance across the board as the new year opens has been very good.

Our portfolio currently yields approximately 6%, with a projected growth of yield of over 8% (in the past twelve months our current holdings increased dividends by a weighted average 8.5%). The yield is substantially higher than long-term treasury bonds, and one is not likely to find greater income, with inflation protection through dividend growth, in any other investment that also offers solid financial strength credentials. Though equity prices may bump and burp, our income has continued to grow through thick and thin. It is not volatile, it compounds by itself, no matter what the markets may do.

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