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INVESTMENT STRATEGY OUTLOOK

July 2000

The first six months of the year continued a pattern of volatility which was enough to make your head spin. In our last three communiqués to you, we warned of the excesses we saw in the marketplace, particularly in the technology, biotech and telecom areas. We specifically focused on some of the more egregious valuations of companies such as Amazon (now down 70% from its high) in our January Investment Strategy Outlook, and Microstrategy in our "Random Thoughts" piece dated March 7 (down 90% since its March high). Many of the Internet e-retailers have experienced declines of 70-80%. In the technology-laden NASDAQ, after advancing 24% from January 1 to March 10 of this year, the Index declined by over 44% through the end of May, matching the decline that the NASDAQ suffered during the market crash of 1987. The USA Today Index of Internet Stocks, through June, was down 38%. All the major indices, including the Dow, S&P, and Russell experienced down second quarters. The volatility in the stock market has increased dramatically in recent years and so far 2000 has been the most volatile year on record. This volatility conjures up a thought from John Maynard Keynes' 1936 classic on investing, The General Theory of Employment, Interest Rates and Money. Keynes was probably one of the most influential economists of the 20th Century, and was a sophisticated and experienced investor who understood well the nature of the psychology of investing. In his book, Keynes stated the following:

> *"A valuation, which is established as the outcome of the mass psychology of a large number of ignorant individuals, is liable to change violently as the result of a sudden fluctuation of opinion, due to factors which really do not make much difference - since there will be no strong roots of conviction to hold it steady."*

To us, this pretty much sums up the environment we have experienced in the last several months in the areas referenced above. Many individuals who have purchased these securities have done so for no other reason than that the stock prices have moved up, and they wanted to "get on the bandwagon." Many of those "investors" had little or no understanding of the fundamentals of the companies they owned, nor the valuations they carried. As a result, when the prices began to decline, investors ran for the door, again, simply because the stock prices were declining. Many suffered significant financial damage.

Anyone who has followed the markets realizes that there has been significant damage wrought on many technology, Internet and biotech stocks. In the environment that we've experienced, Wall Street has dramatically reassessed many investments, and in some cases, ceased funding them to the extent that they did as recently as the end of March of this year. Yet, volatility reigns, and many speculative stocks have seen large moves again. As a group, we think it will be difficult to make money in these sectors. However, we will continue to monitor individual stocks, as we believe there will be opportunities at attractive valuation levels.

Against this backdrop, we were able to fare rather well with our value approach in a very volatile and difficult second quarter. Recent weeks have seen further encouraging strength in our portfolio holdings, but looking at short-term results these days is a little like the weather in Milwaukee - it can change quickly.

Predictably, cash flows have continued to move into technology stocks that haven't "cracked." The following table, courtesy of the High Tech Strategist, is a list of the 40 largest NASDAQ stocks by market capitalization. Almost all are either technology stocks, telecom or biotech companies. These 40 companies represent roughly 50% of the market capitalization of the NASDAQ, yet constitute one percent of the companies (40 of 3953 companies) in the Index. Additionally, these 40 NASDAQ stocks advanced 12 percentage points in the first six months (the NASDAQ was down 2.5% through June 30);

thus, the other 3913 companies declined roughly 18%. Eight of the companies listed are not earning money, while the price/earnings ratio of the other 32 companies (excluding Juniper Network's P/E of over 4000x) is over 230x. Over half of the 40 stocks have triple-digit price/earnings ratios and sell at 35x book value and 50x sales. This compares to your average company, which sells at 2.1x book value, and 1.3x sales. These 40 NASDAQ companies now account for $3.25 trillion of value, or almost one quarter of the total capitalization of all U.S. equities. Yet, even with what we would consider extreme valuations, these companies have moved up considerably over the last 52 weeks. In many respects this is typical of what has occurred in past stock market bubbles; when overpriced groups such as the Internet stocks unravel, as they have in the past three months, the knee-jerk reaction of investors is to pile into the perceived "quality" names, such as these forty stocks, regardless of valuation.

STILL GROSSLY OVERPRICED

Top 40 Nasdaq Stocks as of 7/2/00

	7/2/00 Price $	P/E Ratio	Market Cap ($ Billions)	Price / Book	Price / Sales
Intel	133 11/16	58	453	12	15
Cisco Systems	63 9/16	177	449	22	27
Microsoft	80	48	418	11	19
Oracle	84 1/16	120	227	37	25
Ericsson	20	87	161	20	7
Sun Microsystems	90 5/16	100	143	22	11
WorldCom	45 7/8	30	130	3	4
Dell	49 15/16	77	126	23	5
JDS Uniphase	119 7/8	N/A	98	13	74
Applied Materials	90 5/8	56	74	13	11
Amgen	70 1/4	68	71	22	22
Yahoo	123 7/8	539	69	42	97
Broadcom	218 15/16	476	48	72	87
Nextel	61 3/16	N/A	44	20	11
Juniper	145 9/16	4159	46	97	237
Qualcomm	60	77	45	8	12
Veritac	113 1/64	278	11	11	53
Comcast	40 1/2	39	37	2	5
Siebel Systems	163 9/16	260	33	40	40
Level Three Comm.	88	N/A	33	6	51
Tellabs	68 7/16	49	29	13	12
Sycamore Networks	110 3/8	N/A	28	18	165
Xilinx	82 9/16	110	28	15	28
PMC Sierra	177 11/16	265	26	94	89
Redback Netwks	179 1/8	N/A	26	6	152
ADC Telecom	83 7/8	95	27	15	11
Voicestream	116 19/64	N/A	26	7	18
Network Appliances	80 1/2	383	25	59	48
Immunex	49 7/16	353	26	54	43
Infosys	177 1/4	377	24	118	115
Ciena	166 11/16	981	24	38	40
Global Crossing	26 5/16	N/A	22	2	6
SDL Inc.	286 3/16	648	23	42	92
Altera	101 15/16	84	21	17	23
3Com	57 5/8	31	19	5	4
Linear Technologies	63 15/16	82	20	17	33
Brocade Communications	183 1/2	834	20	185	138
Tibco Software	107 15/64	N/A	21	145	112
Maxim Integrated Tech.	67 15/16	87	20	17	28
Palm Computer	33 3/8	371	18	18	17
Averages		**230**		**35**	**50**

Table courtesy of Fred Hickey, Editor; The High-Tech Strategist; Issue #152; July 3, 2000

Although many visible NASDAQ stocks have rebounded, very few have reached previous highs, and there remains a disturbingly high number of "bombs" (i.e. Computer Associates, BMC, Compuware). We believe the entire group will eventually suffer significant declines not dissimilar to that which the Internet sector experienced in the first half of this year. We still strongly believe that there are further significant declines ahead for those individuals who are heavily invested in the technology sector. The valuations, by any historic yardstick, are simply out of line and we think this sector is in for an extended period of under-performance.

As we've said in our past letters, we continue to believe your portfolio is quite reasonably valued at only 14.1x this year's estimate, and 11.5x our 2001 estimate. While we are pleased to see the strong relative performance of your stocks in the first half of 2000, we think we are at only the beginning of what will be a protracted period of relative out-performance for our type of investing.

Economy

Investor attention has been focused on the Federal Reserve and its attempt, for the past year, to slow economic growth from the torrid pace indicated by the 5.5% real growth experienced in the first quarter. Early reports seem to suggest that the Fed, with its most recent 50 basis point increase in May, is having some success. Indications for the second quarter point toward real growth somewhere between 3.3-3.6%. Whether this rate of growth is slow enough to forestall another rate increase in August is still unclear. Recent data, including the government report that June employment growth was weaker than expected, was received positively by Wall Street. Consumer confidence, while still very high, has moderated as well in the last couple months. Weaker retail sales notwithstanding, consumers still view economic prospects favorably. Higher interest rates began to have some impact on new home sales in the month of May, as well as sales of existing homes. Given the current mortgage rates of 8.5%+, the rate of both new and existing home sales will most likely show further moderation in the months ahead. In line with other recent economic reports, personal income and spending growth have both eased in the last couple of months, while the savings rate has increased, but only modestly. In our view, there is little doubt that the wealth effect of the stock market of the last couple of years has had some impact on consumers' willingness to spend beyond what historically would be their normal pattern of consumption. As an engine for future growth in the economy, we think it unlikely that consumers can continue spending at the rate of the last 24 months. Therefore, with the ratcheting up of interest rates and a somewhat extended consumer (still accounting for two- thirds of the overall economy), we feel it is likely that the Fed's impact, coupled with the aforementioned items, will lead to slower economic growth. If, however, growth does not moderate into the 3.0-3.5% area, we have no doubt that the Fed will continue to raise rates.

Against this backdrop, corporate profits continue to be reasonably robust. Most economic forecasters and market analysts predict a 14-18% earnings growth rate for the Standard & Poor's 500 this year. The companies in your portfolio are experiencing a rate of growth quite similar to the S&P this year, but as we have discussed in our past few letters, the valuations on the Fund portfolio is still only about half that of the S&P 500. Specifically, the Fund sells at 14.1x this year's estimate, while the S&P boasts a multiple of roughly 27.5x earnings. We believe that this continued very favorable relative valuation gap, in favor of your companies, is one of the major contributing factors to the strong relative performance we have experienced in the first half of this year, and most importantly, will be the greatest factor in what we see as a two- to three-year period of very strong relative outperformance for value-type investments, such as those in your portfolio.

We are extremely optimistic about the continuation of these prospects, and as always, thank you for your continued support and belief in our approach to value investing here at Fiduciary Management, Inc.