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INVESTMENT STRATEGY OUTLOOK

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The third calendar quarter and year-to-date period was difficult for stocks and one of the worst on record. While it is true that one cannot "eat" relative performance, our portfolios generally declined significantly less than the averages. For the calendar year-to-date, the respective declines for the Russell 2000 and S&P 500 were 25.1% and 28.1%. Our investment approach continues to shield us from the worst of the bear market, but losses are unpleasant nonetheless. While most of the decline in the stock market over the past two and one half years was due to the precipitous fall of the technology, telecom and high valuation sectors, there was a sharp correction in almost all stocks in the last month or so of the September quarter and we were not spared.

Investors continue to be concerned about economic growth, terrorism, war and corporate malfeasance. These four issues beget fears of falling employment, consumer confidence, capital spending and higher energy prices. There is, at least as of this writing, widespread pessimism. In short, it looks like a classic bear market.

Use of the word "classic" with respect to a bear market might suggest a pattern and perhaps something predictable in nature. Unfortunately, that is not the case; however, we thought it would be instructive to illustrate past bear markets so as to put the current one into perspective. The following table is courtesy of Crandall, Pierce & Company.

Bear Markets Since 1900 (102.75 Years)
As Measured by the Dow Jones Industrial Average

Market Peak	Market Trough	Decline	Duration
February 5, 1900	September 24, 1900	-22.53%	7.6 Months
June 17, 1901	November 9, 1903	-46.14%	28.7 Months
January 19, 1906	November 15, 1907	-48.54%	21.8 Months
November 19, 1909	February 24, 1915	-46.07%	63.2 Months
November 21, 1916	December 19, 1917	-40.13%	12.9 Months
November 3, 1919	August 24, 1921	-46.58%	21.7 Months
September 3, 1929	July 8, 1932	-89.19%	34.1 Months
September 7, 1932	February 27, 1933	-37.25%	5.7 Months
July 18, 1933	October 21, 1933	-23.03%	3.1 Months
February 5, 1934	July 26, 1934	-22.78%	5.6 Months
March 10, 1937	April 28, 1942	-52.20%	61.6 Months
May 29, 1946	June 13, 1949	-23.95%	36.5 Months
December 13, 1961	June 26, 1962	-27.10%	6.4 Months
February 9, 1966	May 26, 1970	-36.58%	51.5 Months
January 11, 1973	December 6, 1974	-45.08%	22.8 Months
September 21, 1976	February 28, 1978	-26.87%	17.2 Months
April 27, 1981	August 12, 1982	-24.13%	15.5 Months
August 25, 1987	October 19, 1987	-36.13%	1.8 Months
July 17, 1990	October 11, 1990	-21.16%	2.8 Months
January 14, 2000	September 30, 2002	-35.24%	32.5 Months
Average		**-37.53%**	**22.7 Months**
Median		**-36.35%**	**19.5 Months**

Data as of 9/30/02. Sources: Dow Jones & Company; Copyright © Crandall, Pierce & Company

The table shows the Dow Jones Industrial Average peak to trough price data along with the duration of the twenty bear markets of the last century. The twentieth bear market may have ended on October 7, at the Dow Jones close of 7423. (As of this writing, the Dow is 7501). If the October 7th price proves to be the low for this cycle, then the Dow Jones decline of 36.7% will be about average and the duration of 33 months will be significantly longer than the average for past cycles. As the table illustrates, the average decline is 37.5% and the average duration is 22.7 months. The longest bear market was 63 months (1909-1915) and the shortest was less than two months (1987). The deepest decline was 89% (1929-1932), and the most shallow was 21% (1990). There have been only five bear markets that have lasted longer than the current one.

It is not our custom to make predictions about the market and we will not do so here. We will point out, however, that the previous bull market was much longer and more powerful than any prior bull market. While equity valuations are getting more attractive, one could hardly argue that they are near the low end of historical averages. But they are now reasonable and given the low level of interest rates and inflation, the investment environment looks more positive than we have seen in awhile.

Many clients have asked about our views on the economy and the various issues mentioned in paragraph two. We have found over the years that the government statistics are usually late and often inaccurate. Throughout most of the summer the economic statistics suggested a nice, steady improvement in employment and the economy. Our opinion, based on anecdotal information and unscientific sampling, was that business was still very tough and that corporations and consumers were pulling in their horns. We continue to feel that excesses are still being wrung out of various industries and that certain sectors may not ever return to prominence. Despite heavy home refinancing activity, we are not expecting a big push from the consumer. Consumer and business indebtedness is very high and it will take time to buttress balance sheets. Business inventories are quite low, however, and this will aid in a potential cyclical recovery next year. Corporate cost structures have also been pared, which will help earnings when the economy recovers.

We think war and terrorism are issues not easily dismissed and which could linger for years. We are not concerned about a military victory in Iraq. We are concerned about our Middle East policy, the NATO alliance and how the USA is perceived by the Muslim world. These issues are beyond the scope of an investment letter. Suffice it to say that these big issues will likely keep a lid on valuations over the foreseeable future.

Despite the pessimism that abounds in these times, money can be made buying and holding good companies at reasonable prices. The performance of our equity portfolios over the past few years demonstrates this. We would like to highlight a few of your investments.

Proquest Company

Proquest has two divisions. The Information and Learning division is a leading publisher of information electronically, in microform and on paper. Customers include libraries in 160 countries and nearly every university library in the United States. The Business Solutions division publishes electronic parts catalogs and performance management systems, which are sold to approximately 38,000 automotive and powersports dealers and OEMs. Both businesses operate under a subscription model and thus exhibit a high degree of recurring revenue. The electronic parts catalog business is a wonderful business with real barriers to entry. Although it is a more modest grower, it generates significant free cash flow.

Proquest benefits from the movement to electronic media, which makes their products significantly more user friendly and facilitates more effective new product development. The company has a deep historical library of microform data that is being digitized and sold to researchers. The company has the world's largest commercial information archive and has, under long-term contracts, 18,000 periodicals and 7,000 newspaper files. Under their digital vault initiative, Proquest has digitized a number of projects, including nearly every English language book from the mid 1400s to the 1700s as well as *The New York Times* and *The Wall Street Journal* since their very first issues. Many more projects are under way. The XanEdu product line addresses the dynamic needs of teachers and professors by offering on-line and printed coursepacks and supplemental educational material.

Recently we spent a day in Ann Arbor evaluating some of the new products at Proquest. XanEdu, the digital vault initiative and the core Proquest search engine have terrific opportunities. We think they can be multiples of their existing size over the long term. The financial characteristics of the company are changing for the better, as a somewhat messy former corporate structure has been restructured. The stock is reasonably priced at less than seven times EBITDA and 14 times earnings.

Arrow Electronics

Arrow is a leading worldwide distributor of semiconductors, passive and other electronic components and subassemblies. The company also offers a variety of value-added services such as design, programming, inventory and supply chain management. Despite its relatively modest market capitalization, Arrow and its twin competitor Avnet, have a market share in excess of 50% of the components distribution business. The industry has undergone a tremendous consolidation over the past ten years and is poised for better profitability once the current cyclical decline has turned. We are optimistic about the long-term growth rate of semiconductors and Arrow is a call on this industry.

Arrow is an unusual stock from the standpoint that even though the fundamental growth of the company's earnings has been roughly in line with the long term growth rate of the semiconductor industry (10-15%), the stock has not kept pace. Unlike many OEM semiconductor manufacturers who have come and gone over the years, Arrow's competitive picture has actually improved. Prior to the recent industry downturn, the margin structure at the company in the 1990s was significantly better than in the 1980s. There is no denying the fact that the semiconductor industry is highly cyclical, and so is Arrow. Nevertheless, through a full cycle, the company's return on invested capital has been respectable and above average.

Normally we cringe when someone discusses an investment idea as "a trade." This connotes the notion that the stock isn't of long-term investment quality. We have always felt if a stock wasn't of long-term interest, it wasn't of short term interest either. It is plain to see looking at the history of Arrow's stock price, that long-term investors have underperformed the market. Yet we have done reasonably well over the years by lightening up on the stock when it gets rich and buying more when it gets cheap. While we yearn for the day when the market recognizes the true value of the enterprise (and a permanently higher multiple), we are not holding our breaths. Currently the stock trades at an enterprise value (market capitalization plus net debt) to sales multiple of .36. At the bottom of the Asian crisis market in 1998, the multiple was .40. The low point for the stock was .27 in the horrible technology and stock market environment of 1990. In good times, the stock has frequently sold north of .50 on an EV/Sales basis. If revenues exceed their previous peak by 15% over the next several years, this would translate into a stock greater than $50 per share versus the current price of $13.

Core Laboratories

Core Labs is a leading oil service company focusing on maximizing reservoir recovery. Our investment thesis is that the stock's current discount valuation should return to its historical premium versus its peer group. The company's services and products have relatively few direct competitors. In addition, their historic return on invested capital has been above average.

Unlike many others in the oil service industry, a majority of Core Lab's revenues is not tied to the North American rig count. Roughly two-thirds of revenues are international and mostly comprised of large-scale oil development projects run by major integrated oil companies or large independents. There is one division, Production Enhancement, which is affected by fluctuations in the largely natural gas-driven domestic rig count. Management is cutting costs here, as well as in a second division, to bring these near-breakeven divisions back to reasonable profit margins. Their largest division, Resource Description, representing 60% of total revenues, continues to perform quite well. Two services offered in this division, core sampling and fluids analysis, are fundamental to enhancing production flow and increasing ultimate reservoir recoverability. Demand for these services, which are high return on investment projects for oil companies, does not fluctuate as much as the typical oil service company's revenues.

The stock is attractively valued based on a reasonable industry recovery thesis in 2003 and beyond. The stock is approximately 10 times earnings estimates for next year and less than six times EV/EBITDA.

Thank you for your continued confidence in Fiduciary Management, Inc.