April 10, 2000

Enclosed are your statements for the first quarter of 2000.

For the quarter, equity investors saw price returns of 2.0% for the S&P 500, -5.0% for the Dow Jones Industrial Average (DJIA) and 12.4% for the technology-heavy NASDAQ. The higher returns for the technology area were also evident in year over year returns, as the price return of the NASDAQ for the last twelve months was a stunning 85.8%. The market values of Microsoft, Cisco and Intel are evidence of such extraordinary returns. These three technology companies now measure as three of the four largest companies in the world.

Also remarkable is the narrowness of company participation in these returns. In 1998, it seemed strange that the stocks of only 80 companies accounted for the performance of the S&P 500. Then, in 1999, we commented in this letter that the stock of only 30 companies accounted for the performance of the S&P 500. As if to prove that normalcy is not normal, that narrowness has narrowed even further. During the last twelve months, the stocks of only 18 companies accounted for the performance of the S&P 500.

In line with these trends is the continuing out performance of “growth” versus “value.” While such terms are too general, the concepts of dividend yield, stock volatility and predictability of earnings are specific and measurable. Analysis of these areas provides surprising answers. Over the last twelve months, stocks with virtually no dividends rose 44.9% while the stocks with highest dividends (2.89% and above) declined by 24.4%. Similarly, stocks with the highest volatility rose 41.7% while stocks with the lowest volatility declined by 18.4%. Finally, stocks with the lowest predictability of earnings rose 30.7% while the stocks with the highest predictability declined by 5.9%.

For the quarter, fixed income investors saw total returns of 1.25% for the Salomon 1-3 year Treasury Index, of 3.36% for the 7-10 year Treasury Index and of 8.07% for the 10+ year Treasury Index. These returns were affected by the combined actions of the U.S. Treasury and the Federal Reserve. In light of reduced deficit conditions, the U.S. Treasury is cutting the supply of certain U.S. Government bonds. This caused higher performance for long term U.S. Government bonds. The Federal Reserve continued to tighten monetary conditions by raising Fed Funds rates twice to the current level of 6.00%. This caused lower performance for the short-term U.S. Government bonds.

“Bubble” conditions continue. During the past quarter, margin debt accelerated to historical highs in the face of rising interest rates. Expectations of continuing high stock returns have triggered higher consumption. Hypercompetitive conditions have driven higher capital investment and increased leverage on corporate balance sheets. Raising rates have not slowed such activities.

In response to such conditions, we have exercised extreme caution. Yet, for the first time in nearly two years, such extraordinary conditions have allowed us to find some exceptional investment opportunities that we believe will bear worthwhile results for our clients. All of these came in the property and casualty insurance area, an area that we like for several reasons. First, insurance companies are driven by numbers that are more understandable than those in many businesses. Second, the numbers are on their side. (Have you ever felt like you got a great deal from an insurance company?) Third, insurance companies hold huge “float” which is the money they collect from premiums before they pay the money out as claims.

We will be building larger positions in these companies as market conditions allow for better pricing. For this reason, we would actually prefer to see these stocks go down until we have made all of our purchases (contrary to the hopes of many of our clients who would prefer to see these prices rise immediately).

We will continue a patient, but attentive search for the purchase of excellent companies at prices significantly under their intrinsic value. As always, we appreciate the stewardship responsibilities you have entrusted to us.

Academy Capital Management