July 7, 2000

Enclosed are your statements for the second quarter of 2000.

For the quarter, equity investors saw price returns of -2.9% for the S&P 500, -4.3% for the Dow Jones Industrial Average (DJIA) and –13.3% for the technology-heavy NASDAQ. The lower returns were driven by concerns about aggressive FED tightening. Strong growth continues to concern the FED and, thus, financial markets. For the year so far, equity investors saw price returns of –1.09% for the S&P 500, -9.1% for the Dow Jones Industrial Average (DJIA) and –2.5% for the NASDQ.

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 stocks 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 5 companies, 4 of them technology-oriented, accounted for the performance of the S&P 500.

For the quarter, fixed income investors saw total returns of 1.73% for the Salomon 1-3 year Treasury Index, of 1.97% for the 7-10 year Treasury Index and of 1.05% 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 once by 50 basis points to the current level of 6.50%. This caused lower performance for all U.S. Government bonds.

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

In response to such conditions, we have exercised extreme caution. Yet, we continue to find exceptional investment opportunities in the property and casualty insurance area, as we build on existing positions when stock volatility permits.

As we stated last quarter, 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).

Consistent with this reasoning, we would ask our clients "and their friends" to add "downward pressure on for-profit educational stocks" to their prayer list. We are close to making a significant commitment to the for-profit educational sector, an area we like for several reasons. First, the rate of change in our world is dramatically expanding the need for continuing education. Second, the usefulness of traditional educational models is declining in a technology-based world (would you want a jet pilot graded on an essay exam?). Third, the existing non-profit educational minimize the view of students as customers (as in "the customer is always right").

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