

THE TANDEM REPORT



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MARKET COMMENTARY

In our last column, we hailed 2000 as a year to appreciate. After the first quarter of 2001, we feel prophetic in an unintended way. Last quarter's steep market decline was both painful and historic, making 2000 an almost pleasant memory by comparison. The decline was painful because of its breadth and severity, historic because it ushered in a bear market.

By most definitions, a bear market is considered to be a decline of at least 20% from a market's high. At its low point during the quarter, the S&P 500 was down about 24% from its high in early 2000. While it appears the worst may have passed, investors still must ask themselves what to do now.

Before looking forward, it is helpful to survey the situation and assess the damage. As pointed out in our last issue, the stock market is a leading

economic indicator. The market started to falter in the spring of 2000. The economy caught up in late fall. As companies began to report or pre-report their earnings for the fourth quarter, signs of a dramatically slowing economy emerged. Future earnings expectations proved to be overly optimistic, and were revised downward. According to First Call/Thompson Financial, there were 1,223 negative earnings pre-announcements in the second half of 2000.

In response to the worsening economic conditions, the Federal Reserve made a surprise interest rate cut of 1/2% on January 3. By the end of January, the Fed had lowered rates a full percentage point in one month with no discernable effect. The economy, and the stock market, continued

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MARKET HISTORY: PUTTING THE MARKET'S DECLINE IN PERSPECTIVE

Perhaps the most destructive aspect of a bear market is its ability to inflict fear and panic onto the investing public. Emotional response to market declines is almost always predictably excessive. In light of the difficulties

investors have faced for the last year, we thought it an appropriate time to introduce some historical perspective.

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TOP TEN HOLDINGS IN THE TANDEM GROWTH COMPOSITE

AS OF MARCH 31, 2001

The list to the right reflects our ten largest holdings, ranked by total market value, in the accounts we manage that make up our Tandem Growth Composite. Remarkably, the declining market did little to change the order since our last report. That means that we were either in the right place, or no stock escaped the market's wrath. We suspect it was a bit of both.

The first four names remain unchanged since year-end. We took timely profits in AMGEN, causing that stock to fall from #5 to #8 on the list. Applied Materials and Microsoft returned after brief absences as a result of their strong performance during the quarter, while Home Depot debuted after a round of new buying by us. Cisco's and T. Rowe Price's fall from the list paralleled their fall from grace, while Dover disappeared as we decreased our holdings in the stock.

1. Merck & Co.
2. Pfizer, Inc.
3. AES Corp.
4. General Electric
5. Johnson & Johnson
6. Applied Materials
7. Microsoft Corp.
8. AMGEN, Inc.
9. Home Depot
10. Mellon Financial

More detailed information about the Tandem Growth Composite, its performance, and the accounts that comprise it are available upon request.

TANDEM NEWS

After months of tinkering, www.tandemadvisors.com is finally up and running. While it remains a work in progress, our aim is to provide added benefit to our clients. At present, those using UMB Bank to custody assets under our management may securely access their accounts through our site. We hope to add links to other custodians soon. Evolution of the site will be driven by input we receive from those who visit and offer their comments. We are committed to making this a valuable tool for our clients, and actively seek your input to help us create such a tool. In conjunction with this effort we would like to collect e-mail addresses from anyone wishing to communicate that way. Our addresses can be found at the web site, or on the back page of this issue.

We are very pleased to announce a formal investment advisory relationship with Caprin Asset Management, L.L.C. of Richmond, Virginia. Caprin specializes in the active management of state specific municipal bond portfolios on a separate account basis. By taking advantage of the volatility of interest rates, Caprin's active management of fixed income portfolios has produced added value for their clients without incurring significant risk. We have known of and admired Caprin's success for many years, and feel privileged to be associated with them. This relationship is an opportunity for Tandem to offer our clients

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SPOTLIGHT ON TYCO INTERNATIONAL

TYCO INTERNATIONAL (NYSE:TYC)

Recent Price: 50

Dividend Yield: 0.1%

Earnings Yield: 6.7%

P/E Ratio on F2002 EPS: 14.9

Earnings Per Share:	<u>F1998</u>	<u>F1999</u>	<u>F2000</u>	<u>F2001</u>	<u>F2002</u>
	1.01	1.53	2.18	2.76E	3.36E

Ordinarily, we reserve this space to feature stocks in our Top 10 list. While Tyco has yet to find its way into that group, it nevertheless has caught our attention, and we find it intriguing enough to write about. Like General Electric, last quarter's featured stock, Tyco International is best described as a conglomerate. Controlling more than 200 businesses worldwide, the company's products and services include electronics, healthcare, security and fire protection, pipe and tubing, and undersea fiber-optic cable. It recently announced plans to expand into the financial services industry with the proposed acquisition of commercial lending company CIT.

Most impressive about Tyco is the company's record of consistent earnings growth. Earnings per share have risen without exception each year since 1992. In that span, the lowest year-to-year rate of growth was 11.5% from 1992 to 1993. The average annual rate of growth has been 31.3%, and the consensus among analysts is that future growth will average approximately 22.5% annually.

Tyco's growth has come from a combination of internal growth of existing businesses and a series of key acquisitions. While the company has generated an impressive record of internal growth, it is most noted for its acquisitiveness. No company we follow is a more active buyer, and Tyco makes no apologies for this strategy. Nor should they, in our view. Tyco has demonstrated the ability to

add complimentary businesses that produce an almost immediate positive impact on earnings. The company anticipates that acquisitions will remain an integral part of its growth strategy.

In late January, the stock was trading at an all-time high of around \$63/share. After the proposed acquisition of CIT was announced in March, the stock traded as low as \$42/share. While the price has since moved up, we believe the company's valuation is reasonable. One of the many sets of historical data we analyze is a company's P/E relative to its rate of growth. Tyco's present P/E of 14.9 times 2002 earnings is half its historic growth rate. We rarely find such valuations in the market place.

Due to a certain amount of healthy skepticism on the part of investors, there is justification for the current valuation. At some point, Tyco will have to demonstrate an ability to manage all the companies it has acquired, as it will eventually become too large for acquisitions to have a meaningful impact on the company's bottom line. Further, the addition of CIT to its portfolio marks entry into a new, perhaps riskier industry. Questions remain.

That said, we admire Tyco's past performance, and believe that it is reasonable to expect similar earnings success in the future.



TANDEM NEWS

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high quality fixed income management when appropriate, and is consistent with our long-term goal of providing value and service to our clients. Simply stated, Tandem can continue to focus on managing equity and balanced portfolios for our clients, while providing professional fixed income management to those who require it. For its part, Caprin can continue to focus on its specialty, yet offer equity management to clients as well. Expect to see some timely economic and interest rate commentary provided by Caprin in future issues.

In February, Robert Northington decided to pursue

other interests. Robert served as our Director of Marketing for just under four years, and has been a friend for far longer. We will miss him in the office, and wish him the best in his future endeavors.

In March, our Charleston office moved into just completed space on beautiful Daniel Island. It took a bit longer to have the space ready for occupancy than we had anticipated, but the result was well worth the wait. Should you find yourself in the area, drop in and say hello. The new address can be found on the back page of this issue. The phone number remains the same.

MARKET HISTORY

(Continued from page 1)

According to the newly published *2001 S&P 500 Directory*, there have been 13 down years for the S&P 500 since 1951. Of those 13 down years, only 2 were in succession — 1973 and 1974. That period of time was marked by President Nixon's ill-advised imposition of wage and price controls and the Arab Oil Embargo, as well as the hangover of the poor economic policies of the sixties. Today's climate would appear to be much more conducive to prosperity.

Further analysis of the stocks that compose the S&P 500 unveils some striking changes over time. We often hear of the overvaluation of stocks. While there is certainly merit to that assessment, perhaps there is some justification for higher valuations. Between 1989 and 1999, earnings for the S&P 500 grew 122.3%, while dividends grew at a much slower 47.4%. In the first quarter of 1990, the companies in the S&P paid out, on average, 52.2% of their earnings to shareholders as dividends. In the fourth quarter of 1999, only

34.7% of earnings were paid out as dividends. This trend could lead one to the conclusion that investors place a higher premium on earnings growth and share price appreciation than they do dividend income. As a result, companies are clearly retaining a higher percentage of their earnings to fuel future growth. If payouts are lower by design, valuations should be higher as a result.

One other item of relevance is the history of the market's reaction to declining interest rates. According to CNBC's Mark Haines, 12 of the 13 previous Federal Reserve rate cuts have led to a higher market twelve months after the initial cut. We are almost five months removed from the Fed's first cut this time around, and there are signs of optimism creeping into the market.

We offer these anecdotes in an effort to keep things in perspective. As investors, we have all faced difficult times, and we certainly will again. We must remember that this, too, shall pass.



MARKET COMMENTARY

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to worsen. A third rate cut again failed to bring about relief.

This sequence of events leaves us to ponder under what scenario investors will begin to buy again. The great bull market of the 1990s was fueled by liquidity, and suddenly buyers seemingly have disappeared. Just as the market decline preceded the economic slowdown, a market rebound will most assuredly precede economic expansion. History tells us that Federal Reserve rate cuts take some time - perhaps six months or so - to have any meaningful economic impact. And while present circumstances make it difficult for one to perceive light at the end of the tunnel, the Fed has cut rates dramatically. Lower interest rates will have a positive effect eventually. Our contention is that the market will predict in-

creased economic activity.

It is not our intention to dismiss the painful and destructive effects of the bear market. However, we continue to be optimists. The market decline was severe, but bear markets are in large part a result of human emotion rather than rational behavior. Just as the stock market benefited from irrational exuberance, it is now being punished by excessive fear. The economy may have slowed, and earnings may have stumbled, but we view this as a bump in the road of a significant period of economic expansion fueled by a technological revolution. We must ask ourselves where we see the economy, and our companies, a year from now, or two years or even five years from now. We cannot predict *when* the market will turn positive, only that it will. For those investors with discipline and patience, the future remains bright.

A FEW TIMELY WORDS ABOUT INVESTMENT DISCIPLINE

We felt this an appropriate time to revisit some basic principals of investing. Often times, investors react to the market by making emotional decisions rather than rational ones. In turbulent times, it is essential to remain disciplined.

There are many sound approaches to investing, but none can work successfully unless strictly adhered to. At Tandem, we believe it is our job to achieve a competitive rate of return with reduced risk across a *complete* market cycle - peak to trough to peak. To accomplish this for our clients, we rely on the time-tested strategy of buying growing businesses at reasonable prices.

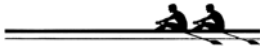
When the market moves up, it is easy to adhere to a strategy. The challenge is to remain as disci-

plined when the market forces conspire against us. An investor must always be aware of all possible scenarios. When in a bull market, we must remember that things will get worse. When in a bear market, we must remember that things will get better. We cannot afford to panic and react to a market. By the time the market has moved down, it is too late to do anything about it.

We believe our approach affords us some measure of comfort in this bear market. We own solid companies with excellent future prospects, and we are confident we paid reasonable prices for them. The market may be down now, and it may indeed be troubling. Switching styles in midstream will not recover losses, but will likely result in missing out on future gains. Trust your investment discipline.



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*...working in tandem with you to
attain your investment goals*

Tandem Investment Advisors, Inc. was founded in 1990 to provide professional portfolio management with uncompromising service to investors. For more than a decade, we have worked in Tandem with our clients to attain their investment goals. If you would like more information, please contact one of us at the following:

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