

THE TANDEM REPORT



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MARKET SCORECARD:

S&P 500:

<i>1 year ended 12/31/01</i>	-13.04%
<i>3 years ended 12/31/01</i>	-2.25%
<i>5 years ended 12/31/01</i>	9.15%
<i>7 years ended 12/31/01</i>	13.97%
<i>10 years ended 12/31/01</i>	10.65%

MARKET COMMENTARY:

WHAT A DIFFERENCE THREE MONTHS CAN MAKE

Imagine the following scenario: As the summer winds down, the United States economy is in recession and the stock market is well-entrenched in a meaningful bear market. The Federal Reserve has cut interest rates seven times, with no perceptible effect. Corporations are laying off workers as earnings erode, and investors are dumping stocks. Against this economic backdrop, terrorists hijack four commercial aircraft and use them as bombs on the World Trade Center and the Pentagon, killing thousands of innocent people and destroying the world's most recognizable skyline. As a result of the devastation in lower Manhattan, the New York Stock Exchange is forced to close for four days. When it reopens, the market sells off substantially. In the aftermath of the attacks, travel comes to a

virtual halt, causing economic activity to recede further. One would be hard-pressed to create a more bleak economic picture, yet this was the environment investors were forced to confront as the third quarter came to a close.

As we entered the fourth quarter, our nation found itself at war with an enemy that was difficult to define, much less locate, and we faced fears of further acts of domestic terrorism. Anthrax was now part of our vocabulary, and our knowledge of geography was expanding daily. It is difficult to recall a time of greater uncertainty, and this time it wasn't just about the economy.

Here is a multiple choice test that

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RANDOM TOPICS

The S&P 500 declined for the second straight year, the first time this index has experienced back-to-back declines since 1973 and 1974. In fact, these are the only two instances of consecutive declines since 1952. During that span, the market never contracted three years in a row. Perhaps

some optimism for the year ahead is justified.

Enron has replaced Afghanistan on front pages and evening news, and fortunately, we didn't own any

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TOP TEN HOLDINGS IN THE TANDEM GROWTH COMPOSITE

AS OF DECEMBER 31, 2001

The fourth quarter brought a strong and welcome rebound from the lows of September. Technology was by far the best performing sector we follow. Of the names in our Top 10, Applied Materials was up 41.0% and Microsoft gained 29.5%. Other tech names we own outside the Top 10 did equally well. Cisco was up 48.7%, Intel was up 53.9%, IBM was up 31.9%, and Sun Microsystems was up 48.7%. Certainly, all of these names remain well below their highs, but the recovery of their stock prices is a constructive sign.

The S&P 500 advanced 10.3% for the quarter. Some other solid performers on our list were Home Depot (+32.9%) and Tyco (+29.5%). The laggards were the pharmaceutical companies. AMGEN declined 4.0%, Merck 11.7%, and Pfizer 0.6%. Johnson & Johnson was the only one that bucked the trend, gaining 6.7%.

1. General Electric
2. Johnson & Johnson
3. Microsoft Corp.
4. Pfizer, Inc.
5. Merck & Co.
6. Tyco International
7. Home Depot
8. Exxon Mobil Corp.
9. AMGEN
10. Applied Materials

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

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would have been fun to take on September 17, the day the market re-opened. Imagine trying to answer the following question at that time:

Given the bleak set of economic circumstances outlined above, the fourth quarter will see the market:

- A.) Crash
- B.) Sell off to new lows, prolonging the bear market
- C.) Gain 10.3%

How many of us would have selected C? What a difference three months can make. In spite of the disasters at every turn, the market digested all the bad news and rallied sharply. Believe it or not, the

S&P 500 actually advanced 10.3% for the quarter, as investors became optimistic that the worst was behind us. How is it that the stock market rallied in the midst of such uncertainty?

The answer, quite simply, is that money talks. Since September 11, the Federal Reserve has cut interest rates four more times. Since January 3, 2001, the Fed has lowered the Federal Funds rate a total of eleven times, with the rate moving from 6.5% to the present 1.75%. That is an unprecedented drop in rates, and is very powerful medicine. In fact, it means that real rates (adjusted for inflation) are almost zero. Rates this low are expected to make individuals borrow and/or spend money, which spurs economic growth. It certainly had the desired effect for the automobile

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PFIZER, INC. (CONTINUED)

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have proven to be greater than anticipated. Further, the company has consistently met expectations on sales and earnings forecasts, giving Wall Street added comfort with Pfizer's dependability.

From a valuation standpoint, the stock is as cheap as it has been in more than five years. That does not mean that it will not get cheaper, but it is encouraging. The price of Pfizer shares soared in the late 1990's with the Viagra rollout, establishing a

high of \$50/share in 1999. Since then, the stock has traded in a range between 30 and 49. There is little impetus for the stock to break out of this range in the near future, but as long as earnings continue to grow, upward pressure will mount.

Pfizer has tried the patience of its shareholders the last few years, as pharmaceutical stocks have been out of favor. We continue to view the company as one of the best, and an essential core holding in a long term growth portfolio.

SPOTLIGHT UPDATES

AES Corp. - We featured AES in the July, 2001 issue at a price of \$36.68. Shortly after that, the company warned that it would have difficulty meeting earnings expectations this year as a result of a slow down in acquisitions, and some currency translation issues, particularly with the Brazilian real. The stock price is presently about half its value at the time of our report. While we are less than pleased with the developments, we remain optimistic, but less confident, that the company is still capable of delivering the long term growth we anticipated. We will continue to hold AES to allow time for the company to overcome the near term difficulties it faces.

Microsoft - Since our report in October, 2000, Microsoft has had a substantial amount of good news. Earnings continue to grow at an impressive rate, the Justice Department's pursuit seems to have diminished a bit, and the rollout of the much-anticipated *X box* in time for Christmas was a success. While lawsuits continue to nip at the company's heels, Microsoft seems to be clearly focused on the future. We continue to view the shares of Microsoft as a core holding in a long term growth portfolio.

General Electric - Since our report in January, 2001, GE's shares have performed roughly in line with the market. However, earnings have grown as promised, and the transition from legendary CEO Jack Welch to his hand-picked successor Jeffrey Immelt has occurred without any outward signs of difficulty. Mr. Immelt has promised to deliver the results Wall Street expects, despite the economic slowdown. We like the stock, and we like management.

Tyco International - This company was featured in our April, 2001 issue, and has been a solid performer in our Top 10. Tyco has grown at an impressive rate through a combination of strategic acquisitions and growth in existing businesses. However, investors have failed to place the premium on these shares that management thought was deserved. Consequently, the company has elected to split itself into four separate, publicly traded units in an effort to maximize shareholder value. As news of this restructuring is still emerging at press time, we will monitor these developments and report again later. The early reaction from Wall Street has not been positive. The long term impact remains to be seen.



MARKET COMMENTARY (CONTINUED)

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manufacturers. When consumers were given the opportunity to buy a new car and borrow the money at zero percent interest, new car and truck sales boomed.

The Federal Reserve isn't the only group determined to get the economy going again. The President and Congress have been busy drafting their own economic stimulus plans, and substantial sums of money have already been allocated to rebuild after the terrorist attacks.

While it remains to be seen if these stimuli will have their desired effect on the economy, they have clearly boosted the stock market. As we have discussed numerous times in these pages, the market is a predictor, not a reactor. The market anticipates that lower interest rates and increased government spending will stimulate growth, and therefore earnings. Thus, stock prices have rallied in anticipation.

The world has changed dramatically in the last

three months. Rather than ringing their hands and fretting over their fates, investors have wisely chosen to look ahead. Imagine the potential of the next three years. Without a doubt, the internet bubble has burst. But the advancements technology can offer are only just being discovered. The world will indeed be a very different place, and wise investors will be rewarded.

The lesson to be learned is that too often investors react to what has already occurred, rather than keeping a clear focus on the potential of the future. We have been in a very deep and painful bear market. To react now is to react after the fact. Timing the market or changing philosophy is a no win game. We must be forward looking, and stick to our discipline. Stock prices are down, but good businesses continue to thrive. As economic growth returns, so will profits.

We urge all investors to stay the course and keep the faith. Bear markets are painful, but, so far, they have always ended. And the stocks of good companies reward patient shareholders.

RANDOM TOPICS (CONTINUED)

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shares. America loves a good scandal, though. With all the scrutiny given Enron's demise, it is likely that laws will change, and those responsible will be punished. The toll exacted on the employees and shareholders of Enron is tragic, to say the least. The one positive (albeit painful) lesson that can be taken from this debacle is that a free market, when left to its own devices, works. Enron was once the seventh largest publicly traded company in the U.S. Investors got hurt, but the market absorbed the losses and moved on. Now comes K-Mart. Free markets allocate capital efficiently, and weed out those that

cannot survive. The process is painful for many, yet we all ultimately benefit from a system that allows each of us to act in our own self-interest without interference.

Some recommended business reads:

Good to Great—Why Some Companies Make the Leap... and Others Don't by Jim Collins

challenging, but well worth the time.

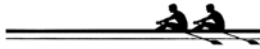
Who Moved My Cheese? An Amazing Way to Deal with Change in Your Work and Your Life

by Spencer Johnson

a quick, entertaining, and useful read.



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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 we can provide further assistance, please contact one of us at the following:

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