



# Auxier REPORT

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## AUXIER FOCUS FUND PERFORMANCE UPDATE FISCAL YEAR ENDED JUNE 30, 2003

### AUXFX RETURNS VS. S&P 500 INDEX

	AUXIER FOCUS FUND	S&P 500 INDEX	DIFFERENCE
3/31/03 - 6/30/03	15.64%	15.39%	0.25%
12/31/02 - 6/30/03	9.47%	11.76%	-2.29%
12/31/01-12/31/02	-6.79%	-22.10%	15.31%
12/31/00-12/31/01	12.67%	-11.88%	24.55%
12/31/99-12/31/00	4.05%	-9.10%	13.15%
since Fund's inception 7/9/99	23.12%	-26.56%	49.68%

**The one-year average annual total return for the Auxier Focus Fund as of 6/30/03 was 5.72%.**

*The S&P 500 Index is a widely recognized unmanaged index of common stock prices and is representative of a broader market and range of securities than is found in the Fund's portfolio. Individuals cannot invest directly in the index. Performance figures reflect the change in value of the stocks in the index, and reinvestment of dividends. The index returns do not reflect expenses, which have been deducted from the Fund's return. The performance of the Fund is computed on a total return basis, which includes reinvestment of all dividends and capital gains. THE FUND'S RETURN REPRESENTS PAST PERFORMANCE AND DOES NOT PREDICT FUTURE RESULTS. Investment returns and the principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. The returns shown do not reflect deduction of taxes that a shareholder would pay on Fund distributions or the redemption of Fund shares.*

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### Management Discussion of Fund Performance

Dear Fellow Shareholders,

The Auxier Focus Fund ended the second quarter with a return of 15.64%, versus 15.39% for the S&P 500. The stock portion of the Fund actually appreciated over 21%. Part of the reason for the lag was due to corporate bonds purchased last year during a liquidity crisis, where yield spreads over treasuries reached 20-year highs. Senior corporate bonds were selling at price levels representing lower risk than the stock market, but with equity-type upside. When analyzing businesses for purchase we look at the entire capital structure. We try to think like a creditor. I have followed Waste Management stock since 1983, when it was trading at 9 times earnings, and determined that it was time to sell in the late 1980s when it was trading in excess of 30 times earnings. After following the company for 20 years, I have determined that Waste Management's

bonds are now the right investment for the Fund. Over the past year the Waste Management 7.35% bonds of 2010 (0.45% of the Fund's portfolio) provided a total return of over 25%. To help mitigate risk, the Fund will typically have "event driven" arbitrage situations where the potential return is based on a specific management or corporate action as a catalyst instead of the direction of the general stock market. The urgency to clean up balance sheets made the senior corporate bond area attractive.

The Fund strives to match the good markets and excel in the flat-to-down markets, while taking less risk. This approach is based on determining favorable odds through in-depth research on facts and fundamentals. When the price is right and the risk/reward is compelling, we want to move. Otherwise we wait. We are watching for mistakes and irrational behavior. Our goal is to be rational when others aren't.

## **AREAS OF MOUNTING CONCERN**

### **Bonds**

This past year investors have poured over \$30 billion into US government bonds as rates were dropping to 45-year lows. Ironically, the government's reflationary policies in the form of tax cuts, deficit spending and an accommodative monetary policy are unprecedented. The lower interest rates go, the higher the risk of principal loss if there is a pickup in inflation. An investor needs to monitor all classes of investment as each class has the potential to be transformed into "high risk" due to easy money, irrational behavior and detachment from fundamentals.

### **Derivatives**

Derivatives were originally designed to hedge risk. Their explosive, unregulated growth, together with inadequate accounting, has created a potentially lethal situation. Corporate derivative valuations are suspect. Any time there is growth without controls . . . watch out. Enron is a good example of what can happen with derivatives and the lack of proper accounting.

### **Housing**

John Templeton is a top global investor with valuable wisdom gained from investing in the world markets for over 70 years. He warns, "Every previous bear market in stocks has been accompanied by a bear market in home prices. This time home prices have gone up by 20%, and this represents a very dangerous situation. Almost everyone has a home mortgage, and some are 89% of the value of the house. When home prices start down they will fall remarkably far. In Japan, home prices are down to less than half of what they were at the stock market peak. A home price decline of as little as 20% would put a lot of people in bankruptcy." Despite house price appreciation, home equity is close to 50-year lows as consumers are spending their equity. The manufactured housing industry shows the results of lax, undisciplined credit standards. Last year out of approximately 160,000 new manufactured homes, 97,000 were repossessed.

## **OPPORTUNITIES**

Events like the Iraq war or the 9/11 tragedy underscore the necessity to seek a margin of safety when investing. That is why many of the Fund's purchases take place when there is some kind of bad news or controversy surrounding a quality asset. Bad news sells newspapers and can unduly impact stock or bond prices. We like it when all the bad news is out. A number of industries are

suffering from sharp downturns and represent attractive long-term valuation levels. The utility industry has suffered from extreme indebtedness following deregulation, which is leading to attractive price levels. This together with the potential repeal of the Public Utility Holding Company Act may lead to profitable restructuring plays. We are monitoring a number of companies and are waiting to see a turn up in fundamentals before committing.

With the mad rush to buy any kind of yield, many high quality, high return businesses have fallen out of favor and have seen their premium valuations compress. This is similar to the post-crash period in 1988 when we were able to buy some of the great global franchises at a discount as investors were running for cover.

## THE POWER OF COMPOUNDING

“Compounding is mankind’s greatest invention because it allows for reliable and systematic accumulation of wealth,” said Albert Einstein. The table below illustrates the importance of properly managing even small sums of money.

### Start With \$1000, and Add Nothing More

Average Yearly Return	Number of Years				
	10	20	30	40	50
2.5%	\$1,280	\$1,639	\$2,098	\$2,685	\$3,437
5.0%	\$1,629	\$2,653	\$4,322	\$7,040	\$11,467
7.5%	\$2,061	\$4,248	\$8,755	\$18,044	\$37,190
10.0%	\$2,594	\$6,727	\$17,449	\$45,259	\$117,391
12.5%	\$3,247	\$10,545	\$34,243	\$111,199	\$361,099
15.0%	\$4,046	\$16,367	\$66,212	\$267,864	\$1,083,657
17.5%	\$5,016	\$25,163	\$126,222	\$633,162	\$3,176,094
20.0%	\$6,192	\$38,338	\$237,376	\$1,469,772	\$9,100,438

*The returns shown are hypothetical and do not represent actual returns for the Fund. Performance returns were calculated after the periods shown, based on total return, including gains or losses plus income, and include reinvested dividends. These returns do not reflect the impact that material economic and market factors might have had on the advisor’s decision-making with respect to the Fund’s investment portfolio.*

This illustration of the overwhelming positive effect of compounding reinforces our strong aversion to permanent capital loss. It also shows how worthwhile every extra percentage point of outperformance can magnify results over the long-term.

Thank you for your support!

Jeff Auxier