AUXIER FOCUS FUND UPDATE
BY JEFF AUXIER

Dear Fellow Shareholders:

For the 12-month period ended December 31, 2000 the Auxier Focus Fund gained 4.05%. This compares with a 10.13% decline for the S&P 500 and a 39.28% decline for the tech-weighted NASDAQ index. SOURCE: The Wall Street Journal

Although this is the first full calendar year of the fund, your manager has over 16 years of experience managing high net worth client portfolios. Some of the benefits of this new fund include:

- A smaller size allows for greater flexibility and a wider universe of investment choices.
- The stock positions are new and have minimal embedded tax liability.
- The manager is the single largest shareholder.
- The investment philosophy is sound, based on a long term, price/value approach with a margin of safety mentality.

In order to compound money at high rates it is important to avoid permanent capital loss. How much can we lose in a worst case scenario? That is the first question to ask. Unfortunately, today most of the investing public has difficulty quantifying the risk that they are taking.

To figure individual company risk, one has to first determine the future earning power of the company and thus the intrinsic value. This is calculated by discounting future cash flows back to the present. The more predictable those cash flows, the higher the net present value. Only after such analysis can you figure out a price that represents value with an adequate margin of safety. True investors try to minimize the potential risk of each transaction.

The ideal company is one with a proven history of a consistent growth in sales and earnings. It is more important to have a slower growth rate if it is more sustainable. Successful execution commands huge premiums in the stock market. The search is for the outstanding business franchise that is mispriced due to temporary factors or excisable problems. Then, patience is required as the company eventually returns to favor and the price is revalued higher.

Over the past couple of years, the public criteria for investment were based on upward price momentum. The focus was on price movements, not fundamental value. This is the riskiest environment -- when all the good news is known and prices soar far above underlying business value.

John Templeton, one of the world's great long-term investors, was recently quoted: "The biggest mistake investors make is being influenced by the widespread tendency of the media to focus on things that are dramatic and to play them up far beyond their true value. You don't make money by doing what the crowd does; you make money by going against what the crowd's doing".

This can lead to one of the threats to portfolio compounding, the "torpedo stock". A torpedo stock is one that is very popular, has high expectations built into the stock, and an extreme valuation. If the company fails to live up to the projections and the earnings drop, the price implodes as well.

That is why it is more sensible to shop in areas that are "out of favor", where expectations are low. The trick is to identify improving fundamentals while prices are still low before the market catches on. This can lead to a situation where the risk is low and yet the upside can be dramatic.

The year in review

The problems of 2000 were a result of higher interest rates, tighter credit and a deceleration in earnings growth. This led to a collapse in the extremely overvalued technology sector. Ironically, the public shifted over $221 billion into growth/momentum funds through the year ended in August. At the same time they took out approximately $83 billion from value funds. The last 8 of 11 months of 2000 saw value outperform growth. SOURCE: Salomon Smith Barney

Recently, the P/E of the Russell 1000 Growth Index stood at 38.8 compared to 17.5 times for the Russell 1000 Value Index. And yet, profitability for growth stocks compared to value stocks is at an historic low. History teaches us that stocks do return to trend, which leads me to believe that the extremely high valuations in technology will continue to be purged while those companies which are deeply undervalued should rise.

Reasons for optimism

- Bear markets purge out greed and speculation leading to more rational capital allocation. Severe market declines are like the weather; they are to be expected and should be viewed as an opportunity to buy high quality businesses at attractive prices.

- Inflation remains low.

- Recent budget surpluses leave some room for retroactive tax cuts if the economy needs help.

- Currently, nearly $4 trillion in mortgages are in a position where it makes sense to refinance. This can help consumer balance sheets. SOURCE: Fannie Mae

- The median price/earnings ratio for the Value Line 1700 is still close to 15 time earnings. The Leuthold Group recently completed a study of 3000 stocks and came up with a median price/earnings ratio of 15.4 times. These are very reasonable, especially if interest rates decline.

- For the first time in over a year the Federal Reserve is aggressively lowering interest rates. This is material. According to Ned Davis Research, the vast majority of positive equity returns for the past 50 years have come during easing periods. Going back to 1914, the Dow Jones Industrial Average has surged 20% on average 12 months after the first rate cut. The returns exceed 25% 12 months after a second rate cut.

In summary, the market has spent the last year purging a lot of speculative excesses. We are returning to a much more rational, value-based investment environment. There are sectors that continue to be way overpriced, but the majority seem to be much more reasonable. With the Federal Reserve embarking on an aggressive easing cycle, the backdrop for stocks looks encouraging. Still, more than ever, it will be important to quantify intrinsic value as well as risk.

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Thank you for your support!

Sincerely,

J. Jeffrey Auxier
Portfolio Manager