As of 12/31/2003	
4Q 2003:	12.61%*
YTD:	32.85%*

CAZ CORNERSTONE PORTFOLIO

Performance Update

The Rally Continues

What a difference a year makes! How many people would have predicted at the start of 2003 that the S&P 500 would have its best performance since 1995? Not only that, but it accomplished that feat in only three quarters. It seems like stocks have forgotten how to go down. From April through December, the S&P only declined one month. For the year the S&P rallied by 28.68%. To say we are pleased with the performance of Cornerstone is an understatement. We finished the year strong and materially exceeded the performance of our benchmark, all the while remaining very true to our disciplined process. This strong year substantially added to our outperformance over time and we are proud to state that we have outperformed our benchmark by more than 5% compounded annually for the last five years. To put that into perspective, a $10 million investment into the Cornerstone portfolio on January 1, 1999 has grown to $12,463,000 compared to $9,453,000 if invested into an S&P 500 index fund. Of course we all know that past performance is no guarantee of the future, but we feel this shows how our systematic approach to stock selection stands the test of good and bad markets.

Now what? We mentioned last quarter that we have moved from “pound the table bullish” to “cautiously optimistic”, and that this stance was similar to our position in 1998. We are now “optimistic but nervous.” During the summer of 2002, we wrote that we felt the market presented the “buying opportunity of this generation.” We have received countless accolades for that prediction and we are pleased that we have reaped the benefits of that call. But the market (S&P 500) has now rallied by 48% since the lows of 2002 and some speculative stocks have rallied by multiples of that number. This means that stocks are not as reasonably priced as they were and in many cases have grown to very UNREASONABLE valuations.

What exactly does “optimistic but nervous” mean? We see nothing but good things happening. Earnings are ahead of expectations, company outlooks are dramatically improved, the economy is growing at a healthy clip, and inflation remains moderate. This is similar to 1999 when it appeared that nothing could derail the bull train. However, we are nervous and feel there is a “shoe” that could possibly drop. We just don’t know where it could come from. We do not think the market has discounted the risks of a geo-political problem. We liken this feeling to that of a person walking on a dark street late at night. We are simply a little tentative and looking around corners a lot more than we would in the middle of the day. There are several factors that cause us to be more tentative. The first is that overall valuations are much higher than they were. The next is the wave of speculative fervor that has crept back into the market. We are not comfortable with valuations for the worst companies; they are simply RIDICULOUS. The size of the budget deficit is disconcerting, the weakness of the U.S. dollar is troubling and job growth is still not robust. What we do not see is a catalyst to cause a meaningful pullback. But remember, just because we cannot see it coming does not mean that it will not happen. We will see a pullback; the question is from what level. What we can say with 100% confidence is that

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the masses who are buying lousy companies just because they are going up will get hurt; the only question is when. As the saying goes, “we have seen this party before, and it ends badly.”

Valuation metrics are becoming stretched, and there are only two ways valuations can change. Either earnings have to go up much faster than expectations, or stock prices must come down. The S&P 500 is currently trading at approximately 20.76 times 2003 earnings. History shows us that, since 1940, the median return for the next 12 months has been -5.3% when the P/E multiple is above 20x. This is a reason to keep our eyes open. Momentum is on our side, but valuations for the market are not.

Do not misconstrue this to assume that we are bearish, that is not the case. We are forecasting approximately 15% cash flow growth this year for the companies in our portfolio. If valuations are able to remain constant, we will experience similar portfolio growth. What we see as more likely is a slight retrenchment in valuations that would cause the stocks to go up, but not quite at the same rate as their cash flow growth. This is why we are still optimistic for 2004. We are just looking around the corners a lot more.

The More Things Change…….

What amazes us the most is how the more things change the more they stay the same. The same people who thought EMC was junk at $4 are now singing its praises at $15. People who were telling you that Cisco Systems was expensive at $8 are now claiming the stock still has room to run from $28. Well, our discipline has served us in good stead. We were buying EMC and Cisco when they were selling, and now we are beginning to sell as they are buying. This does not mean that these companies are not good, but it does mean that they are not as reasonably priced.

The inverse is true. Now “they” are telling us that companies like Merck, Pfizer and Johnson & Johnson have seen their day in the sun and will be struggling to find new sources of growth. As a result of the pessimism, these companies are now trading at their lowest valuations since 1994. We will not argue that growth is harder to find in these areas than it was five years ago. But we look at these stocks with the perspective of an investor who is considering a buyout of the entire company. Would we buy all of Merck at 9.5x cash flow with a 3.4% dividend yield? You bet we would. Great company, reasonable price; that is our discipline and we will not deviate from it. And we look forward to the day when the market cannot get enough of these types of companies and are willing to pay crazy prices for them. We will be happy to sell our positions to them at that time. This is how we made money in 2000 when most people lost substantial amounts of their capital. We bought what most investors did not have an interest in and sold what they could not resist. This time will not be different; the more things change the more they stay the same.

In summary, we are very pleased with our performance for 2003. Our discipline was rewarded and we have continued to be consistent in our substantial outperformance compared to the benchmarks and our peers. We welcome any comments or questions that you may have and hope that you and your family experience a blessed 2004.

* Preliminary return based on model account