CAZ INVESTMENTS

A Wealth Management Firm

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Dear Client:

The worst bear market in 70 years. Unfortunately, that is exactly the title that this current bear market now carries. During the 3rd quarter, the S & P 500 reached 776. At that level, the market had declined by 49%, making it worse than the bear market of 1973-1974. For more than 30 years we have been spared the agony of a drop of this magnitude. We think of the ABC sports line, "from the thrill of victory to the agony of defeat", when we see the skier plummet off of the ramp and tumble down the slopes. That is a fitting visual for the decline that we have seen from the frothy highs of 1999 to where we are today. In the 3rd quarter, our portfolio performed roughly in line with our benchmark, the S&P 500, and we remain slightly ahead of the S&P 500 year to date.

This has been a year of unrelenting declines. In most bear markets there are at least a few good months that ease the pain, although giving a false sense of security. This year the market has not given us any relief. In March we experienced a rally for three weeks and the bounce from the July lows also lasted about 3 weeks. Unfortunately, both of these rallies were promptly met with increased selling, and the spiral down continued.

We have included for your review the performance for the last several years of the 22 industry groups that make up the S & P 500. We are often asked how we were able to make money in 2000 when the market was down so greatly. As you can see in 2000 there were 12 groups that actually MADE money even though the market was down 10.14%. Therefore, there were places to hide in the groups that performed well. In 2001, the picture changed dramatically as there were only 5 groups that were profitable for the year. If you fast-forward to 2002 (through September) you can see there has only been ONE group that has gained ground year to date. As a result, there has virtually been NO place to hide.

In our portfolio we have attempted to avoid as many land mines as possible and position the portfolio for recovery. We continue to reconcentrate the portfolio to fewer names, and we are amazed at the valuations of the portfolio. As of September, the entire portfolio was trading at less than 10x cash flow, and we own fantastic companies! This gives us great comfort, and it should also give you encouragement. These are some of the top companies in the world, and many of them are trading at unprecedented low prices to cash flow, book value, and revenue. We have continued to focus on balance sheet strength, and we feel confident that our portfolio companies will not only survive this downturn but also thrive in the recovery that we expect over the next 24 months.

Recently, we have been able to compare our performance with that of our peer groups, and we have included those comparisons for your information. We are delighted to show that we are in the top 6% of all large-cap growth managers in the Nelson's universe for the three and four year periods ending June 30, 2002. Additionally, we have been very consistent in our strong performance. For each of the last six quarterly rolling three-year periods ending June 30, 2002, we have been in the top 20% of our peer group. This consistency is unusual and we are very proud of our performance. We have demonstrated that our process works and we will continue to strive to deliver returns that exceed our benchmark and that of our peers.

One of the most difficult tasks in a market like this is to "see the forest, because of the trees." Let's step back and look at the current situation from an unemotional point of view. This is difficult to do, but it is also imperative so investors do not get caught up in the moment and lose sight of the big picture. What are the negatives? We have faced many this past year: terrorism on U.S. soil; lack of trust in corporate government; a sluggish economy; unpredictable corporate profits; and stock valuations that, to some, appear to be rich. Is there any doubt that the market has been negatively affected by all of these factors? Now let's compare this list to the concerns the market was dealing with in 1973-1974. Once again: the war in Vietnam had the country divided; protest after violent protest on U.S. soil by its citizens; the President of the United States resigned; the oil embargo brought the U.S. economy to its knees, and citizens were waiting in lines for hours just to buy gasoline; a deep recession with still high levels of interest rates; and unpredictable corporate profits.

The similarities are significant. Does this mean the bear market is over? No one knows for sure. The one thing that is clear is that history has shown us the time to buy stocks aggressively is when prices have come down considerably and no one seems to be able to see an end to the troubles. We will borrow the famous saying from Sir John Templeton, "Buy into chaos, and sell into peace." The question we all have to ask ourselves is when we look back in ten to twenty years, what will we see? It is our strong opinion that we will look back and say to ourselves that the end of 2002 presented the buying opportunity of a generation!

"The Buying Opportunity of a Generation"

The current generation of investors has not experienced a market that resembled the downfall in the early 70s. The crash of 1987 was similar, but the decline was not as deep and definitely did not span the same amount of time. Everyone agrees, with the benefit of 20/20 hindsight, that the 1987 market offered an incredible buying opportunity for those who had the courage to do so. Also, the consensus is unanimous that those who had the wherewithal to buy great companies in 1973-1974 were rewarded with enormous profits. Any person who looks back at the bear market of the early 30's realizes that buyers of blue chip companies received a return in multiples on their money. What made it so hard for a person in these situations was that it seemed so dark and so bleak. Who could possibly think in terms of opportunity? Those who seized the moment, and extracted their emotions from the situation, were greatly rewarded. We believe the same situation is occurring today. Can the market continue to go down from here? Yes, but those who will take their emotions out of the equation and buy great companies as we try to do, may see returns not viewed in percentages but in multiples.

Think back to each of the periods listed above. What decision was made that was correct in every case? The answer: 1) To buy the best companies in America; 2) To ignore the performance over 30, 60, 90 days, therefore benefiting from the long-term growth that these companies delivered over a multiple year period of time. There are no assurances when the market will rally, but we strongly believe when the bull market returns it will surprise people with its strength.

Let's take a few moments and talk about some positive points that seem to be overlooked by the press.

1. Monetary policy continues to be expansive. Interest rates are at the lowest level in 50 years. This has a dramatic reduction on the borrowing costs of companies, which will enable them to make repairs to their balance sheet and spend the interest savings on additional growth initiatives. This, in turn, creates jobs and growth.

2. This historic level of low interest rates has enabled the majority of American homeowners to lock in very attractive long-term mortgages. This will save the consumer billions of dollars that will be available for spending in other areas. Certainly the refinance boom may be close to over, but the benefits to the economy and the financial health of the consumer are long lasting. The interest savings do not disappear quickly and the savings accrues each and every month to the benefit of the homeowner.

3. Valuation metrics for the top companies worldwide have come down dramatically. All will agree that valuations were too high, but now they have gone too far in the other direction. If you adjust valuation metrics for the current interest rate environment, and it is our opinion that this must be done, we are now at levels that are extremely compelling.

4. Unemployment rates have peaked and are beginning to come down.

5. Our economy is still the best and most diversified economy in the world. This recession will end and expansion will return. We are starting to see signs of this already.

We still live and operate in the best country in the world. Would anyone like to trade places with any other major industrial country? Our country will overcome and persevere just like it has so many times in the past. Are there problems that need to be addressed? Most definitely: we need to reform corporate governance; modify the accounting standards; address fiscal responsibility and government waste; we need to knock out terrorism at its roots; and we need to instill confidence in the American consumer. Over time the economy will recover, and as it does, corporate profits will return and stock prices will go much higher than where they are today. We all have to ask ourselves two questions. In twenty years will we be proud of how we handled the bear market of 2000-2002? Did we see the forest, or did we focus on all the trees?

We continue to add to our team and in August, Erica Rhodes joined us as a marketing assistant. She comes to us from Deloitte and Touche, and previously has worked with Arthur Andersen and Steelcase. Erica received her degree from LSU in office systems. She has a great disposition and we are glad she has become a CAZ team member.

CAZ Investments is pleased to announce that we will be launching a new portfolio as of January 1. The CAZ Market-Neutral Fund will open to accredited investors. This fund will be a market neutral vehicle that will not have significant net exposure, long or short, to the market. This portfolio will be designed as a basket of "paired trades" and attempt to isolate risk at the security level. We have shown over time that we are very good at security selection, and this fund will enable us to isolate our efforts while eliminating most of the economic and market risks. We will be providing additional information in the next few months, and we welcome your questions.

You will find with this letter the linear regression charts updated as of September 30. We received positive feedback from you on these charts, and how they helped you keep things in perspective. Please review them and let us know if we can answer any questions you may have.

We have given you a wealth of information and data in this letter. It is our opinion that the more informed you are the better we can serve you. We appreciate all of your support and welcome any questions, comments or suggestions.

All my best,

Christopher Alan Zook
Chairman & Chief Investment Officer