The TANDEM Report

Volume 3, Issue 4, October, 2002

INSIDE THIS ISSUE:

MARKET SCORECARD:

S&P 500:

year-to-date	**-28.99%**
Annualized returns:	
1 year ended 9/30/02	**-21.68%**
3 years ended 9/30/02	**-14.01%**
5 years ended 9/30/02	**-2.96%**
7 years ended 9/30/02	**4.87%**
10 years ended 9/30/02	**6.91%**

TANDEM Investment Advisors

MARKET COMMENTARY:

INVESTOR SENTIMENT IS THE ISSUE OF THE DAY

The market reached its peak in the spring of 2000, nearly four years after Federal Reserve Chairman Alan Greenspan uttered the phrase "irrational exuberance" to describe investor sentiment and its effect on stock prices. Obviously, his concerns fell on deaf ears as the market continued its ascent. Investors elected not to heed his warning of a looming speculative bubble.

Now that the bubble has burst, is it fair to say that the market has reached its current depths as a result of irrational pessimism, or is the bleak outlook for stocks justified? The S&P 500 has fallen nearly 50% from its high of 1527 on March 27, 2000 to its recent low of 777 on October 9, 2002. In terms of duration, this is the longest bear market on record. In terms of decline, it is one of the most severe. So what happens next?

The facts, as we see them, are as follows: the economy is growing; almost 95% of the U.S. workforce is employed; good companies are growing their earnings; interest rates are low. All of these factors make for a stable economic environment.

Thus, we are left to conclude that economic factors have little to do at present with the market's behavior. Many have suggested that the uncertainty of war with Iraq weighs heavily on stock prices. Perhaps, but we are skeptical. The U.S. has been to war many times, most recently with the very same Iraq. Economic impact and stock market reaction historically have been positive. Investors know this. Corporate corruption that has come to light no doubt has played some role in undermining the performance of stocks. It appears, however, as though the corporate scandals are finally behind us. Perhaps, then, the threat of terror or concern about another recession are driving stock prices lower. Maybe.

The more likely scenario is that the bad news of the day has poisoned investor sentiment. Any of the above items, taken alone, would have minimal impact in more "normal" times. But these are not normal times, and these items have come in bunches, not alone. The result is that bad news has driven prices lower, and the lower prices go, the more frightened investors have become. The more frightened investors have become, the lower prices go, and so on.

Is there more bad news to come? Who knows. But what is certain is that investor sentiment has become as negative as we have ever seen. And believe

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Top Ten Holdings in the Tandem Equity Composite

As of September 30, 2002

As always, the list to the right reflects our ten largest holdings, ranked by total market value in the accounts that make up our Tandem Equity Composite. The S&P 500 declined 17.6% during the quarter, and six names in the Top 10 turned in better performance.

All four in the pharmaceutical group (Merck, J&J, Amgen and Pfizer) beat the market, along with BB& T and General Electric. Once again, the technology sector really struggled. Indicative of the market conditions, only Johnson & Johnson actually managed to turn in a positive performance, up 3.91% since June 30. Home Depot dropped out of the Top 10 because it declined 28.71% for the quarter, while BB&T made the list for the first time, at number 9. In addition to pharmaceuticals, the financial sector enjoyed strong relative performance.

1. Merck & Co.
2. Johnson & Johnson
3. Microsoft Corp.
4. General Electric
5. General Dynamics
6. Exxon Mobil Corp.
7. Amgen
8. Pfizer, Inc.
9. BB&T
10. Applied Materials

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

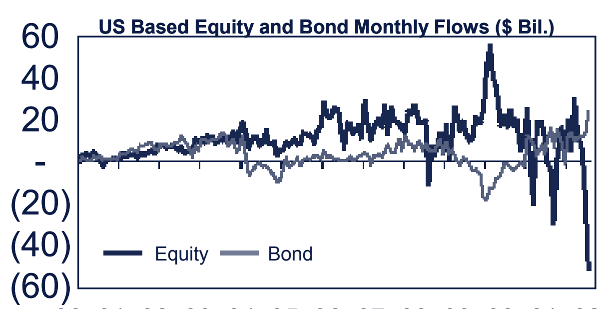
What other investors are doing:

Give Yourself a pat on the back

Hopefully, you have not felt alone as you have watched the market's painful decline. But the truth of the matter is that, while you have not been alone, you have been in select company.

Much to your credit, you have not panicked in the face of this market. You have stayed the course, and hopefully taken some comfort in knowing that you own the stocks of good companies, and that this shall pass. Statistics tell us that others have thrown in the towel. Why do so many investors behave with a herd mentality? Inevitably, we see every market top accompanied by widespread optimism, and every market bottom marked by despair. It seems the average investor has a knack for buying high and selling low.

Zigging When They Should Zag?



Source: ICI, Morgan Stanley research.

The accompanying chart shows money flow into and out of stock and bond mutual funds. Remarkably,

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What is Your Business Plan?

A properly managed business begins with a plan. Planning creates a strategy for success by establishing a road map to reach important goals. It is essential to begin with the end in mind. A business must know what it intends to achieve before it can determine how or where to begin.

The same holds true for investors. What end do you have in mind? Many investors have short-term goals such as wealth creation. Others have more long-term goals, such as retirement. The challenge is to understand what the appropriate goals are, and then tune out the noise that creates distraction. For instance, if your goal is to have enough money to provide for retirement in the future, than you must concentrate on the long-term future of your investments, while tuning out today's market movements. If, however, your goal is to have a certain dollar amount available in the immediate future, than the long-term growth of a particular company you own is less relevant than its price fluctuation.

The challenge is to follow the plan. Too often busi-

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What Other Investors are Doing Continued

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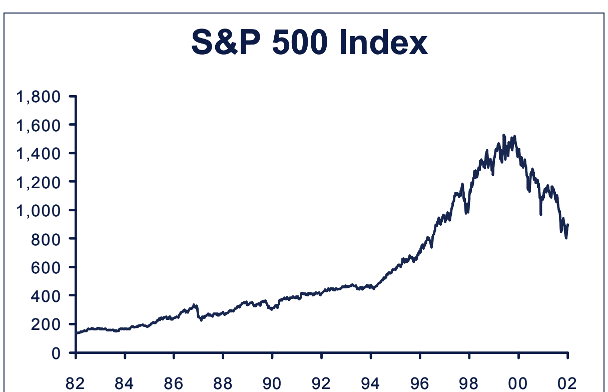
investors poured money into stock funds in 1999 and 2000, leading up to the market peak. Now, stock mutual funds are experiencing record withdrawals as the market perhaps bottoms. And where is the money going as it comes out of stocks? You guessed it - bonds. Money is flooding out of stocks and into bonds just when it appears likely that neither stocks nor interest rates can go much lower.

Over the course of the last several months, we have heard the concerns of many of our clients. They are telling us that this is not fun, and that they are worried about their future. Does this sound familiar to you? It should, because who among us has not felt pain as we watch the market reports? It is normal and natural to feel this anguish.

But the reason we suggest you give yourself a pat on the back is because you have refused to let emotion guide you. We have said in these pages numerous times that the successful investor is the one who sticks to his or her plan, and sets out on a course of action, *not* reaction. Sometimes, we know, this is easier said than done.

We offer no predictions, but October is known as the Bear Killer, and this one may be following in that tradition. Everyone has a different time frame and perspective, but it is reasonable to conclude that we invest in stocks because we expect superior rates of return over time. Let us look admiringly at the accompanying chart of the S&P 500 since the great bull market of the 1980's began in 1982, and keep things in their proper perspective.



Source: Historical prices provided by CSI, Inc.

What is Your Business Plan? Continued

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nesses, or investors, forget the end because something happens along the way that distracts them. Evidence cited throughout this report indicates that investors have become distracted by recent news, and forgotten why they owned stocks in the first place.

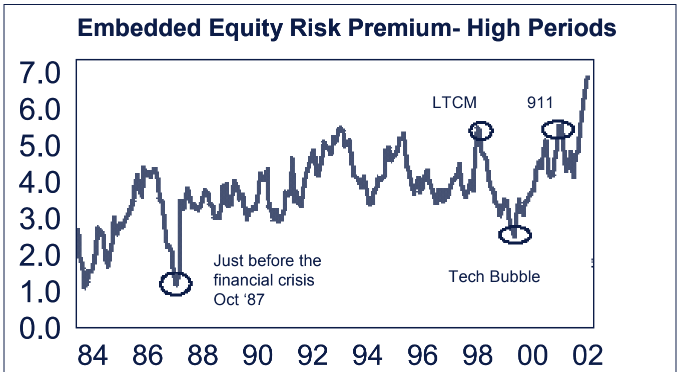
The hardest time to stick with a plan is when events conspire against you. But that is precisely the right time to have confidence in your plan, and to allow it to work. If the end has not changed, don't change the course.

In the face of trying circumstances, having faith in your plan can be quite challenging. But history is full of examples that can help boost our convictions. Warren Buffet has not become a day trader or a short seller, and J.P. Morgan did not amass his personal fortune because he sold when every one else did. So, beginning with the end in mind, what is your business plan?

Market Commentary Continued

(Continued from page 1)

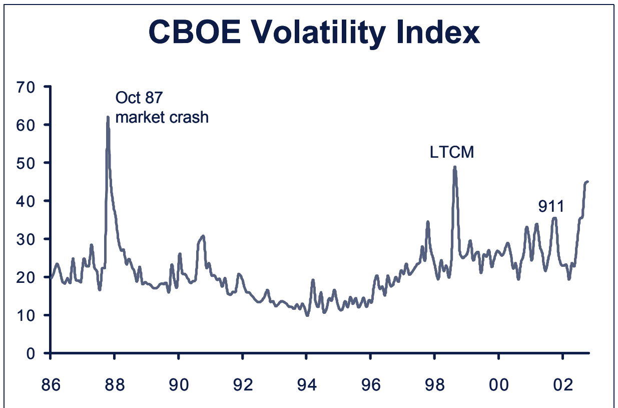
it or not, this is a very positive occurrence. The accompanying chart is a useful visual tool to highlight why investor sentiment is a good contrary indicator. Equity risk premium is one measure of determining how risky investors view stocks to be. During the time from 1984 to the present, investors viewed the least risky time as that period right before the crash



Source: Morgan Stanley Research. DDM derived, assumes fair market value

of 1987. Another time of lesser risk, ironically, was preceding the market's peak in 2000. Please note that investors view the present as the single most risky time in recent history to own stocks. More risky, even, then immediately after 9/11.

The Chicago Board Options Exchange has developed its own index for quantifying investor fear. According to the CBOE Volatility Index, fear and complacency are the extreme measures. An increase in volatility indicates an increase in investor fear. The chart above indicates that present fear is at high levels.



Source: Chicago Board Options Exchange

It strikes us that investors do not have the best timing. This helps to reinforce our view that the bleak outlook for the market is not justified, and that fear is the great motivating factor driving stock prices lower. Experience indicates that we have come full circle. Look for Chairman Greenspan's imminent warning of irrational pessimism.

Tandem News

This year has been unusually volatile. Managing volatility is a challenge, and we are pleased that our composite's 10-year annual risk measure ranked 18th in Money Manager Review's latest ranking of Large-Cap Blend managers. We believe this achievement is the result of the patience and discipline of Tandem's investment process.

Different clients have different information needs. Accordingly, we have launched a new publication for investment professionals. With this new publication, we have established two different communication channels that reach two different audiences: ***The Tandem Report*** has been available to private clients since July, 2000. This quarterly publication is designed to help our clients identify relevant market events and relate them to their investments at Tandem. ***The Tandem Monthly Update*** was made available to investment professionals in September. This monthly publication is designed to help our business partners be informed about our investment management activity.

We owe our allegiance to those who entrust us with their investments. Our efforts are focused exclusively on better serving our audience. The only constant in our business is change. At Tandem, change is driven by a determined effort to better serve private investors. We encourage you to share your ideas on how to improve our service to you.

Commentary

This has been a very trying market for all who have participated, and many who have the misfortune of simply being related to those who have participated. Sometimes, it helps to have a sense of humor. As we are not known for this admirable trait, we better stick to the more serious matter of what else might help bring relief to the suffering.

Much of this report has been devoted to negative investor sentiment. Anything that can bring about a positive outlook would be welcomed. Any number of events could help; a rate cut by the Fed, meaningful improvement on the terrorism front, an end to Saddam's regime, or something as mundane as earnings growth could put investors in a better mood. But one item recently popping up on the radar screen has gotten our attention.

There is a movement in Congress to eliminate the double taxation of dividends. Surprisingly, it appears that there is enough bipartisan support for such a bill to pass both houses. Political commentary aside, elimination of this tax would be a huge boon to investors.

Double taxation of dividends may not be a hot topic around the dinner table, but it should be. Currently, before a corporation pays any dividend to its shareholders, it must first pay its federal taxes. Dividends are then paid on the earnings after taxes. The shareholder then pays taxes on the dividend as well, resulting in the aforementioned double taxation.

The proposed legislation would allow corporations to pay their dividend *before* taxes, making it a deductible expense. Shareholders would still be required to pay tax on investment income, but there might be more income to pay tax on.

Until now, most investors and corporations have eschewed lofty dividends in favor of capital gains because dividends are taxed as ordinary income, while gains receive preferential tax treatment. Under the proposed change, corporations would have incentive to pay out more of their earnings to shareholders, and shareholders would have the immediate, less risky benefit of more cash in hand.

There are other investor friendly law changes being debated, but this one has a likely chance of passing, and would certainly have a positive effect on stock prices. Keep your fingers crossed, or write your congressman. This bill's time has come.

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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 us.

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