September 1999 Volume 7.3

EDMP, INC. Quarterly Review

PRESIDENT'S MESSAGE

LONG-TERM INVESTOR?

We believe the portfolio strategies and disciplines practiced by EDMP are the most prudent, reliable and low risk methodologies of equity investing. Our approach has little or nothing to do with the stock market, which we feel is one of its greatest strengths and attributes. Our philosophy is to invest in solid well-managed businesses at prices or values that make long-term economic sense. This behavior has proven to produce sound above average returns at reasonable or low risk.

The nature of the stock market and stock prices implies volatility and occasional aberrant or illogical valuations. Therefore, the long-term owner of a sound business realizes that to get to the top of the mountain you must expect to walk through a series of valleys. Over long periods of time no company's stock price goes either straight up or straight down. There is always a long-term trend line and it is always jagged but inevitably follows and correlates to the long-term operating results of the actual business. Operating results (earnings) are generally much smoother and more predictable than stock prices.

Sometimes operating results are not as smooth or consistent as we would like, but do tend to trend either up or down. "Steady Eddy" earnings growth at an above average rate is ideal. Few companies are capable of generating perfect results. Currently great names like Coca Cola, Gillette, ConAgra, Mattel and many others are experiencing poor short term earnings results. True investors understand this to be an inevitable reality and count on management to fix it. In most cases, good management delivers. Solving problems takes time, and generally speaking, investors that give good management time are well rewarded.

Short-term price volatility is very disturbing and can be quite dangerous to investing success. However, the greatest risk with volatility is reacting to it. When the price of a good company falls, the typical knee-jerk reaction is to sell. People tend to try to avoid pain. Recent investing studies have shown people to be two and one half times more disturbed by loss than they are pleased by gain. Consequently, one of the most difficult lessons for many investors to learn is that a loss is not a loss until you sell. More often than not, our so-called "dogs" or losers become our best winners. It's all a matter of time, and there are many examples in your current portfolios.

A more recent issue that deeply concerns us as money managers is what we refer to as the great bull market misconception. Thanks in great part to the media; many people mistakenly believe that we are in a great bull market. A close examination of the facts tells a different story altogether. An article by Pierre Belec dated September 17, 1999 on Reuters clarifies this issue. What follows are a few key excerpts from this important article:

"A curious thing has happened. The bull market died in the spring of 1998 but Wall Street hasn't been told."

"The headline-grabbing stock market indices the Dow Jones Industrials, Standard & Poor's 500 and NASDAQ composite may be cruising at record highs, but the truth is that many stocks have not kept up."

"In fact, a big number of stocks are below the highs made in the rip-roaring days of the 1997 and 1998 bull market."

"The overall market has been in a bear market since April 1998. Yes, that is right- 1998."

"It's a smoke-and mirrors market."

"With only four technology stocks making up 25% of the weighting of the NASDAQ and the media only concentrating on the indices, the 'Stealth Bear Market' is being ignored."

"What do you think the headlines would be saying if the major indices were 19.7% under the mid-April 1998 highs?"

"Ned Davis Research in Venice, FL says, "The average stock in its 7,736 stock data base has fallen nearly 20% since April 1998- a virtual bear market for a large number of stocks."

"Richard McCabe, Chief Market Analyst for Merrill Lynch, found that 23.6% of the New York Stock Exchange's common stocks and 22.7% of the NASDAQ market's stocks are below their summer-fall 1998 lows. The up trend in the major market indices is misleading because it does not represent what the majority of stocks have been doing."

"The downsizing of stock portfolios started this summer. In July, investors redeemed shares from mutual fund companies at an annual rate of more than 20%, according to the Investment Company Institute, a Washington based mutual fund lobbying group."

"A reasonable case can be made that what has been occurring simultaneously over the last 16 months is a bull market in a minority of large-cap issues and a bear market in a majority of mid- to small caps."

"After all, the limits of a stock's P/E are largely decided by investors' expectations of earnings growth and risk."

In summary, the majority of publicly traded stocks have been in a bear market since the spring of 1998. More importantly, the ones that are not are massively overvalued due to a high concentration of demand. The key question is what happens when all this concentration decides to leave?

An article in the September 13, 1999 issue of Businessweek magazine titled "When Capital Gets Antsy" points out another serious threat to investor complacency. This article deals with the frenzied trading behavior of today's investor and I quote: "Some 76% of the shares of the average U.S. company listed on the New York

Stock Exchange turned over last year. That's up from 46% in 1990 and only 12% in 1960. Through May of this year, the annualized rate was 82%. On the NASDAQ, where more high-flying, high-tech concerns are listed, shareholder turnover is nearly three times as high."

High turnover is not a good thing for investors, especially those that hold overvalued stocks. With everyone's trigger finger twitching nervously, volatility must surely follow. The following table from the same article puts it all into perspective.

LONG-TERM INVESTOR?
IT'S ALL RELATIVE

Company	Average Time a Share is Held
Priceline.Com	4 Days
Double Click	5 Days
Amazon.Com	7 Days
Yahoo	8 Days
Dell Computer	3.7 Months
Abercrombie & Fitch	3.8 Months
Delta Airlines	6.3 Months
Microsoft	6.3 Months
Cisco Systems	8.5 Months
Gillette	11.1 Months
IBM	13.8 Months
Wal-Mart	18.5 Months
McDonald's	22.1 Months
Procter & Gamble	25.1 Months
Emerson Electric	25.6 Months
Bell Atlantic	25.9 Months
Coca-Cola	26.4 Months
Exxon	29.6 Months
Johnson & Johnson	30.2 Months
General Electric	33.1 Months

Now that I have disturbed all of you, let me try to make you feel better. As previously stated in this letter, the philosophy we use at EDMP has little or nothing to do with the stock market. That is not our game. Our objective is to build properly diversified portfolios of sound businesses bought at attractive prices. Our focus is on the business we own and its potential future operating results. In the long run stock prices will follow earnings. The remainder of this quarter's letter will focus on our strategy and the logic behind it.

An important tenet of our philosophy is that our portfolio must be properly balanced and diversified. To us a portfolio is balanced when it contains the proper mixture of aggressive and conservative holdings. Our "off the showroom" standard is 80% conservative 20% aggressive. The logic is that if only one or two aggressive holdings pan out, long-term performance (5 years or more) is turbo-charged, and will compensate for any mistakes. Names like Microsoft, Intel, Cisco, Amgen, Applied Material, EMC and Conseco are past examples of companies that generated returns of 10-20 times our original investment in five or six years.

The more conservative companies representing approximately 80% of our average portfolio are our anchors. Names like Colgate Palmolive, Merck, Superior Industries, Reynolds & Reynolds, Mattel, Bank One and many others are expected to produce a reliable low risk long-term return of 15% to 20% per annum.

A balanced portfolio, especially a young one (3 years or less) will almost never move in lock step. In the beginning some will fall lower, some will rise and some will stay the same. In the long run (5 years or more) each company will normally go through a process of higher highs and higher lows each year. Remember, volatility in stock prices is an undeniable fact. In the end, however, the stock prices of carefully selected growing companies will converge with the majority commanding prices much higher than original purchase. This is a process that cannot be avoided, therefore it should be expected, and in truth there are not short cuts.

Our view of diversification is that investors should have neither too little nor too much. If a portfolio is too diversified (too many holdings) it is doomed to produce average results without reducing true risk. Too much diversification merely dilutes the upside and not the risk. On the flip side there needs to be enough diversity to prevent disaster.

For example Charlie Munger (Warren Buffett's partner at Berkshire) believes you only need four or five carefully selected companies. We understand his logic, but believe that it is a little too aggressive for most people. We prefer 15-30 holdings with 20 being about average. With 20 or so holdings no one company can destroy your portfolio results, and it is concentrated enough to outperform. The secret is to know as much about those companies as possible.

This is precisely why we provide so much information on each of your holdings. Our objective is to get you to focus more on the actual businesses you own and less on short-term stock price volatility. Long-term investment success requires confidence, a steady hand and a cool head. The inherent volatility of stock prices is detrimental to all three. The trick is to put stock prices aside and analyze your companies based on their quality and prospects for future long-term growth. Once this is done, then and only then, bring stock prices in to get a perspective of valuation. When done successfully, (our fundamental charts make it easy) you can then ascertain whether your holdings are fairly priced, overpriced or under priced. On this basis, sound decisions can be made and reactive mistakes can be avoided.

As managers of other people's money, we can see the veracity of the above concept much more vividly than our average client. It often amazes us how differently two people can feel about the same company. If we purchase a company for a client and the price falls, that client will normally hold a jaundiced view of the company. On the other hand, a newer or prospective client that doesn't yet have their money down is easily convinced that this same company is a bargain of a lifetime. The first client wants us to sell it badly; the second client can't wait for us to buy it. Our job is to empower the first client to think like the second client.

The final point we would like to discuss in this quarter's letter relates to the cash we are currently holding. Many of you have questioned our reasoning and strategy behind our not being fully invested in what appears to be a roaring bull market. This is an important question and deserves a good answer. There are actually several reasons, some related - some not, behind our behavior.

As previously pointed out in this letter, we have in actuality been in a bear market for a majority of stocks since the spring of 1998. More recently, the few "big caps" that were defying gravity have begun to catch up or rather catch down. The average correction has been approximately 20% with some companies falling farther and others less. This is by definition a bear market. The problem however, is that for the "big caps" at least,

many were 100% or more overvalued based on historical norms and sound business principles. Therefore, we believe the correction in "big caps" has just begun. This is not a market timing statement, this is a valuation statement. It is difficult for small/mid caps to make headway, despite compelling valuation, while the large caps undergo price declines.

The good news in all of this is that after a long hiatus, many high quality "big caps" are showing up in our radar screen. The recent additions of Mattel and Bank One in many of your portfolios are evidence of this. Other quality names like ConAgra and even the great Gillette are getting close. With great companies heading to value, we believe it only prudent to have some cash.

Another important reason why we are holding cash relates to companies we already own. These are businesses we know a lot about. Some have actual problems that need to be assessed, others do not. Clayton Homes, Superior Industries, Reynolds and Reynolds, Invacare and Cooper Tire are a few examples of companies that are delivering superior operating results and lousy short-term stock prices. These companies need to be averaged down where appropriate for each individual account. They are clearly bargains.

Names like Crown Cork and Seal, Andrew Corporation, Cabletron, Helig Meyers, Olsten, and Sensormatic are examples of companies that had or are having short term operating problems that management is resolving or has resolved. We believe they are all excellent companies with excellent futures and need to be held or averaged down, again as appropriate for each individual account. Some of our cash is earmarked for this purpose.

Also, there are companies like Genesis Health Ventures, Integrated Health Services, Phycor, Landry's Restaurants, and Sports Authority that had or have more serious problems. On each of these, the jury is still out regarding the decision to buy more or sell. For most of these, the decision to sell makes little sense to us. The downside is limited from here and the upside is enormous if the management of these companies is successful. Imagine the cost and lost opportunity had we sold Cabletron or Atmel last October at $6. Cabletron now trades between $15 and $20 and Atmel between $35 and $40. The smarter move, which we made, was to buy when they were cheap. This was accomplished with sound analysis and objective reasoning rather then a panicky knee jerk reaction.

Finally, we are currently holding cash for purely prudent reasons. Our prime directive at EDMP is first to protect your money, then safely grow it over time. With all the excessive speculation, the high concentration of large sums of investor capital in a narrow scope of companies, rising interest rates, the Y2K issues, etc., etc., it seems only reasonable to us to have a little dry powder on hand.

In closing and perhaps most importantly of all, your portfolios are not, in our view, in any real long-term danger. Our companies have been and are thoroughly researched and generally quite cheap. Yes, they may temporarily fall in a market panic, but they will recover if they do. Your businesses are sound and their long-term futures are bright. As we have stated previously, the only thing we have to fear is fear itself. With our portfolio positioned as they are, the stock market and all of its nonsense can only hurt us if we let it. We have the power!

It remains our privilege to serve you. And, as always, remember; *Earnings Determine Market Price, always have, always will.*

Sincerely,

Charles C. Carnevale
President

PORTFOLIO REVIEW