4th Quarter 2001

EDMP, INC. Quarterly Review

What Stock Market?

America and the world will never, and should never, forget calendar year 2001. That fateful day in September simultaneously defined the worst and the best aspects of humanity. America's great and tragic loss, though unacceptably high in cost, awakened our spirit and garnered our strength and resolve in a most profound way. With "Old Glory" prominently displayed like never before, we enter 2002 proud to be an American. And proud we should be, for it is no accident that the world's symbol of freedom is also the world's model for prosperity. At EDMP, Inc. we don't wish you a prosperous new year, we acknowledge it as your destiny. God bless America, and protect our brave soldiers as they defend our precious freedoms.

From an economic point of view, 2001 was a difficult year, not withstanding, the tragedy of September 11th. After many years of extraordinary growth, our economy entered a recession. This is an inevitable aspect of our free enterprise system at work. The forces of supply and demand are continuously seeking equilibrium. When demand is higher than supply, which is typical during prosperity, the corporations that provide the goods and services we consume, independently increase production to satisfy our appetites. Soon, these independent actions meet our demands and then eventually our supply of goods and services begin to exceed our ability to consume them. With excess inventories on hand, these same corporations, again acting independently, respond by tapping on the brakes. This is commonly known as the business cycle. Contrary to what many economists and business prognosticators tried to lead us to believe during the recent prosperous times, the business cycle is an economic reality. There is not and never will be a so-called "new economy" or paradigm.

Denying economic reality is not only foolish, but dangerous to your future economic well being as well. During prosperous periods, people are often led to a false sense of security, therefore needlessly exposing themselves to the pending perils ahead. This is precisely why so many investors suffered large losses in 2000 and 2001. On the other hand, during weak economic periods like we are currently experiencing, people become gripped with unwarranted fear and fail to participate in the prosperity ahead.

It is much more sensible and profitable to acknowledge and recognize the economic reality of the business cycle and therefore be empowered to act appropriately. Astute investors that recognize these truths are capable of making sound and rational decisions. Consequently, they can avoid reacting to the whimsical and volatile nature of short-term stock market swings. Armed with prudent economic principles, their decisions are based on valuation, which is quantifiable rather than current price, which is often unrealistic or not reflective of true worth. In other words, if price is higher than value, they are inclined to sell, and conversely when price is lower than economic worth, they are inclined to buy. This is not only safer than "playing the stock market" it is also more predictable and profitable in the long run.

At EDMP, we clearly recognize that it is difficult for the average investor to make these distinctions. The financial press and media find it much more profitable to feed our human penchant for immediate gratification than to educate us. A falling or rising stock market is enticing and exciting "news." Most people, on the other hand, find economics rather drab and boring. Provocative headlines attract viewers, while mathematical principles generally serve as sedatives. Therefore, it's no wonder that people are incredulous when we emphatically state that the stock market has nothing to do with investing. Our greatest challenge has been and continues to be convincing you, our valued clients, that we do not speculate in the stock market. The simple truth, however, is that we don't and won't. We freely acknowledge that most money managers do play the stock market and therefore we understand the confusion. But, once again, we emphatically state that we do not acknowledge the stock market nor do we participate in its folly. This is truly what differentiates us.

The Wall Street Journal recently reported that 83% of all U.S. equity mutual funds were down an average of 11% in 2001. This is consistent with the results of the stock markets and clearly validates that most managers are playing the market. In 2001, the Dow Jones Industrial Average was down 7%, the S&P 500 was down 13%, and the broader NASDAQ was down 21%. Managers that play the market are doomed to mirror it, which explains why so few professional managers outperform the indices.

As the old saying goes, the proof is in the pudding. When you review EDMP's average performance in 2001, you find a stark contrast to the general markets' performance as reported above. Our positive double-digit average returns last year clearly have no correlation to the general markets'. In fact, this is the second year in a row where we achieved positive overall performance when the market averages

were sharply lower (recall the NASDAQ plunged 40% in 2000). This is undeniable evidence that our disciplined approach has little or nothing to do with the "stock market." Rather than "playing the market" our business perspective strategy is about investing in excellent growing businesses at valuations that make economic sense.

In previous newsletters, we have pointed out that you make your money on the buy side. In other words, by purchasing a business only when it is at or below intrinsic value based on future cash flow and earnings expectations. A most important corollary to this principle is that you also maximize safety by following this sound and prudent strategy. Our recent solid and positive performance in a generally down market environment clearly validates this statement. Business perspective investing, based on sound economic principles, is safer, more predictable, and ultimately more profitable than playing the market.

Over the holidays, I received the gift of a new book: *The Warren Buffett CEO*, authored by a Tampa based entrepreneur, Robert P. Miles. Chapter 4 covered Lou Simpson, Mr. Buffett's heir apparent and manager of Geico Insurance and its 2.5 billion dollar equity portfolio. With a track record spanning more than twenty years, Mr. Simpson ranks with investing greats like Warren Buffett and Peter Lynch. On page 53, Mr. Simpson shares his five basic principles for investing success. For brevity, we would like to share his third principle; see if it sounds familiar.

"3. Pay only a reasonable price, even for an excellent business. We try to be disciplined in the price we pay for ownership even in a demonstrably superior business. Even the world's greatest business is not a good investment, if the price is too high. The ratio of price to earnings and its inverse, the earnings yield, are useful gauges in valuing a company, as is the ratio of price to free cash flow. A helpful comparison is the earnings yield of a company versus the return on a risk-free long-term United States Government obligation." (Special note: You can find the earnings yield vs. T-Bond comparison on EDMP's fundamental charting program just above the forecasting chart titled View/Print 10 Year Earnings Yield.)

As we enter the New Year, we will continue to apply the same principles of investing that have served out clients so well over the last decade. Our intention is not to be pure contrarians, but we will continue to look for new investments that tend to be ignored by Wall Street because the immediate gratification is not apparent. We will also maintain proper diversification, even if it means short-term pain such as adding to badly beaten down telecommunications stocks as their prices continue to weaken. It is important to attempt to establish positions before the recovery becomes obvious, since by that time the prices will have already moved much higher. We take great pain to find investments not merely because they are inexpensive, rather we look for solid potential combined with reasonable valuation.

We expect to hear the same groan from clients as we accumulate names such as Tellabs and Compaq that we always hear when the stock is not moving higher. We have, however, done our best to determine whether such companies have the financial condition, business model and management foresight to weather short-term weak operating environments. Some of our greatest winners caused the loudest groans upon initial purchase. We will also continue to pare back holdings that become expensive or where the fundamentals do not progress in accordance with our expectations. Most importantly, we will continue to exercise patience, which we believe is one of the least recognized, yet critically important virtues of successful long-term investing.

God bless America! And, in matters of investing please remember; *Earnings Determine Market Price*, always have, always will.

Sincerely,

Charles C. Carnevale
Chief Investment Officer