

Small-Cap Value Commentary Letter First Quarter 2004

“The shortage of attractively-priced stocks in which we can put large sums doesn’t bother us, providing we can find companies to purchase that (1) have favorable and enduring economic characteristics; (2) are run by talented and honest managers and; (3) are available at a sensible price.”

-Warren E. Buffett, Berkshire Hathaway 2003 Annual Report

Market Commentary

On the surface, the first quarter appeared to be positive across most styles. However, a deeper evaluation reveals that there was much more than meets the eye. The quarter started off strong as the technology sector continued the advance we witnessed in prior months. However, as we entered the last weeks of January, and on into February, the market took on an entirely different tone. Although returns continued to be positive, we began to see a larger divergence in stocks moving up in price versus those declining in price.

As we mentioned in last quarter’s letter, we felt that investor expectations had risen to a point that there was an increased risk of disappointment across individual companies. In general, earnings were very strong on a year-over-year basis; yet as we expected, these solid earnings reports only have served to raise the expectations of continued large increases.

Your Portfolio Performance

The ICM small-cap portfolios experienced strong gains in the first quarter, as the equity marketplace picked up in 2004 where it left off in 2003. Energy, health care, and consumer discretionary stocks led the charge in the first quarter, all meaningfully outperforming the benchmark index. Although the ICM small-cap portfolios were over-weighted in each of these three strong sectors, weakness in one particular health care investment somewhat moderated our performance. Furthermore, the relative weak performance of consumer staples stocks also negatively impacted first quarter performance. We remain convinced, however, that the investments in these more traditionally defensive sectors will prove wise over time, and were generally pleased to see the ICM small-cap portfolios “standing their ground” this quarter.

Continuing Cautiously

We continue to observe strengthening economic fundamentals. We also have welcomed the earnings reports released by many individual companies, and while somewhat mixed, it seems clear that the earnings picture is improving. We do, however, want to continue cautiously as we believe market valuation levels in general remain too high. Obviously the price one pays is a key influence on the resulting rate of return experienced.

Good News to Report

As Mr. Buffett expressed, investment efforts are challenged when the marketplace as a whole is expensive. One indicator that has moved in our favor this year is market breadth. When there are areas of the market where sellers dominate the sentiment, we often have the opportunity to make purchases at sizable discounts to intrinsic value. Sometimes this happens in a particular sector; more often on a company specific basis. When a particular company fails to live up to an inflated expectation, sharp declines can be the result. In many instances we believe these declines are merited, but occasionally they lead to significant under-valuation of assets, and opportunity abounds for the patient investor.

So far this year we have found several new investment ideas in the wake of these sharp sell-offs. Thankfully, many recent additions to these portfolios have characteristics that are often very expensive in the marketplace, while we were able to acquire them at large discounts. High levels of management ownership, strong long-term growth outlooks, low levels of debt, measurable competitive advantage, and strong returns on invested capital are common themes among several of our new purchases. As the year progresses, we will keep you informed about these stock developments.

Please feel free to contact our Client Services department at (800) 488-4075 if you have any questions about your portfolio. We are available to discuss our current positioning and your investment objectives. On behalf of everyone here at ICM Asset Management, Inc., thank you for your business.

We request that clients advise ICM and their financial advisor in the event that there are any changes in their investment objectives, financial situation, or whether they wish to impose or modify restrictions on the management of their account. Please call ICM at (800) 488-4075 or visit our Web site, www.icmasset.com, if you have any questions or need additional information.