



Suncoast Equity Management, Inc.

January 2, 2002

Dear Client,

The stock market rebounded meaningfully in the final quarter of 2001, following the terrible events of September 11th. Investors, placing a vote of confidence in America's eventual recovery and hope for global stability, lifted the stock market from the depths of a -27% decline (for the Standard & Poor's 500) to a year-end close of -11.91%. Our satisfactory break-even performance for 2001 and long-term results are shown below versus the S&P 500:

	SEM	S&P 500	SEM -Value	S&P 500 - Value
<u>Time Period Through 12/31/01</u>	<u>% Return*</u>	<u>% Return</u>	<u>of \$1,000,000</u>	<u>of \$1,000,000</u>
One Year	+0.12%	-11.91%	\$ 1,001,200	\$ 880,900
Two Years	+4.39%	-19.97%	\$ 1,043,900	\$ 800,300
Four Years (Since Inception)	+13.16%	+5.63%	\$ 1,640,400	\$ 1,245,300

* Composite results of all SEM managed accounts, net of all fees.

Note: Performance results for the four-year period represent the annual average rates of return.

The strong fourth quarter rebound demonstrates that ***time in the market is more important than timing the market***, even when great uncertainties exist. For the period 1970 - 2000 the annualized return to investors for the S&P 500 was about 9%. However, if you moved in and out of the market and missed the 21 best days of the market in those 30 years, the return is cut nearly in half to 4.7%.

Time in the market is more important than timing the market goes hand-in-hand with another idea we have proposed over and over again... ***any attempt to predict the next moves in the stock market is gibberish***. Yet human nature being what it is, the temptation to make stock market predictions can trap even the best of us, including on more than one occasion, Mr. Warren Buffett and his partner Charlie Munger. As I have studied Mr. Buffett and Mr. Munger quite intensely, I have from 1982 evidence of their negative sentiments for the economy and their expectations of weak equity returns going forward. Of course, it turned out that they were dead wrong since 1982 - 2000 was one of the greatest bull market runs of all-time.

Not satisfied with his earlier misses, Mr. Buffett entered the stock market prediction business again this year in recent television interviews and in Fortune magazine. His closing remarks in the December 10,

2001 Fortune article are: "I would expect now to see long-term returns run somewhat higher in the neighborhood of 7% after costs."

Interestingly, these statements are from the same man who has consistently stated that the only meaningful value of a stock market or economic forecaster is that they make fortune-tellers look good.

So in print, the best investor of our time if not of all-time, violated his basic principle of sound investing. My point is nobody knows what the stock market will return next month, next week or even in the next ten years, not even Mr. Buffett. Furthermore, the rub here is that although Mr. Buffett seemed to have violated his principle of being against making market performance forecasts, he never let his gut feelings for the market environment creep into his actual investment decision process. His focus, like that of SEM, is on part ownership of fine businesses, not the ups and downs of the stock market. No matter what my gut feelings are about the market environment, it never corrodes the **Suncoast Equity Management - Disciplined Investment System (SEM-DIS)**.

If Mr. Buffett had asked me how to close his well-written article, I would have said: "the current environment strengthens our long term belief that investing in companies that have (1) a heavy emphasis on cash generating characteristics, (2) a strong balance sheet position, (3) a consistent operating track record and (4) a managerial reluctance towards unsuitable capital allocation decisions, are likely to enjoy increased recognition in future years by selectors of common stocks." End of story, and I would leave the stock market predictions to the fortune-tellers on CNBC.

Our **SEM-DIS** objective to become part owners in a small collection of businesses, that meet the above criteria and are not too expensive by our measurements, is well intact as evidenced by two back-to-back years of minimal investment returns, albeit terrific relative returns, in a market that declined 20%.

The companies in our portfolio are outstanding businesses, which are rarely greatly undervalued and are not always well understood. Since all of our companies generate substantial excess cash each year, one important use is to reinvest this excess cash into new product development. One factor that is not well understood is the powerful cycle of increasing cash invested in research & development (R&D) and its long-term effects on future profit growth. A sample of our important holdings are listed below to demonstrate this idea:

	1991		1995		2000	
(\$ Millions	<u>R&D</u>	<u>Profits</u>	<u>R&D</u>	<u>Profits</u>	<u>R&D</u>	<u>Profits</u>
Amgen	\$ 121	\$ 98	\$ 452	\$ 538	\$ 845	\$ 1,139
Medtronic	\$ 117	\$ 179	\$ 226	\$ 312	\$ 578	\$ 935
Microsoft	\$ 235	\$ 279	\$ 860	\$ 1,453	\$ 3,772	\$ 9,421

As you can see from the table above, the linear increase in both profits and new investment in R&D fed each other continuously over the years and consequently support a more valuable corporation and above average return for the investor. These are the companies SEM identifies through its SEM-DIS to achieve above average equity appreciation.

Despite interruptions throughout history, new innovation is alive and well and though inefficiencies abound within society, the benefits seem to always march towards improved standards of living and a chance of a better world. Of course, we also all have a lot to be thankful for in this country and I look ahead with great enthusiasm and with what I believe is a collection of excellent businesses in our portfolio.

Best wishes for the New Year and thank you for your continued business.

Sincerely,

Don Jowdy

President