Foundation Resource Management
Quarterly Commentary
4th Quarter 2003

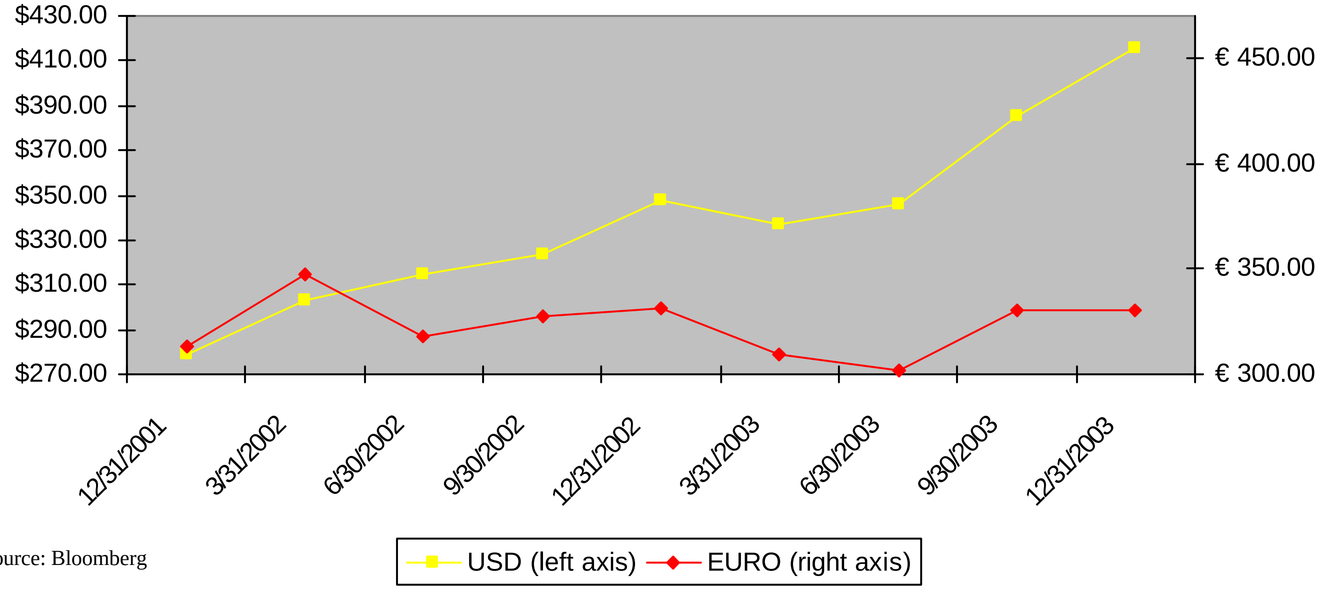
In many ways, we hated to see 2003 come to a close. This business is one in which your results are highly quantifiable. We are forced to enumerate our results in some type of time frame, which we do quarterly and annually. However, quarterly numbers, in our opinion, are meaningless and even annual numbers do not provide sufficient information until at least five consecutive years have been put together. Still, a year like the one we just finished is very gratifying, if for no other reason than the short–term performance pressures, difficult to escape in our society, are somewhat relieved. We caution all of our clients that the results just experienced in the last year are the exception rather than the norm. More about performance later.

We have received several questions from clients regarding why we would hold any cash in the current market environment, which is characterized by returns on cash of less than 1%, a rip-roaring stock market and a fixed income market that begs you to lock in rates in long maturities in order to pick up significant additional yield. The short-term penalty for holding cash has been quite severe. Why do we hold any at all? Any fool (our wives frequently address us in this manner) should be able to see that cash has penalized performance lately. Indeed, we do have plenty, especially in accounts that have started with us in the last couple of years or have made significant additions to the account during that time. The answer is that we have not made a cognizant decision to have more cash, but that it is the result of a shortage of current investment opportunities. We don't know if the stock market is going higher or lower. Ditto for the bond market and interest rates. What we do know is that it is currently very difficult to find good value in either market, though we stand ready with a list of attractive candidates should they reach our price targets. Since our sole focus is on an attractive return on investment for our clients, we are as sensitive to the price we pay for securities as anyone we know or follow. Yes, we monitor what others of our training and discipline are doing. While we do not always agree with them on all matters of security selection, it is not uncommon to see some of the same themes in the portfolios of different value managers. An example would be Warren Buffet's Berkshire Hathaway. As of the end of the third quarter, Buffet held over $30 billion in cash, or about 18% of his total assets. We assume the short-term pain of doing so was the same for him that it is for us. There is an unwritten theorem of investing (at least we've never seen it in writing, so you saw it here first) that says when an asset is most difficult to hold (e.g. cash today), that is exactly what you should be doing. Likewise, when an asset is very easy to hold (e.g. technology stocks in the late 1990's), then you should beware. We will continue to search for securities that hold the potential for above average returns for our clients and will be unbowed by the near-term pressures of holding cash. Funny thing, but you never hear that old saw about "cash is trash," popular in the late nineties, in years like the market experienced in 2000-2002.

Now back to last year's results. In a certain sense, our good relative performance for the year was very unusual for us. Usually, when the stock market is highly speculative, our portfolios will lag, since we don't tend to be invested in the real sexy stuff. 2003 was an exception, but we think we know the reason. Last year saw a period of sharply rising commodity prices, which are represented in our portfolios much more so than the overall market. Oil, gas, timber, copper, nickel, aluminum, zinc, gold and companies related to these and other commodities represent almost half of our portfolios. A positive attribute of owning these companies when prices are increasing (it works the other way as well) is that the earnings per share of the companies tend to be highly leveraged to the price of the commodity. Since we probably already have you thoroughly confused, let's consider an example. **Newmont Mining** earned $.41 per share in 2002 on an average gold sales price of $313 per ounce. It looks like their 2003 earnings will be about $1.25 per share. Average gold sales prices have increased approximately 20%, so 2003 earnings per share will triple on a 20% increase in sales prices. That is what we mean by the earnings per share being highly leveraged to the price of the commodity. Higher gold prices would continue to provide earnings leverage to Newmont. Such leverage provided a big boost to our portfolios in the year just ended.

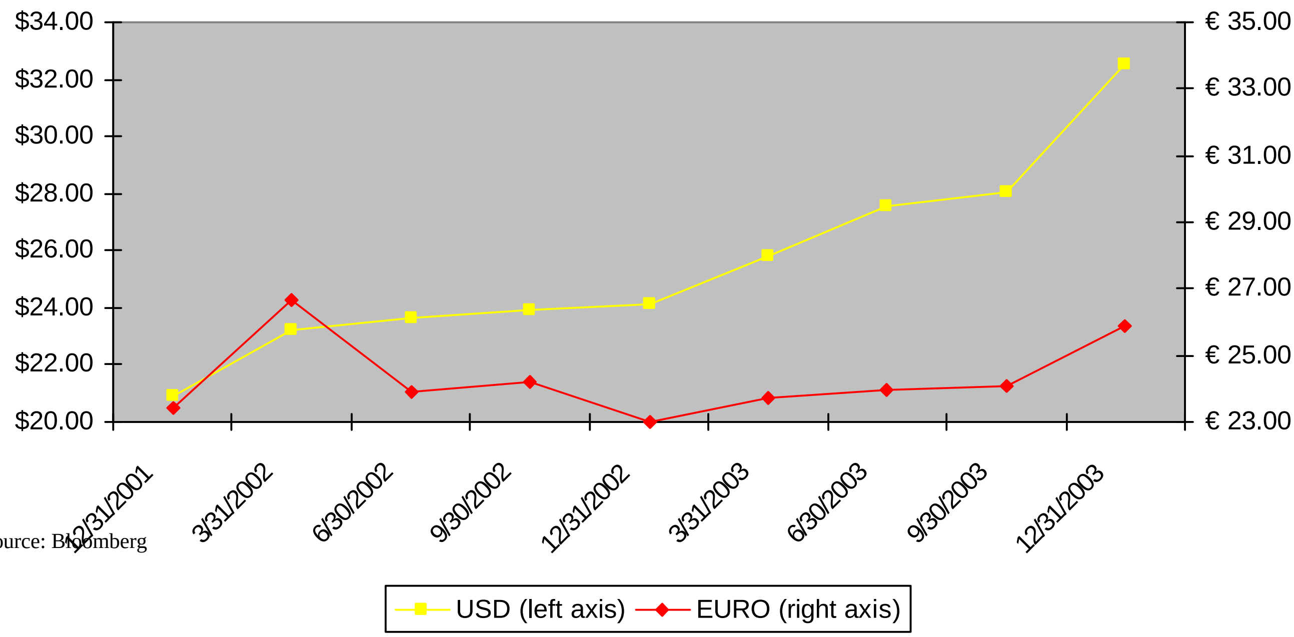
Because the prices of many commodities to which we are exposed have risen rapidly, it is incumbent on us to determine whether these prices are sustainable, or whether they are speculative in nature. A big factor for commodities in the last couple of years has been the declining value of the U.S. dollar. While we, as consumers, pay for all commodity related products in terms of dollars, so does much of the world to a certain degree, as many commodities are quoted worldwide on the basis of our currency. Our dollar dropped 19.8% against the Euro in 2003 and had a similar performance relative to other major currencies. Gold rose 19.6% during the year, but when measured against the value of the dollar, there was very little change. Oil closed the year at $32.52 per barrel. This was only 4.2% higher than the price at the end of '02, but remember that pre-war anxiety had run the price up sharply to that level in 2002. Oil has not declined in price following the ouster of Saddam as many expected. Since these are worldwide markets, as are the others mentioned above to a large degree, we will have to determine if worldwide commodity prices are heating up to speculative levels. Thus far, we see much of the dollar increase in commodity prices related to the declining value of the U.S. dollar. Since the dollar decline and the price rise of commodities has been ongoing since the start of 2002, we charted the prices of gold and oil in terms of the dollar and the euro for the same time period. You can see that the charts that follow support our conclusion thus far.

Gold Prices 12/31/01 - 12/31/03



Source: Bloomberg

Oil Prices 12/31/01 - 12/31/03



Source: Bloomberg

Knowing when to sell is **the** most difficult part of our job, and trying to determine sustainable prices for these commodities only adds to our current conundrum. But if you look at the historical prices and the highs reached on those commodities in the last twenty-five years, we are not topping those currently. For example oil, which topped out at over $50/barrel in the seventies, again went back up as high as $41/barrel in the early ‘90s when Saddam invaded Kuwait. The lows were in ’86 at just under $11/barrel and again in ’98 during the Asian currency crisis when oil dropped to around $12/barrel. Crude closed the year at $32.50/barrel. Copper is still well off of its high of $1.40/lb. from 1988, after hitting lows in 1998 that matched those from 1986 around the $.62/lb. level. We finished the year at $1.04/lb. Gold spiked to over $800/oz. in 1980. Since that time it has been as low as $254/oz. in 1999. As you can see, we are coming from very low commodity prices reached in 1998 and 1999. Previous highs were generally recorded many years ago. While all of this has been going on, the cumulative level of inflating (as measured by the monetary base) has increased four fold over the last twenty-five years. Adding to the complexity of the question at hand is that many commodities have become more expensive to explore, develop, produce and refine. We know we will not time the highs, but we do want to sell at a level that reflects a premium to the sustainable price.