

October 4, 2002

THIS ISSUE

The Stock Market

The Psychology
of Market Tops
and Bottoms

Bear Markets
and Recoveries:
Two Historical
Examples

Summary

Kirr, Marbach
Partners Value Fund

"Courage is not the absence of fear, but rather the judgment that something else is more important than one's fear. The timid presume it is lack of fear that allows the brave to act when the timid do not. But to take action when one is not afraid is easy. To refrain when afraid is also easy. To take action regardless of fear is brave."
Ambrose Hollingworth Redmoon

"The farther backward you can look, the farther forward you are likely to see."
Winston Churchill

"I can predict the motion of heavenly bodies, but not the madness of crowds."
Sir Isaac Newton

DEAR CLIENTS:

Americans have endured one of the most tumultuous periods in our country's history over the past year. Our collective innocence was shattered by the terrorist attacks on our own soil. We learned to not accept as gospel every assurance uttered by a CEO or bullish recommendation made by a Wall Street analyst. The CEOs of Enron, Tyco, Adelphia, Global Crossing and WorldCom were actually running Three Card Monte games, not businesses, and some analysts wrote whatever their investment banking departments told them to write. Some "clean" audit opinions were tainted by audit firms' desires to increase revenues (and income of the partners) by cross-selling non-audit services. These have been excruciatingly painful and expensive lessons, for sure. However, they have also forced investors to be more skeptical, rational and self-reliant. At the end of the long day, that will be good for our financial markets and capitalism.

In our last quarterly letter we stated, "We think the U.S. equity market is in the process of forming a bottom from which an important buying opportunity is developing. While the market averages may make marginal new lows before the ultimate bottom is reached, the risk/reward parameters are once again very much in our favor." The performance of our portfolio and the U.S. equity market in the third quarter of 2002 indicate our market "call" was early. However, we remain confident time will prove our words to be prescient. We will continue to focus our efforts on what we do best; trying to find good businesses that sell at attractive prices. Our history shows we're good at determining a good business from a bad business as well as a wise bet from a foolish bet. If there is a silver lining to this bear market, it's the opportunity to purchase *better* businesses at valuations reached *only* in times of great market distress. Markets are irrational in the short run, but investment managers worth their salt are not. As always, we will continue to try to exploit the market's *short-term* irrationality, for the *long-term* benefit of our clients.

THE STOCK MARKET

We would normally be thrilled to report we outperformed the S&P 500 Index by a significant amount through the end of the third quarter. However, these are anything but normal times and given most of our client equity portfolios ended the quarter down more than 20% for the year-to-date, we're certainly not patting ourselves on the back.

Periods ending September 30, 2002 (Total Returns-Cumulative-Bloomberg)

| | S&P 500 Index | NASDAQ | Russell Midcap Index |
|---------------------|------------------|---------|----------------------------|
| 3-months | -17.28% | -19.82% | -17.64% |
| 6-months | -28.36% | -36.36% | -25.50% |
| 2002 (year-to-date) | -28.16% | -39.73% | -22.34% |
| One-year | -20.49% | -21.51% | -8.98% |
| Two-years | -41.63% | -67.87% | -29.33% |
| Three-years | -33.88% | -56.95% | -6.99% |

The headlines blared the S&P 500 suffered its worst quarterly decline since the fourth quarter of 1987 (which included the October 19 Crash.) To give you a longer-term view of the scale of the market's meteoric rise and precipitous fall, the S&P 500 began 1995 at 459.27, climbed to its high of 1527.46 on March 24, 2000 and closed the third quarter of 2002 at 815.28, giving back about *two-thirds* of its gain. After underperforming in 1998-1999, value did exceedingly well in 2000-2001 as the former high-fliers came crashing back to earth. Unfortunately, there has simply been no place to hide in 2002 as the continuing bear market has caused both over-valued and undervalued stocks to be marked down.

Our April 2002 letter stated two primary risks for the stock market. First, valuations were exceeded. Second, earnings growth expectations for 2002 were aggressive and heavily loaded into the second half of the year. In other words, there was very little room for error. The economic recovery has sputtered from its torrid pace of early 2002, causing actual earnings to trail those earlier aggressive estimates. Add uncertainty over Iraq to the mix and you have a brew that has been toxic to the market. Still, interest rates and inflation remain very low and the Fed has clearly indicated its willingness to reduce rates further should the market and/or economy continue to falter. The positive impact of last year's *eleven* rate reductions should begin to be felt shortly. Finally, forward earnings expectations are being ratcheted down rapidly and with upcoming comparisons relatively "easy," the probability of upside surprises is better.

THE PSYCHOLOGY OF MARKET TOPS AND BOTTOMS

The market in 2002 has become almost a mirror image of the late 1990s. Back then, technology and the Internet had spawned a "New Economy," one that would be immune to the business cycle, and cause earnings to grow to the sky. CEOs were viewed as paragons of capitalism as corporate boards of directors gladly awarded pay packages measured in the hundreds of millions of dollars. Wall Street analysts competed to see who could come up with the most bizarre valuation criteria (i.e. "page views") to support the most outrageous price targets. Investors seemingly couldn't buy stock fast enough. As the market roared ever higher, declines were short-lived as investors "bought the dip." The book *Dow 36,000* was published in September 1999, with the Dow Jones Industrial Average (DJIA) at 10,000 and change, and immediately moved to the best-seller list.

Fast-forwarding to 2002, the technology “miracle” was all smoke, mirrors and outright lies. The business cycle is still passé, but only because corporate earnings are weak and will only get weaker. CEOs are, at best, crooks in training, as are their skills on Wall Street. Investors seemingly can’t sell stock fast enough (witness July’s record \$53 billion net withdrawal from U.S. equity funds.) With the market plummeting, advances are short-lived as investors “sell the rally.” Bill Gross, the “King of Bonds” from PIMCO, penned a research piece, “Dow 5,000,” in September 2002, with the DJIA at 8,000 and change, which quickly sent shudders through the investment community.

While every market top and bottom is different, each can be characterized as an emotional extreme. At the top, investors feel safe, secure and supremely confident in the future. In contrast, bottoms are frightening stuff, marked by panic, extreme uncertainty and stocks becoming washed-out. Recoveries are typically powerful, but major market bottoms look irresistible and obvious *only* in retrospect, long after the storm has passed. Our point is we didn’t buy into the hyperbole on the way up and we’re certainly not selling into the hype on the way down. Earning 1% in a money market fund is obviously preferable to losing 30% in the stock market, but it’s still not a winning strategy for the long-term. Our call in the late 1990s proved to be early, as the market was making new highs, but ultimately correct *and* profitable for our clients. Similarly, we believe our call made in July was early, as the market makes new lows, but will prove to be correct and profitable for our clients, over the long-term.

BEAR MARKETS AND RECOVERIES – TWO HISTORICAL EXAMPLES

We thought clients would gain useful and informative perspective on how the current bear market compares with past bear markets and recoveries. In many ways, the 1973-1974 bear market was very similar to today’s bear. The seeds for both were sown during the prior period’s massive overvaluation. The Nifty-Fifty era of “one-deci-

sion” growth stocks preceded the ’73-74 bear as the “New Economy” era preceded the current bear. During the ’73-’74 bear market, the S&P 500 declined 48% from its high, while the Value Line Index (that period’s equivalent of the NASDAQ) fell 75%. Our current bear market has witnessed the S&P 500 falling 47% from its high while NASDAQ has declined 77%. However, as Morgan Stanley’s Byron Wien wrote in a late July 2002 report, the fundamental background was very different thirty years ago.

In ’73-’74:

- A) the price of oil had quadrupled and the U.S. was entering a period of increasing inflation and higher interest rates,
- B) the U.S. economy was in the midst of its worst recession since the 1930s,
- C) the Vietnam War, which had sharply divided the nation, was winding down towards an unsuccessful conclusion,
- D) Watergate would lead to the president’s resignation and
- E) the Cold War with the U.S.S.R. continued unabated.

Contrast with today, when:

- A) the Cold War is over and the U.S. is the world’s sole economic and political superpower,
- B) inflation is virtually nonexistent and short-term rates and mortgages are at levels last seen in the early 1960s and
- C) the economy is recovering, albeit at a slower rate than many had hoped for or expected.

Unless the S&P 500 is able to generate a total return in the fourth quarter of 2002 of at least 39.2%, 2002 will mark its third consecutive negative year. As the chart shows on the next page, the

continued on pg. 5

S&P 500 INDEX TOTAL RETURNS

| Year | Total Return | Year | Total Return | Year | Total Return | Year | Total Return |
|------|--------------|------|--------------|------|--------------|------|--------------|
| 1926 | 11.6% | 1945 | 36.4% | 1964 | 16.5% | 1983 | 22.5% |
| 1927 | 37.5% | 1946 | -8.1% | 1965 | 12.5% | 1984 | 6.3% |
| 1928 | 43.6% | 1947 | 5.7% | 1966 | -10.1% | 1985 | 32.2% |
| 1929 | -8.4% | 1948 | 5.5% | 1967 | 24.0% | 1986 | 18.5% |
| 1930 | -24.9% | 1949 | 18.8% | 1968 | 11.1% | 1987 | 5.2% |
| 1931 | -43.3% | 1950 | 31.7% | 1969 | -8.5% | 1988 | 16.8% |
| 1932 | -8.2% | 1951 | 24.0% | 1970 | 4.0% | 1989 | 31.5% |
| 1933 | 54.0% | 1952 | 18.4% | 1971 | 14.3% | 1990 | -3.2% |
| 1934 | -1.4% | 1953 | -1.0% | 1972 | 19.0% | 1991 | 30.6% |
| 1935 | 47.7% | 1954 | 52.6% | 1973 | -14.7% | 1992 | 7.7% |
| 1936 | 33.9% | 1955 | 31.6% | 1974 | -26.5% | 1993 | 10.0% |
| 1937 | -35.0% | 1956 | 6.6% | 1975 | 37.2% | 1994 | 1.3% |
| 1938 | 31.1% | 1957 | -10.8% | 1976 | 23.8% | 1995 | 37.4% |
| 1939 | -0.4% | 1958 | 43.3% | 1977 | -7.2% | 1996 | 23.1% |
| 1940 | -9.8% | 1959 | 12.0% | 1978 | 6.6% | 1997 | 33.4% |
| 1941 | -11.6% | 1960 | 0.1% | 1979 | 18.4% | 1998 | 28.6% |
| 1942 | 20.3% | 1961 | 26.9% | 1980 | 32.4% | 1999 | 21.0% |
| 1943 | 25.9% | 1962 | -8.7% | 1981 | -4.9% | 2000 | -9.1% |
| 1944 | 19.8% | 1963 | 22.8% | 1982 | 21.4% | 2001 | -11.9% |

Source: ISI Group

S&P 500 hasn't suffered three consecutive down years since 1939-41. World War II began in 1939 and 1941 ended with Japan's attack on Pearl Harbor, which led the U.S. to formally join the war. Osama bin Laden is a formidable foe and Saddam Hussein is an unpredictable dictator having access to and the willingness to use weapons of mass destruction. However, it is clear the threat from the Axis of Germany/ Italy/Japan sixty years ago to America and capitalism was *many* times greater than the threat the "Axis of Evil" of Iraq/ Iran/North Korea poses today.

The purpose of this section is not to downplay the seriousness of the issues, but to hopefully illustrate the market has faced many days that were darker than today and still recovered. It is darkest before the dawn, but there will be a dawn.

SUMMARY

The financial devastation of the bursting of the bubble of the late 1990s has been unprecedented, with the market value of the Wilshire (Associates) 5000 index (proxy for the entire U.S. equity market) declining \$7 trillion from its March 24, 2000 peak. The shockwaves from this destruction of wealth and the purging of excesses from years of greed and avarice have continued to reverberate and wreak havoc in all sectors of the market, even the stocks of good businesses selling at attractive prices. Even though we had outstanding relative *and* absolute performance in 2000 and 2001 and are well ahead of the S&P 500 this year, we understand you can't spend relative performance and are more disappointed than anyone to be down more than 20%, year-to-date. The best time to buy is at the point of *maximum uncertainty*, but it takes a lot of discipline, confidence and courage

to do it. Great investments always seem obvious, in retrospect, but it is precisely the panic and uncertainty enveloping them at the time of purchase that gives them that upside potential. We thank you again for your trust and confidence in our abilities, particularly in difficult times like these.

KIRR, MARBACH PARTNERS VALUE FUND

Mark D. Foster, CFA, KM's Chief Investment Officer, was listed as one of the "Top 100 Fund Managers" in the July 29, 2002 issue of *Barron's*, a national, weekly financial publication. Value Line performed the study, screening a universe of 6000 domestic equity mutual funds to come up with a list of 650 funds qualified for ranking (based on fund performance and risk as compared with peers in same investment sector, for the 12 months ending June 30, 2002.) Under this criteria, Mark Foster was listed as #74 on *Barron's* Top 100 Fund Managers list. Congratulations to Mark and the KM investment team!

KM is the investment adviser to the Kirr, Marbach Partners Value Fund ("Value Fund")—NASDAQ-KMVAX,) a registered, open-end investment company, more commonly known as a mutual fund. Value Fund is a diversified equity portfolio managed in KM's traditional, value investment style and commenced operations on December 31, 1998. You can visit Value Fund at www.kmpartnersfunds.com.

For a prospectus and account application, please call Craig Kessler at Value Fund at 812-376-9444 or 800-808-9444 or write to Value Fund at 621 Washington Street, Columbus, IN 47202-1729. Read the

Prospectus carefully before you invest or send money. The Prospectus contains important information about Value Fund, including charges and expenses. The performance data quoted represents past performance and assumes the reinvestment of capital gains and income distributions. Performance also reflects fee waivers in effect. In the absence of fee waivers, total return would be reduced. Past performance does not reflect how Value Fund may perform in the future.

The investment return and principal value of your investment will fluctuate. When redeemed, your share may be worth more or less than their original cost. Raferty Capital Markets, LLC is the Distributor for Value Fund.

Regards,
Kirr, Marbach & Company, LLC



David M. Kirr, CFA



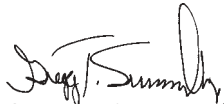
Darrell H. "Kip" H. Wright, CFA



Allan C. Nichols, CFA



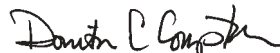
Deborah N. Malone



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Terry B. Marbach, CFA



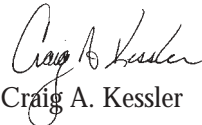
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