KIRR, MARBACH & COMPANY, LLC

KM &Co

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"In the business world, the rearview mirror is always clearer than the windshield." *Warren Buffet*

Dear Clients:

2002 was an eminently forgettable year of negative extremes and we're glad it's now in the history book. The explosive rally off of the October 9 lows faltered in December, leading to gains for the fourth quarter that were insufficient to keep the major stock indices and stock mutual funds from posting their worst performances since the 1970s. Bonds outperformed stocks for the third consecutive year, the first time that has occurred since 1939-1941, according to *The New York Times*. Unlike 2000 and 2001, when we were able to generate outstanding relative *and* absolute returns by staying true to our value discipline, there was nowhere to hide in 2002. Morgan Stanley reported *all 10* of the sectors comprising the Standard & Poor's 500 Index (S&P 500) finished the year with losses, possibly for the first time in history. Lipper Inc. reported 96% of U.S. equity funds had negative returns, while Morningstar identified precious metals and real estate funds as the *only* gainers for the year. We've discussed what went wrong in 2002 *ad nauseam* in prior quarterly letters, so we won't waste your time reciting them. Suffice to say economic growth was neither as strong nor as straight-line as investors had hoped at the beginning of the year. We previously identified back-end loaded earnings growth expectations as the primary risk factor for the market, so when expectations were disappointed, the reaction was both predictable and swift.

Periods ending December 31, 2002

(Total Returns-Cumulative-Bloomberg)

	S&P 500 Index	NASDAQ	Russell Midcap Index
3-months	+8.4%	+14.1%	+7.9%
One-year	-22.1%	-31.3%	-16.2%
Two-years	-31.3%	-45.6%	-20.9%
Three-years	-37.6%	-66.9%	-14.4%

That was then. What about now? Stock prices will be higher a year from now. Though the overall market is not cheap and we obviously can't guarantee this outcome, we have solid reasons for our belief. We think we've seen the lows and a reasonable expectation is a total return in the mid- to high-single digits. However, given past recoveries from multiple-year declines (see graph on Page 4), we would not be surprised to see a more robust gain. This is not to say we're wildly bullish nor falling. The greatest *risks* occur when there is nothing but sunshine, the news is good and getting better and prices are rising. The investment mantra of "buy low/sell high" sounds simple enough, but in practice it takes a tremendous amount of discipline and conviction.

The Economy – It Isn't As Bad As You Think

Our friends at ISI estimate real GDP grew at 2.5% in 2002 and will be up 3.1% in 2003. When viewed in context of the tremendous shocks the economy has absorbed over the past couple years listed below, we'd argue the economy has actually performed remarkably well.

- $7 trillion in equity market value/wealth vaporized since the March 2000 peak.
- Terrorist attacks on our own soil (with the constant threat of more to follow).
- Almost certain war with Iraq.
- Revelations of corporate fraud and corruption perpetrated on a massive scale.
- Major bankruptcies, each larger than the last.

Skeptics scoff at the Fed's ability to stimulate the economy through monetary policy, noting the 11 interest rate reductions that took the federal funds rate from 6.50% on January 3, 2001 to 1.75% on December 11, 2001 had failed to generate much economic "traction." When the Fed reduced the discount rate further, to 1.25%, on November 6, 2002, they pointed out the rate was rapidly approaching zero, at which point the monetary policy "gun" would be out of bullets. While we can't argue with the mathematical fact that 1.25% is close to 0%, we'd point out the environment is quite a bit different in early 2003 than it was a year ago, when monetary policy was acting alone. A year ago, the U.S. was running a fiscal surplus (i.e. fiscal policy was restrictive), the dollar was rising in value and long-term bond yields were relatively high. In early 2003, President Bush has proposed a massive fiscal stimulus package (i.e. good-bye budget surplus), the dollar has declined (making U.S. exports more competitive) and long-term interest rates have plummeted. Thus, we now have stimulative monetary policy, stimulative fiscal policy, a weaker dollar, low long-term interest rates and low inflation all pulling together. Add to these factors the Fed's stated ability to use additional, non-conventional weapons in its arsenal to stave off future weakness and you have a good case for growth in 2003.

Running fiscal deficits and having a depreciating currency will have positive near-term impacts, but the longer-run implications can be very tricky. Our point is the resilience exhibited by our economy to date, in the face of some pretty daunting obstacles, and the sheer amount of firepower aimed at improving growth both here and abroad give us more reasons to be optimistic than pessimistic.

Crisis Of Confidence – It's Not A Permanent Condition

When we're being physically pummeled, the human survival instinct causes us to cover-up to protect ourselves from the blows. This is good, as it helps keep us from getting seriously injured or killed. This instinct also kicks-in when we're being hit repeatedly with psychological blows, as has been happening in the economy and stock market. This aversion to risk has caused a "bunker mentality" to become pervasive. The CEO whose business has been weak and seen his stock cut in half is reluctant to hire or spend on capital equipment. Wall Street analysts are under fire for being overly optimistic during the bubble years, so don't view

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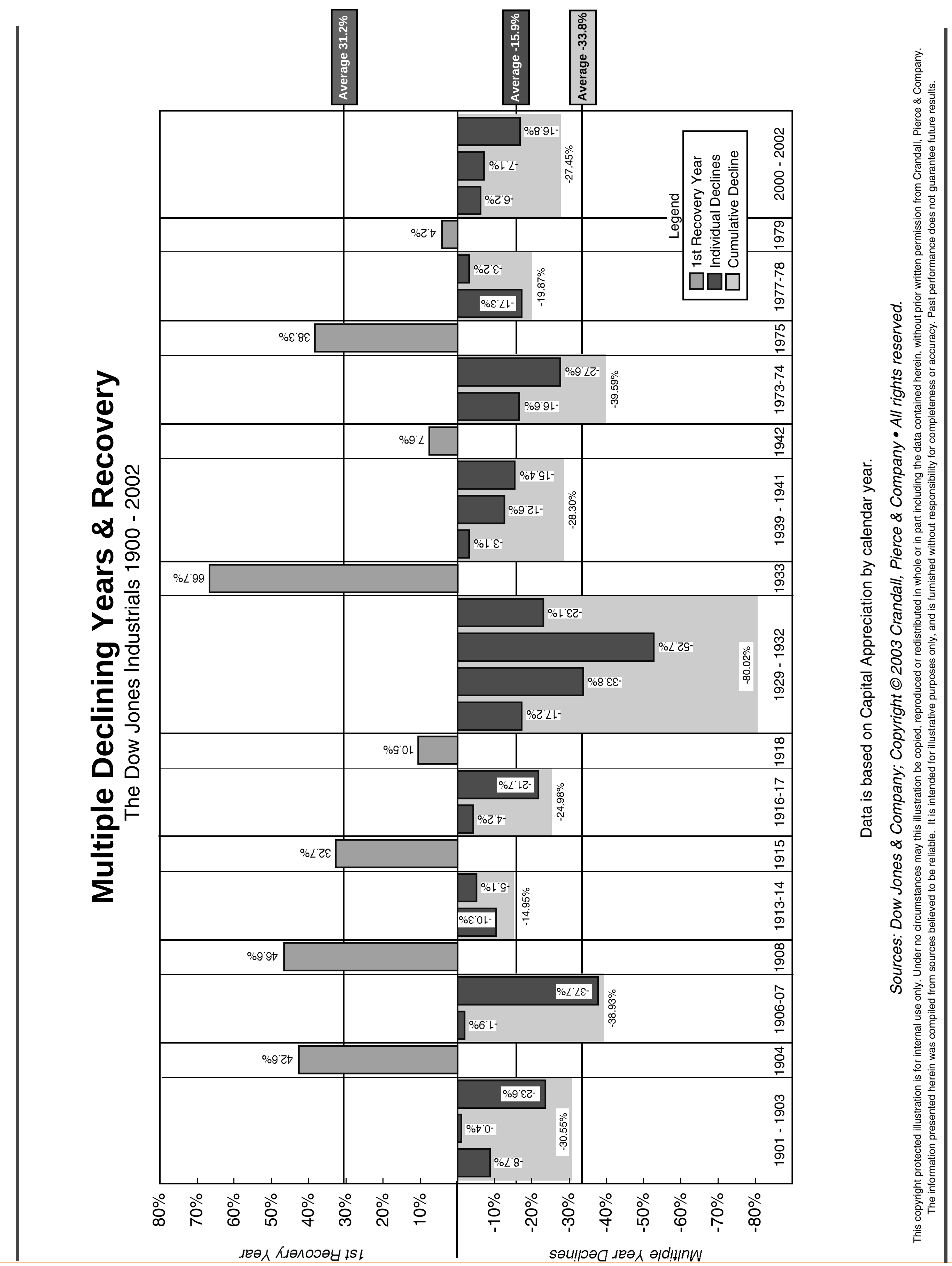

think the recovery will follow a smooth trajectory. Indeed, we expect the market to continue it's wild ride, buffeted by conflicting economic indicators and the winds of war. Stock picking ability will be key. In addition, it will be critically important to "be there" for the up moves. In other words, if the up moves are short in duration, but powerful (as they have tended to be), it does us no good to have *identified* good stocks if we are not actually *invested* in them. As always, we'll try to identify good stocks at attractive prices, accepting the risk of short-term decline with the goal of reaping the long-term reward of out-performance.

Our hypothesis of higher stock prices a year from now is based on four factors. First, the overall market is reasonably valued and we continue to identify solid value opportunities. Second, though it may seem a paradox, when perceived risk is exceptionally high, as it is today, actual risk is low. Third, neither the magnitude nor the pace of the economic recovery has been all that bad and the stage has been set for both to improve in 2003. Fourth, what's really ailing the economy and market is a crisis of confidence, which we don't believe will be a permanent condition.

Overall Market Is Reasonably Valued And We Continue To Identify Solid Value Opportunities

The bears correctly point out the overall market is not cheap. However, we assert that, given short-term and long-term interest rates are at 40-year lows, the economy is growing, corporate profitability is recovering and inflation remains low, the overall market shouldn't be valued as if the sky were falling. Further, we continue to find undervalued situations within the context of a reasonably valued market. Though we posted negative returns in 2002, as many of our undervalued stocks became even *more* undervalued, we remain undaunted.

We mentioned the stellar performance of bonds over the past three years. According to The Leuthold Group, the 10-year U.S. Treasury bond had total returns of +14.4% in 2000, +6.0% in 2001 and +13.5% in 2002, as the yield tumbled from 6.4% at the end of 1999 to 3.8% at the end of 2002. Given Treasury bonds have been in nirvana over the past three years, it seems reasonable to us further gains will be much more difficult. As an illustration, if the yield were to back-up to 5% (120 basis points) by the end of 2003, a level seen as recently as June of 2002, the total return for 2003 would be -4.5%. This is *not* our prediction, but shows what could happen to "risk-free" Treasury bonds if yields move higher.

Putting this all together, the overall market is fairly valued, we continue to find undervalued situations and the competition from bonds, particularly Treasury bonds, is likely to be less going forward.

Perceived And Actual Risk – Today's Risks Are Well-Known

The perceived risks today are well known, having been drilled into investors' conscious and sub-conscious through a constant barrage of negative press and reinforced by three years of pulverizing negative returns. Contrast this with the late 90s, when the total return on the S&P 500 was compounding at almost 29% and the "new economy" was growing to the sky. There were few perceived risks as investors' biggest concern was planning enough garage space in the new mansion for the new Porsche *and* Mercedes. We would argue the *actual* risk was *significantly* higher in early 2000, when the Dow Jones Industrial Average (DJIA) was closing in on 12,000 and investors were feeling bulletproof than it is today, with the DJIA approaching 8,000 (at year-end 2002) and investors feeling vulnerable. Today's perceived risks have been well discounted in the market, perhaps overly so, and have caused the business sector to contract and investors to become bearish. If some of today's perceived risks *don't* come to pass tomorrow, or are not quite as dire as the doomsayers predict, there is tremendous capacity for optimism and improvement in the business sector and market.

The greatest *opportunities* occur when the skies are stormy, the news is bad and getting worse and prices are expressing non-consensus positive viewpoints as a career-enhancing move. Investors who have endured three years of stock market pain have pulled in their horns and shifted funds to bonds.

Can this crisis of confidence last awhile longer? Absolutely. However, it won't be a permanent condition. Economist John Maynard Keynes wrote of the "animal spirits" of capitalism that cause entrepreneurs, corporate managers and investors to take risks in hopes of reaping economic reward. These so-called animal spirits of capitalism have been suppressed during this time of extreme stress, but just as sure as day follows night, you can be certain the overpowering force of economic self-interest will emerge again.

Summary

The keys to a prosperous 2003 will be good stock-picking ability, discipline, patience and a strong stomach. We view the pain we're enduring in this transitional period, during which many of the gross excesses of the bubble are in the process of being purged, as absolutely necessary for a healthy economy and market going forward. As with many things in life, the pendulum has swung from absolute Greed to absolute Fear. A little Greed is good (see "animal spirits" above), as is a little Fear. We look forward to a little more balance in the months ahead. We think we've seen the lows in the market and the economy and earnings will gradually improve. Stock prices will follow earnings and, given low current expectations and the fact corporate America is running fairly lean, we can construct a plausible scenario where earnings and stock prices are better than most investors are forecasting today.

We thank you for the trust and confidence you have placed in us. We try hard everyday to earn the opportunity to manage your funds.

Kirr, Marbach Partners Value Fund

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.

During last summer, Morningstar* changed its method for classifying and ranking domestic equity funds. As a result, Value Fund was classified as "Mid-Cap Blend" and its Overall Rating dropped to 3-stars. We are pleased to announce that as of rankings released as of 11/30/02, Value Fund had regained its 4-star Morningstar Overall Rating (among 158 Mid-Cap Blend funds).

*Morningstar ratings on U.S.-domiciled funds reflect historical risk-adjusted performance as of 11/30/02. The ratings are subject to change every month. Morningstar ratings are calculated from the fund's 3-, 5- and 10-year (if applicable) average annual returns in excess of 90-day U.S. Treasury bill returns, with appropriate fee adjustments and a risk factor that reflects fund performance below 90-day U.S. Treasury bill returns. The proprietary Morningstar Overall Rating is based on a weighted average of the fund's 3-, 5- and 10-year (if applicable) risk-adjusted performance. The top 10% of funds in a broad asset class receive 5 stars, the next 22.5% receive 4 stars, the next 35% receive 3 stars, the next 22.5% receive 2 stars and the bottom 10% receive 1 star. Value Fund's Overall Rating of 4 stars is based on its 3-year average annual return within a universe of 158 Mid-Cap Blend funds.

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. Performance does not reflect the deduction of taxes that a shareholder would pay on Fund distributions or the redemption of Fund shares. 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. Rafferty Capital Markets, LLC is the Distributor for Value Fund.

Regards,

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