

April 9, 2003

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Turn Off the TV, Put the Duct Tape in the Drawer

"Whatever men attempt, they seem driven to try to overdo. When hopes are soaring I always repeat to myself, 'Two and two still make four and no one has ever invented a way of getting something for nothing.' When the outlook is steeped in pessimism I remind myself, 'Two and two make four and you can't keep mankind down for long.'"

— Bernard Baruch, early 1900s investor and financier

DEAR CLIENTS:

As the U.S. prepared for and ultimately entered the war in the first quarter of 2003, the equity market and economy continued to suffer from the uncertainty created by the inherent unpredictability of war. This uncertainty kept both investors out of the stock market and Corporate America out of the market for new employees/capital expansion. The impact on the stock market and economy was not surprising. With buyers moving to the sidelines, stock prices moved lower. With company managements not hiring or investing to grow their businesses, economic growth stalled.

We don't view this "fog of war" as a permanent condition. With embedded reporters and instantaneous electronic and visual updates from the front lines, it's profoundly difficult to not get swept-up in the gut-wrenching emotions and the ebbs and flows of the war. While others have been paralyzed into inaction "until the Iraq situation is resolved," our charge is to best position our client portfolios *today* for success over the long-term. Though we are as cautious and keenly interested as anyone, we are avoiding being mesmerized by the constant information overload. We are attempting to use the market's extreme volatility to find attractively priced stocks of companies we believe will

perform well in today's uncertain environment and even better after the fog has lifted. We have kept dry powder on hand to take advantage of some outstanding opportunities. We said in our most recent quarterly letter we expected stock-picking ability and "being there" (i.e. actually *invested* in the attractive stocks we have identified) to be key going forward. Though it subsequently gave back some of the gain, the 998-point rise in the Dow Jones Industrial Average from the March 11, 2003 close to the March 21, 2003 close (eight trading days) illustrates the potential power of future rallies.

THE STOCK MARKET AND THE ECONOMY

After starting 2003 with a flourish, the U.S. stock market began a grinding descent that, by March 11, had many of the major market indices rapidly approaching their lows of last October. As soon as it became clear the impending war was about to become reality, investors aggressively bid prices higher. However, as it became apparent the Iraqi leadership and military weren't going to give up the ghost without a fight, stocks again sold off, leading to low single-digit losses for most U.S. indices for the first quarter.

Periods ending March 31, 2003
(Total Returns – Cumulative-Bloomberg)

	S&P 500 Index	NASDAQ	Russell Midcap Index
3-months	-3.15%	+0.58%	-2.37%
One-year	-24.76%	-26.97%	-21.50%
Two-years	-24.57%	-26.52%	-13.71%
Three-years	-40.91%	-70.36%	-24.06%

As we noted in the introduction, this is the first truly “real-time” war. The instantaneous access to information about the war is certainly a wonder, but it’s been a two-edged sword as investors grapple with how to process and react to all this information. During the first weeks of the war, investors appeared to be marking the market according to their assessment of the reports from the most recent battle. Investors were disappointed victory did not occur in the first two weeks. In the interest of symmetry, we’d add a few more items to the list of things that haven’t happened during the first weeks. The Iraqis have not used chemical, biological or weapons of mass destruction against coalition forces. While one death would have been too many, there have not been a huge number of coalition casualties. The Iraqi oil fields weren’t destroyed or massively damaged by fleeing troops. Saddam Hussein has not been successful in his effort to transform the war from U.S. vs. Iraq into a pan-Arab and eventually pan-Islamic war. In other words, his calls to jihad have supposedly been embraced by a few thousand, perhaps, but certainly not the masses. Iraq has not fired missiles at Israel. There has been no mass exodus of civilian refugees. Finally, there has not been a major terrorist attack in the U.S. or the rest of the world. The fortunes of war can undoubtedly change in the blink of an eye. Although the coalition forces encountered some setbacks and didn’t achieve victory in a matter of days, there were numerous darker possible scenarios that didn’t occur, either.

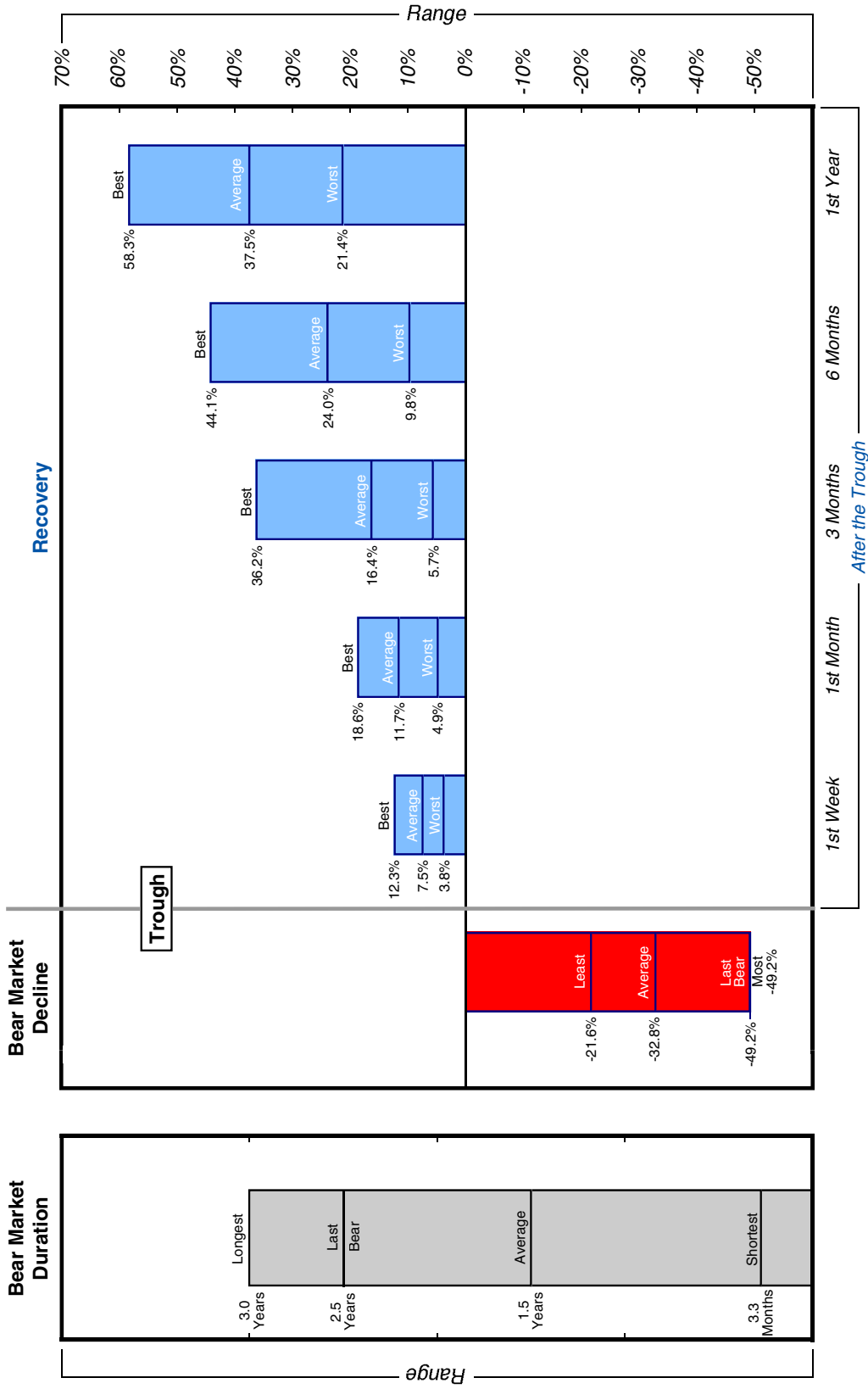
The short-term outlook for the market is unknowable, particularly during time of war. Since the “ground level” view of the market is so obscured, we thought it might

be useful to take a look from “30,000 feet.” Warren Buffet quoted Ben Graham as saying, “Though the stock market functions as a voting machine in the short run, it acts as a weighing machine in the long run.” This means fear and greed may drive the market to extremes in the short-run (witness the rapid inflation and subsequent bursting of the recent bubble), but *fundamentals* determine stock prices over the long-term. The stock market also functions as a *discounting mechanism*. The news on the economic and geopolitical fronts has admittedly been bad, but as of March 31, 2003, the S&P 500 Index was about 45% lower than it was at its March 24, 2000 high. There is a lot of bad news priced into the market. For the market to go up, the news going forward doesn’t have to be great, it just has to be not as bad as what the market has already discounted.

The study of behavioral finance has generated increasing interest as academics and investors alike attempt to understand and explain the events leading to bubbles and their aftermath. Briefly, markets go to extremes when everyone is thinking the same way because there is some irresistible, extremely compelling theme, either positive or negative, in the market. With a positive theme (i.e. the “new era” of technology/the Internet), the market soars, valuations go to the moon and investors feel flush, optimistic, bullish and entitled to their just rewards for possessing “superior knowledge.” Conversely, with a negative theme (i.e. economic weakness/deflation), the market plummets, valuations go from cheap to cheaper and investors feel poor, pessimistic, bearish and unjustly punished for their losses. The Leuthold Group (Leuthold) estimated investors withdrew a net \$18 billion from equity mutual funds between January-March, usually a seasonally strong period for *inflows* (estimated at \$51 billion for the same period in 2002). Further, there have been nine months out of the last ten with net outflows, totaling about \$107 billion. Throughout history, markets have gone to extremes as investors have gotten it wrong by being either overly optimistic or pessimistic. The trick is to be able to identify when those mistakes are being made and to have the conviction to do the opposite. Though it was most difficult, this is exactly what we did as the bubble was expanding in the late 90s. It’s been painful as the bubble has subsequently deflated, but this is exactly what we’re trying to do now.

When Bear Markets End

The Standard & Poor's 500 Stock Index



Note: Data includes post-WWII Bear Markets as defined by the Standard & Poor's 500 Stock Index through February 28, 2003.

Sources: Standard & Poor's Corporation; Copyright © 2003 Crandall, Pierce & Company

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We profess no special insight as to what the market will do over the next three to six months and caution you about listening to those who do. We believe the market has seen its lows for this cycle and stock prices will be higher at the end of the year than they were at the beginning. The course of the war is unpredictable and the market will undoubtedly be challenged if the tide should turn negatively. However, we don't doubt that the coalition forces will achieve a decisive victory within a matter of months, if not sooner. If we are correct we've seen the worst of the bear market, the graph on page 5 shows the promise of the history of past recoveries from bear market declines.

The U.S. economy has faced both a literal and figurative blizzard of trouble over the past several months. The uncertainty of war has cast a general pall over economic activity. Crude oil went from just under \$20/barrel (West Texas Intermediate) at the end of 2001 to almost \$38/barrel just before the war started, due to the threat of war, a cold winter and civil unrest and violence in Venezuela and Nigeria, two oil exporting nations. Retail sales have been weak as consumers have too much debt and sentiment has plummeted to the lowest level since 1993. The bubble created so much excess capacity that companies have no pricing power and the only way to maintain profit margins has been to cut costs.

It's human nature to try to come up with "universal truths" to help us understand the world, particularly when things appear to be either much better or much worse than we expect. During the bubble years, the promise of technology unleashing a productivity miracle led corporations to abandon bricks and mortars for the Internet and to "new era" valuation metrics used to justify out-of-this-universe valuations. Today, the U.S. consumer is essentially bankrupt, corporations aren't in much better shape and deflation is lurking behind every dark corner. If there is one thing we've learned about "universal truths" in our twenty-eight years in business, it's **there are no universal truths**. A large and growing number of consumers have declared or are surely headed for bankruptcy, but that's not the case for the vast majority. Similarly, while certain sectors (i.e. airlines and telecom to name just two) and individual companies clearly have more debt than they can service, most are *not* being strangled by debt. Morgan Stanley pointed out Microsoft's net cash position (i.e. cash minus debt) alone would be the 35th largest stock in the

entire S&P 500. Finally, though there are high levels of excess capacity in a number of industries, where pricing flexibility will remain difficult, this is certainly not the case in all industries.

In sum, beware of sweeping generalizations. They are analytically easy to make, but can give investors false comfort as they shun analysis at the micro-level to paint with an excessively broad macro brush. Occasionally, they can also cause markets and/or sectors to go to extremes. As contrarians, this is good for us, as this broad painting of entire sectors tends to lead to outstanding investment opportunities at the micro level. "Independent" research has become a hot topic on Wall Street, as the common practice of analysts shilling for their firm's investment banking clients has taken center stage. The Street's response to the outcry and decreasing profitability has been to slash the number of analysts and companies they research. For example, *The Wall Street Journal* recently reported 44% of the 3,611 companies whose stocks trade on NASDAQ have no analyst coverage at all, with an additional 14% are covered by only one analyst. KM has *always* relied primarily on internally generated research to uncover attractive investment ideas. Unlike many of our competitors, who relied on the Street to do a great proportion of the heavy lifting of research for them, this change in Street focus will be a net benefit to us and our clients.

INTEREST RATES AND THE BOND MARKET

The yield on the benchmark 10-year U.S. Treasury bond fell to 3.568% on March 10, 2003, its lowest level since the summer of 1958, according to Merrill Lynch, as the stock market was plunging towards its October 2002 lows. Leuthold estimated inflows into bond mutual funds of \$48 billion during January-March, indicating the money coming out of equity funds plus the new, beginning of the year money that has typically gone into equity funds has instead gone into bond funds. About \$138 billion (net) has flowed into

bond funds over the past ten months. With bonds massively outperforming stocks from 2000-2002, the yield on the 10-year Treasury bond having reached a *44-year low* and money pouring into bond funds, the *overall* bond market doesn't hold compelling value.

We are having some success uncovering corporate bonds meeting our criteria for risk and reward, but less success actually purchasing these bonds. The "good stuff" has been essentially locked-away and is very difficult to buy. With an increasing number of dollars all pursuing the same relatively small and finite universe of improving credits, spreads have compressed. Unlike some other fixed income managers, we are not compelled to put every last dollar into the market, nor will we seek incremental yield by taking on materially higher risk. We don't know if the bond market is becoming or will become the next bubble. In an environment where Treasury bonds are probably more likely to move up in yield (and down in price) and where it's very difficult to purchase good, improving corporate credits, we may choose to hold some bond money in shorter-maturity instruments or cash.

SUMMARY

KM will celebrate its 28th birthday on May 1, 2003. We've learned a lot in these past 28 years. First and foremost, without the loyalty and confidence of our clients, we would not have a business. **We thank you very much!** Second, there are many brilliant people in this business (some undoubtedly much smarter than us), but there are **no shortcuts to long-term success and no free lunches. Success is about doing your own homework, thinking independently and keeping your head while others are losing theirs. It always will be.**

KM INVESTMENT TEAM UPDATE

KM's investment culture has always been oriented towards intensive, internally-generated fundamental research. We've recently made two important changes to our team. **Richard H. Hummel, CFA** was promoted to Director of Research, effective January 1, 2003. Rich joined KM in 1997 after receiving his MBA in Finance and Accounting from the Owen Graduate

School of Management at Vanderbilt University. Rich has done an outstanding job since the day he walked in our door and is responsible for researching stocks and coordinating KM's research efforts. **Craig S. Thrasher** recently joined KM as a Research Analyst (Equities). Craig received his MBA in Finance and Economics from the University of Chicago Graduate School of Business last year. Congratulations to Rich and welcome to Craig!

SECURITIES AND EXCHANGE COMMISSION—FORM ADV-PART II

Form ADV-Parts I and II describe an investment adviser's business and practices. Federally registered advisers, like us, are required to file an annual updating amendment to Form ADV-Part I electronically with the Investment Adviser Registration Depository (IARD). We made our annual amendment filing in March. The SEC is contemplating changes to Form ADV-Part II, but has not implemented any changes at this time. Advisers are to amend Part II as needed, but are not required to file amendments with the SEC. As a matter of practice, we have provided each client account with a copy of our annual amended Form ADV-Part II for the past several years and do so again this year.

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.

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

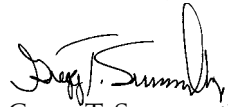
distributions or the redemption of Fund shares. Past performance does not reflect how Value Fund may perform in the future. The investment return and principal value of your investment will fluctuate. When redeemed, your share may be worth more or less than their original cost. Rafferty Capital Markets, LLC is the Distributor for Value Fund.

Regards,

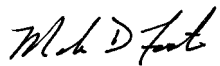
Kirr, Marbach & Company, LLC



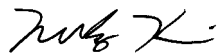
David M. Kirr, CFA



Gregg T. Summerville, CFA



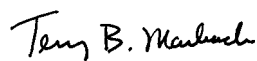
Mark D. Foster, CFA



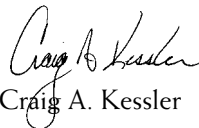
Mickey Kim, CFA



Darrell H. "Kip" H. Wright, CFA



Terry B. Marbach, CFA



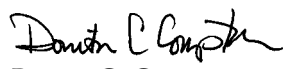
Craig A. Kessler



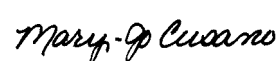
Richard H. Hummel, CFA



Allan C. Nichols, CFA



Donita C. Compton



Mary Jo Cusano



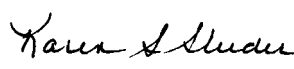
Patsy A. Kaisher



Deborah N. Malone



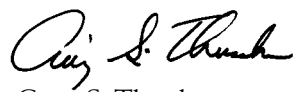
Mary A. Schoettelkotte



Karen S. Sluder



Joseph R. Haire



Craig S. Thrasher