RED HILLS CAPITAL, LLC

522 E. Park Avenue
Tallahassee, FL 32301

Phone: (850) 425-1110
Fax: (850) 915-0101
Web: www.rhasset.com

Visit us at www.rhasset.com

Tallahassee Money Management

Success Through Independence

THE FUNNY PAGES

The Qwest for Revisionist History

QWEST reports accounting issues.....

Can we really find this surprising given their proficiency in spelling? I mean, QWEST?? What is that from the Latin *qwesto, qwestare* meaning: *To inquire into the veracity of a balance sheet; To search for missing profits?*

The misspelled corporate names are almost as annoying as the high-dollar "inventful" names produced by specialized public image consultants. Enron.... a cross between Energy and Moron. Adelphia.... takes the "brotherly love" right out of investing. Lucent ... your portfolio is so thin that light passes through it.

In all fairness, not all of these made up names are poorly designed. Take Accenture for instance (my apologies to the company, but I couldn't remember which letter had the accent mark). Accenture was formerly known as Andersen Consulting. Good timing, as this was not the year to have Andersen in your name. How badly did Accenture want to remove itself from any perceived connection with Arthur Andersen? Check out the "Our History" link on the Accenture web site:

http://www.accenture.com
<About Accenture/Our History>

Their own version of their corporate history makes no mention of their having ever been named Andersen Consulting. Right…. And we were never at war with Oceania…

RED HILLS CAPITAL, LLC

RED HILLS REVIEW

August 2002 Volume 1,Issue 4

WILLIAM C. LAMB, JR.
RICHARD M. O'LEARY

INSIDE THIS ISSUE:

Upcoming Economic Releases

- Aug. 1, 8:30 Initial Jobless Claims; (10:00) Construction Spending
- Aug. 2, 8:30 Average Workweek; Hourly Earnings; Nonfarm Payrolls; Personal Income; Personal Spending
- Aug. 2, 10:00 Factory Orders
- Aug. 7, 8:30 Import/Export Prices
- Aug. 8, 8:30 Initial Jobless Claims; Producer Price Index
- Aug. 9, 8:30 Productivity; (9:45) Consumer Sentiment
- Aug. 13, 8:30 Retail Sales
- **Aug. 13, 2:15 Fed OMC Meeting**
- Aug. 16, 8:30 Building Permits; Housing Starts; Consumer Price Index (CPI)
- Aug. 19, 8:30 Leading Economic Indicators
- Aug. 20, 8:30 Trade Balance
- Aug. 22, 8:30 Consumer Price Index (CPI)
- Aug. 26, 10:00 Existing Home Sales; New Home Sales
- Aug. 27, 8:30 Durable Goods Orders
- Aug. 28, 10:00 Consumer Confidence
- Aug. 29, 8:30 GDP; Initial Jobless Claims
- Aug. 30, 8:30 Personal Spending; (9:45) Consumer Sentiment; (10:00) Chicago PMI

MARKET COMMENTARY

RED HILLS BOLDLY CALLS A BOTTOM!

With this newsletter, we are officially calling a bottom to the drop in the stock market. The lows set on July 22 will be the lows for the year in our opinion and we look forward to the grinding recovery ahead. Even in our Value Portfolio, we had increased cash positions throughout July but are now buying back in. On a long-term basis, we recommend buying anywhere in this market. There is a better than 50%-50% chance we re-test the 7/22 lows, however; so with short-term allocations to the market (as in the timing of our additions to the Value Portfolio) we view the market with some skepticism. On any dips, we will be looking to add significantly to the equity positions in our Value Portfolio in the weeks to come.

At the time of this commentary, the Dow Jones Industrials Average (DJIA) is at 8561, up over 1,000 points from the intraday low one week ago. Market volatility is extremely high. Even the Wall Street Journal pointed out this morning the relationship between high volatility (as implied by prices of stock options) and market bottoms. The last time we saw the VIX (Volatility Index) get near this level was the week the market re-opened following 9/11. The DJIA rallied over 2,000 points from that low in September before this summer's cliff dive.

Volatility is but one measure that characterizes a market bottom. The amount of fear we have seen from investors in the last few weeks has reached panic proportions. Plainly, in the sell-off of July 22, the sellers wanted "out at any price." The cool-headed buyers on that day profited handsomely and quickly.

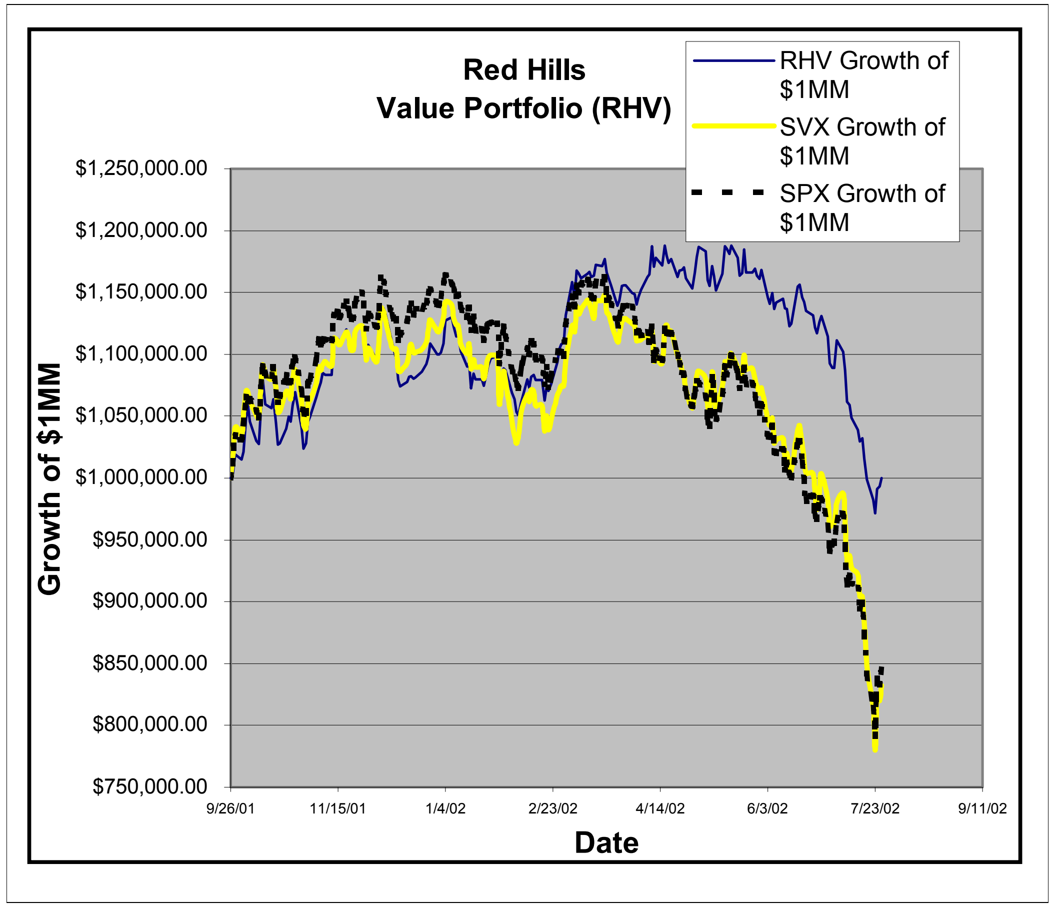
What lies ahead? The economy is showing some signs of strength and corporate executives, the legitimate ones who are not behind bars, spoke on conference calls of brightening horizons. Red Hills is positioning itself into companies that will benefit from continued economic recovery (see the Red Hills Value review on Page 2). We continue to take advantage of some corporate bond yields with maturities in 2004 and 2005. Despite one of the best outlooks on the market we've had since 1997, it never hurts to play some fixed-income defense. So what companies/sectors to invest in? Call (850-425-1110) or email us (info@rhasset.com) to talk more.

THE RED HILLS TEAM

William Lamb

Richard O'Leary

Red Hills Value



Source for S&P-Barra Value Data: Reuters Datalink. Source for Red Hills Value Index: Marketocracy. S&P-Barra Value data do not include dividends. Red Hills Value Index data include management fee. SVX is the S&P-Barra Value Index; SPX is the S&P 500. Data through 7/26/2002.

"Courage is being scared to death — but saddling up anyway."

— John Wayne

Summary of Red Hills Value Performance

	RHV	SVX	S&P-500
Since 9/26/01	-0.02%	-16.76%	-15.31%
Year-to-Date	-9.11%	-25.58%	-25.72%
Last 4 Weeks	-11.22%	-15.97%	-13.84%

The Red Hills Value Portfolio (RHV) continued its dominance over its closest benchmark, the S&P-Barra Value Index (SVX). Year-to-date, RV has outperformed by an astounding 16%. A similar whoopin' has been placed on the S&P-500 Index (SPX), with Red Hills beating SPX by 16.5% for the year. From the beginning, we have been preaching that our managed accounts have flexibility that the major funds do not. Namely, we can increase our cash position if market conditions warrant. Specifically, we increased our cash position to nearly 50% during the month of July. Now that we believe the bottom has been reached, look for our equity allocation to increase between now and the next newsletter. It is precisely times like these when money is made in the stock market. To paraphrase Jim Rogers, you wait until the money is sitting in a pile over in the corner and then you walk over and pick it up. We believe this to be one of those times.

... with Red Hills beating the S&P-500 by 16.5% for the year.

There were many deletions in RHV mostly due to sell-discipline rules that we have in place. While it often pains us to sell positions for no reason other than the drop in the stock price, these rules also got us out of positions in Mirant (MIR, currently $2.90 per share); Providian (PVN, $3.63); and Tyco (TYC, 12.61) long before their near-death experiences. The only purchases in the last month were additions to our holdings of The Mens Wearhouse (MW) and Fresh DelMonte Produce (FDP).

Insider Information

Do You Dare?

Recently, when I have been out talking to people about today's market, they are mad, bitter, distrusting and scared to get back into equities. In some respect I can't blame them for their negative emotions and cynical attitudes. It hasn't been a ray of sunshine around here either. The real estate market has been on fire and property values have appreciated considerably. Investors have been buying income producing properties, raw land, building or increasing the equity in their homes. Due to the incredibly low interest rates, this has been a great time to refinance your home or build the house you dreamed of. This is great BUT, property values have appreciated or maybe a better word would be "inflated" due to basic economics of supply and demand. Historically, real estate values increase in an inflationary economic environment. Currently, we have no threat of inflation. Even Alan Greenspan said the Fed did not see raising interest rates as a defensive strategy against inflation in the near future. Investors have been looking for an alternative to the stock market. The increased buying volume of real estate has inflated values to unrealistic levels. This should sound very familiar to everyone who invested in the stock market in the late 1990's. As we have seen, artificially inflated prices of any security or investment cannot be sustained and eventually, they fall from fantasyland, back to the land of reality.

As we have discussed in past articles, diversification and asset allocation are the cornerstones to any long-term investment strategy. Real estate can be a great investment, works as a hedge when other asset classes are underperforming, and should be a part of a portfolio's asset allocation. So many people got burned in this recent bear market because they got caught up in the frenzy and were invested 100% in high-risk equities with no cushion in the bear market. Can this same frenzy happen in the real estate market? What will happen to property values when interest rates go up? What governmental policies and other unsystematic risk could affect the value of your property? How fast could you convert a particular piece of real estate to cash? We have seen income property prices in North Florida increase dramatically over the last several years, but have rents increased? This makes the price to earnings (P/E) ratios significantly higher. Sound familiar? These are all very real factors that need to be considered.

Have you pulled all your money out of the securities markets and never going back in? Now is the time when equity investors make money. The market has sold off at a staggering rate. Even the "veteran" money managers have never seen a market this bad in their lives. All things being equal, would you rather invest in a market that everyone is chasing and inflating prices, or buy into a market that is not very popular and undervalued to fairly valued? Red Hills believes we have seen the worst, outside of a global tragedy, and we are feeling bullish. There are still the same inherent risks as always and some new ones have been created in the last several months, but with the proper help, you can navigate the market to profitable returns. The stock market: Will you get back in? **DO YOU DARE?**

"It is not because things are difficult that we do not dare; it is because we do not dare that they are difficult."

— Seneca

We have seen income property prices increase dramatically but have rents increased? This makes the P/E ratios significantly higher. Sound familiar?

1987 Revisited

October 1987 featured the worst single-day performance by the Dow Jones Industrial Average (DJIA) and the S&P-500 indices. In one day, the DJIA fell over 22% — a number that would be roughly equivalent to a 1900 point drop in the DJIA today. What would have happened if you had been unfortunate enough to invest $10,000 in the S&P-500 on the last day of September 1987 — before the massive sell-off?

Your $10,000 would be worth $7,824 at the end of October; $7,156 at the end of 11/87; and $7,677 by year's end. However, by the end of 1989 you would have had $10,981. You would peak at $47,158 in August of 2000 and even after this awful market the last two years, you would have about $28,000 now.

Despite two horrific market environments, you average a respectable 7.2% return. And that doesn't factor in over 1% per year in dividend income...

Despite two horrific market environments, you average a respectable 7.2% return.