January 6, 2005

Dear Friends,

Before commenting on our results for the year, we would like to welcome Lea Paine Highet as a Principal in our firm. Lea joined Douglass Winthrop early last year as Director of Marketing and quickly took the firm by storm! For many of you who already know Lea, you will agree that her integrity, professional skill, sound judgment and work ethic made her a natural addition to our partnership. As always at year-end, we are enclosing our privacy notice. Our Form ADV (Part 2) is available at your request.

Last year the common stocks in our Composite gained 3.94%[1]. By comparison, the Dow Jones Industrial Average returned 3.15% and the S&P 500 Index returned 8.99%, with the entire gain for the S&P occurring after October 26th, the day oil peaked at over $55/barrel. While our results lagged the S&P for the year, our common stocks have out-performed both the Dow and the S&P over the past two years, returning 40.25% vs. 29.27% for the Dow and 37.75% for the S&P.

The gain in the S&P last year was achieved in the face of headwinds. The Fed raised short-term rates five times during the year from 1.00% to 2.25%, suggesting that inflation is a more pressing concern than recession. Crude oil hit its high in October before retreating to $44 at year-end, still 34% above its price in January 2004. The dollar tumbled against most currencies, propelled by record current account and budget deficits in the U.S. And the Iraq War raged unabated throughout the year, with over 1,300 American soldiers killed in action since the war's start. Despite these challenges, stock investors were encouraged by a decisive presidential election, rising corporate earnings and continued low long-term interest rates. While short-term rates rose quickly, the 10-year Treasury note barely budged, finishing the year with a yield of 4.22%, slightly below its 2003 close of 4.25%. Profit growth remained strong for American companies, with earnings projected to rise 19% for the year. Resurgent capital markets activity underscored the market's confidence, as 249 companies completed initial public offerings in 2004 vs. 85 in 2003. Mergers and acquisitions rebounded as well, with $2 trillion of announced deals, up 41% from 2003.

One of the largest announced deals of 2004 was Johnson & Johnson's acquisition of Guidant for cash and stock valued at $25 billion. The deal

[1] Composite includes all fee-paying, discretionary accounts, with an equity weighting of 65% or greater and a total value of $100,000 or greater on the last day of the prior quarter. Composite results are calculated using a "Time Weighted Rate of Return" methodology, and are net of fees and include reinvestment of dividends and income. The composite excludes accounts that maintain legacy positions not initiated by Douglass Winthrop where these positions comprise more than 25% of account's value, and accounts open for less than one quarter. Results for benchmark indexes are index-only returns. Past performance is no guarantee future performance. Results are unaudited.

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gives JNJ a leading position in the fast-growing implantable defibrillator market, strengthens its vascular stent business and reduces its dependence on pharmaceuticals. JNJ has a record of successfully acquiring companies, and its management is among the few who have diversified into growth areas of healthcare, notably devices and biotechnology, through acquisitions. Still, the deal raises some concerns. By issuing approximately 240 million shares, management may believe its stock is fully-priced. In terms of valuation, JNJ is paying 30x Guidant's earnings, a premium to JNJ's own multiple of 20x.
Acquisition-led growth can be risky, as combining different cultures and systems is more challenging than investment bankers suggest. Despite our concerns regarding stock mergers in general, we believe the Guidant deal makes strategic sense and will make JNJ a more formidable competitor in the device market.

Pfizer was also in the news last year, as Merck's recall of Vioxx put intense scrutiny on the class of pain-killers known as Cox-2 inhibitors, including Pfizer's Bextra and Celebrex. While there are important differences in the ways Merck and Pfizer managed the clinical data regarding a possible link between Cox-2 inhibitors and cardiac events, the headlines were sufficient to impact Pfizer's share price. Serious public policy issues are raised by this controversy, such as whether it is socially acceptable for drugs to have dangerous side effects or whether drug innovation and affordable healthcare can coexist. In this case, our research suggests there is no conclusive evidence that normal usage of Celebrex causes the same type of serious side effects associated with Merck's Vioxx. Regardless, we expect Pfizer's Celebrex/Bextra franchise to be impacted. Even so, Pfizer remains in exceptional financial shape with no net debt, $1 billion in operating cash flow per month, a 2.9% dividend yield and a valuation well below that of the market. While Pfizer clearly faces competitive and regulatory threats, it is an inexpensive stock that should perform well in a challenging stock market.

In fact, we are confident our core holdings in aggregate will do well in the lower rate of return environment we foresee. Last year we added several stocks to the portfolio, including Gannett, Intuit, Fifth Third Bancorp and Medtronic. We also repurchased Tiffany after selling the stock at higher levels in 2003. Each company has unique strengths, which we would be pleased to discuss with you. Each also exhibits the attributes we demand of our portfolio companies, including proven management, attractive valuations, high returns on equity, strong balance sheets, rising free cash flow and high-quality earnings. All except Intuit pay dividends and in fact have increased their payouts an average of 12% per year over the past five years.

We financed these purchases by eliminating several stocks that achieved our price target, including Plum Creek Timber and Biogen Idec. Since our initial purchase in September 2003, Biogen Idec gained over 70% and now trades at 45x consensus earnings of $1.46, far above our purchase valuation and leaving little room for error should its new compounds stumble. We sold Plum Creek Timber at $37-38/share, a price which values the company's timberland at over $1,000/acre, up more than 40% since early 2003, and more than the $750-800/acre we believe it is worth. Plum Creek's dividend yield of 3.78% is sharply lower than its yield two years ago when tax rates favored long-term capital gains. Significant insider sales also suggest to us that much of the upside potential has been achieved.

Valuation is seldom the only reason we sell a stock but in the cases of Plum Creek and Biogen Idec, as in the case of Tiffany in 2003, it was the decisive factor. We also sold Marsh & McLennan last year on news of the investigation by New York's Attorney General into potential bid-rigging by the company. Since our sale, the stock has rebounded partially, however we are not in the business of owning turnarounds or companies with unquantifiable risks. In the case of Marsh, we felt the allegations were serious enough to irreparably damage the business model and potentially imperil its existence.

Douglass Winthrop's portfolio reflects our continuing view that dividends will be an important component of investment returns over the next several years. Many stocks appear fully priced in an environment of rising interest rates, inflation pressures, moderate global economic growth and possibly tighter profit margins. Bonds appear particularly expensive, with long-term rates near historic lows despite a weak currency and large deficits in the U.S. Simply put, too much capital is chasing too few investments, and most economies outside East Asia are not growing very fast. In a low-return world, we believe our clients are best-served by owning the common stocks of companies with proven management, high returns on capital, strong balance sheets, rising dividends and steady earnings growth, even when they are out of fashion. Multiple companies in our portfolio have long histories of returning value to shareholders in tough times, and we believe the outlook for these stocks is especially positive now.

Last year was a year of growth for the firm, for which we owe our clients and friends heart-felt thanks. We intend to build on the achievements of 2004 while staying faithful to our core values of putting our clients' interests first, achieving positive investment results, charging a fair fee and communicating clearly. Please stop by the office or give us a call if we can be helpful with your financial needs. Best wishes for a happy 2005!

Sincerely,

Jay Winthrop
Robert R. Douglass, Jr. Charles T. Howard
Lea Paine Highet Arthur Yorke Allen
Hal Howard