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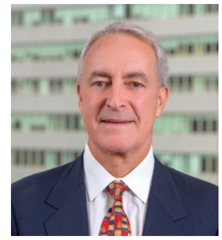

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Thoughts for Investors

Letter to Clients

FALL 1997

At least four times over the last few weeks I've attempted to write this newsletter. On October 27th the Dow declined 558 points. The very next day the Dow rose in response to the birth of our son, Alexander Baker Boris (born October 28, 1997; 7 lb. 1 oz; 20 inches; Dow Jones Industrial Average up 337 points). Now it's the problems in Southeast Asia. Sometimes, it seems we go from one "crisis" to another. When I get concerned, I recall the Chinese word for "crisis" which consists of characters from two other words: "risk" and "opportunity." Clearly these are times of both for world markets.

Most investors, in periods of crisis, seek the safety of US stocks and bonds. Yet that seemingly easy answer ignores opportunities, while assuaging feelings of fear. The task at hand in these times is to seek out opportunities. Searching for opportunities worldwide inevitably leads one to examine the techniques of John Templeton, the acknowledged dean of global investing. In November 1979, Templeton wrote about common sense investing, opportunities and bargains:

"If you want to buy the same thing that is popular with your friends or popular with the investment security analysts, you can't get a bargain. If you buy the same thing they buy you will get the same performance they get. If you are going to have a superior performance, you've got to buy what the other people are not buying or even what those are selling. Therefore, we search for those areas that are unpopular and then we study them to see if that unpopularity is permanent."

He then stressed the importance of diversification:

"It seems to be common sense that if you are going to search for these unusually good bargains you wouldn't just search in Canada. If you search just in Canada, you will find some, or if you search just in the US you will find some. But why not search everywhere? That's what we've been doing for (forty) years. We search anywhere in the world"

The current situation in Southeast Asia, and to a lesser extent that in Europe is creating precisely the opportunity that Templeton speaks about. To understand the extent of that opportunity it would be helpful to look at a similar "crisis" that occurred closer to home.

Not that long ago the US banking system was embroiled in a financially crippling situation called the "Savings and Loan Crisis". Much was, is, and will continue to be written about the cause of the problem and its long-term deleterious effect. Little was written at the time about the "opportunity" that was created. In order to survive, the S&L's dumped billions of dollars’ worth of real estate at prices below previous market value. Selling begot even more selling as panicked S&L's eventually sold at prices as low as $.30 on the dollar. "Efficient Market" theorists proclaimed that transactions could only occur at these prices because that's what it was really worth. Today, while there are still areas with depressed prices, most real estate values have recovered sharply, and new fortunes have been made.

A postmortem of the S&L crisis revealed that the problem centered not on the real estate itself but on the "financials" of the Savings and Loans. Too much cheap money was being offered by the S&L's and used to finance real estate speculation. Rising real estate values drew even more money in and the cycle continued. Eventually the "wheels came off", many people were burned, and the seeds of opportunity were sown.

Today, southeast Asia is experiencing a similar situation. Very cheap foreign money was being thrown at these fast-growing economies. The result was overbuilding, over buying and rampant currency and stock speculation. The "wheels" have now "come off" and people are beginning to understand the extent of the crisis. Granted this is an oversimplification, and the risks are real and still present. Yet the opportunities are now starting to surface in Southeast Asia as they have in Europe.

The first step to understanding the opportunity is to recognize that the market is not efficient at least not in the short run. George Soros has often reiterated the words of other great investors. He states that in the long run only the fundamentals of a business matter; in the short run only emotions. Mark Holowesko, the manager of the Templeton Foreign Fund was recently quoted in the New York Times speaking on the investment opportunities today in Southeast Asia. Holowesko says he "feels like a venture capitalist", referring to how venture capitalists are able to acquire large stakes in what they consider great business opportunities at low prices.

Again, it must be stressed that investing overseas requires patience and discipline. Even accounting procedures and political stability must be carefully examined. Currencies will continue to be devalued and some businesses will go bankrupt. However, strong companies will survive. Citizens, having now enjoyed health care, leisure, education, electricity and refrigeration, will no longer be satisfied with the past. Boeing's $100 billion order backlog is the sign of a huge untapped world market for air travel.

Europe also presents opportunities. Perennially lagging the US and Japanese economies (and hearing the footsteps of the rest of Southeast Asia), the Europeans are looking toward the EMU as their last best chance at being competitive with the US. The price of admission to the EMU is quantifiable fiscal austerity of the government sector. Many countries such as the United Kingdom are very close to qualifying while others such as Italy are making considerable progress. Meanwhile many companies are switching from government run and financially (supported to independence. These companies are experiencing double digit growth rates and (single digit market valuations versus many US companies whose market valuations far exceed their growth rates.

In summary, international markets have experienced a "crisis" and it is clear that "opportunities" abound. The growing pains that they are experiencing only serve to strengthen and teach them much as similar experiences have taught and strengthened the United States. The wise investor, employing patience, discipline and the assistance of an experienced international money manager will use these opportunities to expand and diversify their holdings in the world's markets.

"The only investors who shouldn't diversify are those who are right 100% of the time."

– John Templeton

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Hear the Other Side

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If you would like to discuss the topic of this newsletter, or our team's approach to investing, please feel free to contact us by email at al.boris@alexbrown.com.

Thoughts for Investors is a quarterly newsletter written for clients since 1997 by this author. The purpose is two-fold. First, it is meant to help explain the investment philosophy that guides the author's approach to portfolio management. Second, it is meant to remind readers of important behavioral skills that the author believes are necessary to help them become successful investors. The author welcomes comments and criticisms, especially if they can be shared for the betterment of all investors. Quotation is permitted with full attribution.

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