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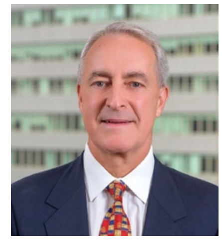

Thoughts for Investors

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Letter to Clients

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Preface

Long term clients will notice this letter as a new addition to our repertoire of services. I intend to do this quarterly. The purpose is to share philosophical ideas on investing. While most will come from the great investors such as Templeton, Fisher, etc., many will also come from you. I have been fortunate over the years to work with great clients. Sometimes I will talk about specific companies but usually to illustrate a point. I would appreciate your feedback on these letters as well as ideas for future letters.

Past Performance isn't Indicative of Future Performance

Not long ago, John Bogle of the Vanguard Group said that the average mutual fund investor can quote the performance numbers of all their mutual funds but can't tell what stocks those funds own. The first criteria people look at today is performance. This may be because successful mutual fund managers are reluctant to publish actual holdings. They fear other managers "piggybacking" on their ideas. Or it may be because performance is the only way investors know to judge a fund. Either way the long running bull market has dulled some long-term investors sharp senses and "New" investors don't have a chance to learn investing techniques since they haven't yet been put to the test. Yet, investing based on past performance is like driving by looking out the rear-view mirror.

Copy the Great Investors

A long time ago I read an autobiography of Abraham Lincoln who liked to read about great people. His theory was that much could be learned from people you admire. To that end I have read about the lives of such great investors as John Templeton, Philip Fisher, Warren Buffett, Paul Cabot and T. Rowe Price to name a few. Since not everyone has the time to do this (though for me it is part of my job) I thought I would, share some of their wisdom.

When to sell (and when not to)

As the market seems to be "choppy" lately I will refer you to a chapter in Philip Fisher's Common Stocks and Uncommon Profits (originally published in 1958) the chapter is entitled "When to Sell (And When Not To)".

"There are many good reasons why an investor might decide to sell common stocks. He may want to build a new home or finance his son in a business...

This type of selling, however, is personal rather than financial in its motive ...! believe there are three reasons, and three reasons only, for the sale of any common stock which has been originally selected according to the investment principles already discussed."

– Philip Fisher

Fisher explains that the three reasons are: 1. When you make a mistake and the factual background of a company is less favorable than originally believed. 2. When a company's prospects deteriorate either because of a deterioration in management or a deterioration in "the prospect of increasing the markets for its products." 3. When another stock is found that presents a greater opportunity for growth. Fisher is quick to point out that the third reason seldom arises and should only be acted upon if the investor is "very sure of his ground." This is because there is always a risk that you have misjudged the potential of the new investment whereas with the stock you currently own you already know its "less desirable as well as more desirable characteristics.

But what about Alan Greenspan (or the Persian Gulf War, or the seizing of the Pueblo)?

Fisher goes on to say, "At this point the critical reader has probably discerned a basic investment principle which by and large seems only to be understood by a small minority of successful investors. This is that once a stock has been properly selected and has borne the test of time, it is only occasionally that there is any reason for selling it at all. However, recommendations and comments continue to pour out of the financial community giving other types of reasons for selling outstanding common stocks. What about the validity of such reasons?"

"Most frequently given of such reasons is the conviction that a general stock market decline of some proportion is somewhere in the offing. In the preceding chapter I tried to show that postponing an attractive purchase because of fear of what the general market might do will, over the years, prove very costly. This is because the investor is ignoring a powerful influence about which he has positive knowledge through fear of a less powerful force about which, in the present state of human knowledge, he and everyone else is largely guessing. [f the argument is valid that the purchase of attractive common stocks should not be unduly influenced by fear of ordinary bear markets, the argument against selling outstanding stocks because of these fears is even more impressive."

His final thought " "If the job has been correctly done when a common stock is purchased, the time to sell it is -- almost never."

For those invested in mutual funds, look at your fund's turnover rate, the rate at which all of the stocks in the fund are sold or " turned over" in a given year. Good managers have less than 50% turnover, the best sometimes less than 25% turnover. That means that the entire portfolio changes once every two or more years; anything higher is an admission that mistakes are being made in the selection of stocks being included in the portfolio.

Recently a study was done at the University of California at Davis on the average turnover rate among individual investors at a discount brokerage firm from 1987-1993. The turnover rate was 78%.

The Conclusion

Whether you are invested in individual stocks or mutual funds of stocks, practice becoming a great investor. Check to see if what you own fits your philosophy. Be flexible though since different styles work at different times. And remember, performance is the conclusion to a successful investment plan not the starting point.

If anyone would like a copy of Fisher's book, please give me a call. I would be more than happy to send you one.

AUDI PARTEM ALTERAM

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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