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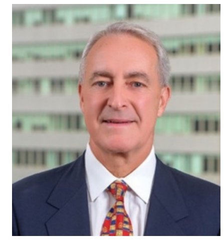
# Thoughts for Investors

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## Spring Newsletter

JUNE 2000

***"Too often we…enjoy the comfort of opinion without the discomfort of thought."***

– John F. Kennedy

February marked my sixteenth anniversary in the investment business and I feel fortunate to have participated in the greatest bull market of all times. Is this the end though? Has the curtain come down for the last time? Should we take our chips and go home?

In this issue I would like to take a stab at what happened to the stock market and postulate where we go from here. CAUTION: I remain bullish about the long-term prospects for the world and especially for this country. I believe that we have only paused to catch our breath. If you disagree with this outlook, PLEASE STOP READING NOW!

### Where Were We?

Clearly investors have been "exuberant" over the past several years. Considering the tremendous growth of the economy, it's arguable whether it really was "irrational". I believe the real danger comes from the magnitude and breadth of our past bull market successes. Up until this recent decline, investors thought this "game" was "easy." Everyone was making money because almost every strategy has worked since 1982. Problems started to appear when investors began to believe that their strategy worked under all scenarios. The first class of investors to get doused with cold water were the value investors, people like George Vanderheiden, Julian Robertson or even John Neff of the Windsor fund. Fortunately for John Neff, he retired just before the problems with value investing started, and unfortunately his successor, Charles Freeman, is the one who got all wet. Did value investors really believe that they would be able to buy great companies at discount prices during an economic expansion? That would be like expecting to buy a winter coat at a 50% discount…in November! The underperformance of value investing over the last several years occurred because when they couldn't buy at a discount, value investors found themselves shivering in January with no coat at all! Recently, growth investors likewise have been doused with cold water, although it's not been as cold as that thrown on the value investors. Some growth investors believed that price was no object, paying 200 or 300 times revenues, while value investors balked at 20 times earnings.

It is possible, however, to pay too much for a winter coat if: A) You already have a perfectly good one that is doing the job and; B) Buying that new coat doesn't make you any warmer and interferes with your ability to buy food or pay the rent. Should you sell Cisco Systems to buy XYZ Systems just because someone said XYZ is the next Cisco? Many growth investors became dissatisfied with the measly 25% to 50% revenue growth rates of companies like Intel, Cisco Systems, and Oracle and instead moved on to dot.coms or bio-techs promising more. Unfortunately, these stocks turned out not to be any warmer. In some cases they even had to be sold when the rent came due (margin calls).

It is imperative that investors upgrade the quality of a portfolio, replacing stocks whose prospects have dimmed, with stocks whose prospects are brighter. However, an investor must be very confident in the changes lest the only opportunity you create is more tax revenues for the IRS.

It's understandable that investors are confused. In the past, roadblocks to prosperity arose from very tangible events. Wars, droughts, even plagues swept over the land and eventually retreated. You could see their effect. Today, few people in developed countries have to be concerned with these problems and their effect on one's social or economic wellbeing. If a drought prevents us from getting New Jersey tomatoes we can get them from California, South America, South Africa, or even Israel.

Today's economic roadblocks are more difficult to interpret. We have been told that inflation would sink the SS United States. When that didn't happen we were told that deflation would. A strong dollar has alternately been good, bad, good and currently bad for the United States. A decade ago we worried about corporate layoffs and high unemployment, today we worry that too many people are working! My all-time favorite phobia is in vogue again. Not long ago, CEO's were chastised for concentrating on short-term profits at the expense of building for the future. Today's battle cry is "we need to see profits now!"

Where Are We?

We have moved from "irrational exuberance" to "irrational paranoia". As of this issue the market has given up its 2000 gains and part of 1999's. I believe we have passed through two of the three stages of a bear market. Stage 1 is the CAUTION or "buy on the dips" stage. Stage 2 is the CONCERN or "forget the dips, buy food stocks because people always have to eat" stage. I believe that we are somewhere in Stage 3. Stage 3 is the CAPITULATION or "sell everything and hide in cash" stage. Unfortunately, we never know when a stage is over until we are into the next one. We won't know when we are out of Stage 3 until the market has already gone back up.

Where Do We Go from Here?

What have we learned from this bear market? Be wary of "experts." The British economist John Maynard Keynes pointed out that "economists set themselves too easy, too useless a task if in tempestuous seasons they can only tell us that when the storm is long past the ocean is flat again."

Don't get side-tracked by political events. While they usually have great news making capacity they rarely have across the board, long term, negative effects. Trust your research of the fundamentals. If a company has: 1) A large market opportunity; 2) Superior products and execution; 3) Barriers to entry; and 4) Great management; then the stock will do well in the long run. Use this time of uncertainty to prepare your portfolio for the next leg of the bull market.

There are winter coats available now, even brand-new ones at a discount. It's time to go shopping!

***"When one door closes, another door opens, but we so often look so long and so regretfully upon the closed door, that we do not see the ones which open for us."***

– Alexander Graham Bell

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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.

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