

Thoughts from

Hanson Investment Management Inc.

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The Race Isn't Always to the Swift . . .

WE DON'T HAVE TO BE TOLD that the stock market is a lot more volatile today. Prices spike up and then spike down with dizzying regularity. And annual turnover or the amount of trading investors do has also gone way up. These charts are courtesy of Brad Perry and the *Babson Staff Letter*.

People trade for two reasons. The first is they think they know something about the future. The long bull market of the 1990's made many people very certain of their own talents. But remember the old adage, don't confuse brains with a bull market! A second reason we trade is we are scared. We don't know what the world is going to look like so we want to be in the most popular areas where every one else is. This means a lot of jumping around.

What is so wrong with the doubling of turnover on the NYSE the last 10 years? For one, it makes losers out of winners. The annual return of the S&P 500 between 1984 and 2000 was 16.3%. This is good. But Dalbar, a consulting firm in Boston, reports that the annual return of the average mutual fund investor was only 5.3%. How can this be? Because investors moved in and out of equity funds at just the wrong time. The moral of this story is that overtrading almost always guarantees you will miss the free ride of the market's return. Better to be the hare in this race and follow our oft mentioned advice: In investing, Exercise Extreme Sloth!

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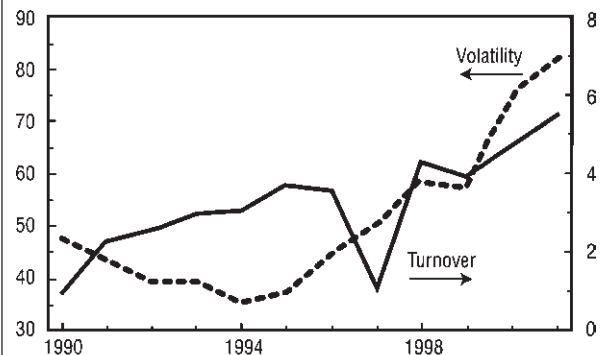
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Hanson Investment Management is an investment counsel firm managing portfolios for individuals and institutional clients. The firm also consults with individuals on financial planning and works with self-directed retirement plans on investment options.

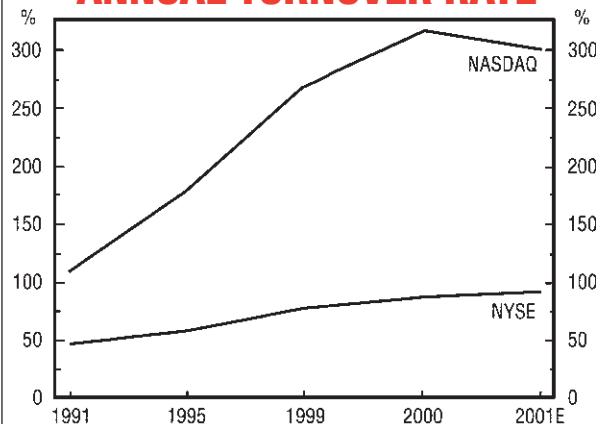
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TECH TURNOVER & VOLATILITY



Source: Morgan Stanley Research
Top 100 market-cap tech companies.
Turnover=annual share volume divided by average shares floating.
Volatility=annualized standard deviation of monthly returns.

ANNUAL TURNOVER RATE



Sources: NYSE & NASDAQ

Source: David L. Babson

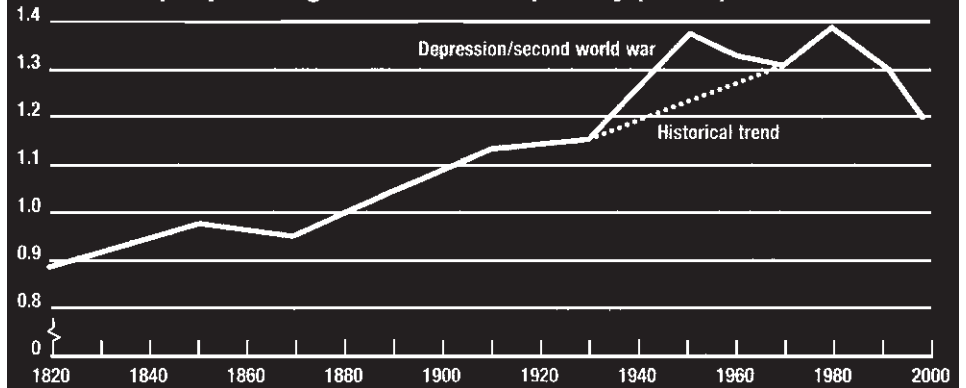
The Post 9/11 World . . . Globalization in Retreat . . . Can the Patient Be Saved?

THE IDEA THAT GLOBALIZATION IS GOOD for the world has gained a lot of strength the past two decades. But a backlash is now building. Globalization is based on the idea that the world is getting more interconnected and doing so at an ever-increasing speed. Trade is more free, capital is moving more quickly and representative government is taking hold in more places. But the critics argue that globalization encourages environmental destruction and a loss of local culture. In addition local and national governments are losing power to multilateral organizations. And the biggest criticism is that globalization is unfair. There are winners like the developed countries, some select developing countries and the well educated but for the losers there is only hopelessness and a feeling that they will never get a share of the wealth.

Why is this so important? Because globalization and the growth of world trade is vital to the U.S. Take a look at

World Poverty

Number of people living on less than \$1 per day (billion)



Source: Financial Times

the chart on page 3. U.S. trade, that is total exports and imports, make up almost 25% of total growth domestic product (GDP) today. This is up from just over 10% twenty-five years ago. But exports are only part of the picture. What IBM produces in Japan and exports to other countries in Asia or Europe for instance is not included in

our GDP. This is a very important number since total affiliate sales of U.S. companies total more than twice U.S. exports. Globalization means more exports and affiliate sales of U.S. companies abroad and any backlash against globalization will be a big blow to us.

day has declined in the 1980's and 1990's. This is good news. Global trade has opened markets, created jobs and given upward mobility to many. But the bad news is this decline in poverty is due to a great extent to one country — the rise of China. Since it first opened its farm markets in the late 1970's China has lifted more people out of poverty than any country has ever done in history. Pretty impressive. But two billion people or approximately one third of the global total still live in countries with extreme poverty. You can see where a lot of the bitterness towards globalization (and its chief henchman, the U.S.) comes from.

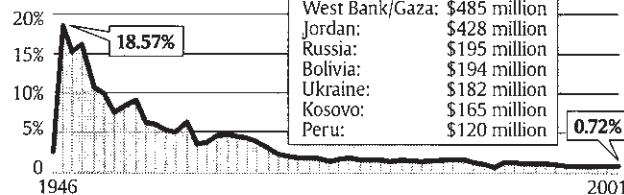
So what is the solution here? Can globalization be made more fair? I hope so but I don't have the Holy Grail on this one. I do however have three modest suggestions.

1. We need to do more.

The United States is the largest foreign aid donor in the world today. But as a percent of GDP we give away only .1%. Compare this to the other developed countries (see chart). We need to do less of what we have done in the past, that is "buy friends" with our aid dollars and do more of what is really important in the emerging world. Malaria for instance claims

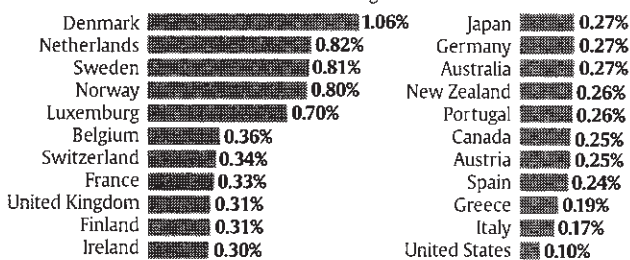
Falloff in U.S. Foreign Aid

Foreign-aid spending as a percentage of the federal budget has declined steadily since World War II.



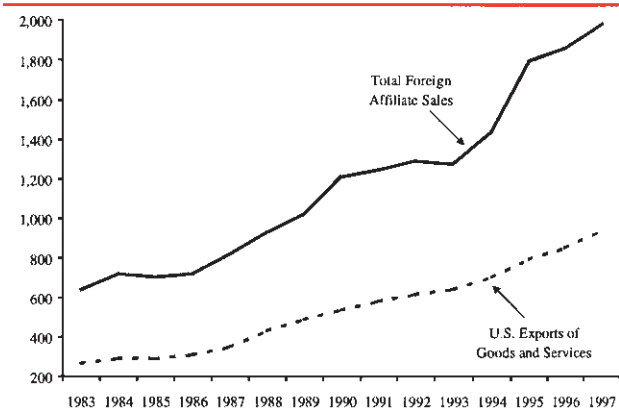
What other countries give

The United States ranked 22nd in 2000 foreign-aid spending as a percentage of a nation's gross national product, not including military assistance. The United Nations recommends that countries give at least 0.70%



Sources: U.S. Agency for International Development; Congressional Budget Office; Organization for Economic Cooperation and Development
By Quin Tian, USA TODAY

**Total Sales of U.S. Foreign Affiliates
Versus U.S. Goods and Services Exports, 1997
(Dollars in Billions)**



Sources: Bureau of Economic Analysis,
U.S. Commerce Department.

Source: Morgan Stanley

perhaps two million lives annually and infects another 200 million people. But drug companies are not interested in malaria because the sufferers in poor countries can't pay for the drug. The U.S. has not stepped in here but fortunately the massive \$20 billion Bill and Melinda Gates Foundation has. Founded less than five years ago the Gates Foundation has targeted among other things under financed areas of scientific research in emerging countries. \$750 million will be spent over the next five years on vaccine programs and fifty million dollars alone of this will go to malaria doubling worldwide research spending on the disease. This is what the U.S. should be doing with its aid dollars. The total United States aid budget works out to \$5 a year for every man, woman and child in this country. We can do better.

2. Reform the Reformers.

One of the consequences of globalization is the increased power of multi-lateral organizations such as the World Bank, International Monetary Fund (IMF) and the World Trade Organization (WTO). The record of these organizations has not been stellar. The World Bank has historically lent money to developing countries for big- ticket projects such as dams and power stations. By the Bank's own reckoning however nearly 60% of its projects are a failure. Pretty dismal. The IMF was originally created to act as a lender of last resort to countries in financial distress. It

has moved increasingly to mandate fundamental financial changes (structural adjustments) for struggling countries. But its record is also checkered. Both organizations need reform.

My focus here is on trade and the World Trade Organization. The WTO acts as the policeman of world trade, setting the rules of the game and then adjudicating trade disputes. Last year in Doha the 143 members of the WTO (and this includes China and Taiwan now)

agreed to work on a new set of trade rules to be completed by 2005. Shown in the lower right are some of the most contentious issues. Well over 50% of third world exports consist of just two things, agriculture and textiles. Developing countries need relief here. The U.S. wants China to open its market further to U.S. soybeans. But at the same time we want to keep our markets closed to commodity agricultural exports from poor countries. Obviously we like it both ways. Special interests here, be they southern textiles makers or midwestern sugar beet growers have so far had the upper hand. The U.S. government needs to work harder to make fair trade fair, not just for us but also for everyone.

3. Power to the People.

It is often said that third world economic problems are inherently cultural and that reforms will do very little here. This is only partially true. Culture is indeed important but a recent book by a Peruvian, Hernando DeSoto (*The Mystery of Capital*), which has received much press, goes a long way to exploding this myth. DeSoto's claim is that 50% to 80% of a typical poor country's economy is off the books, meaning informal businesses like hair dressers or small factories which operate outside the legal and reporting system. The poor do not climb the development ladder because they have no legal standing. Squatters living in favela shantytowns in Brazil for instance cannot sell their

houses because they have no title to the land. DeSoto estimates that 80% of all new job growth in Latin America comes from the underground economy. If you legitimize this and give property rights to the poor you free up much human and financial capital. The U.S. needs to pressure emerging countries to create the systems and infrastructure to allow everyone to participate.

The issues of the global economy are very thorny indeed. The U.S. has to take the leadership here and wrestle with the hard choices. We need to keep globalization bearing fruit. But it won't be easy. The world is clamoring for immediate results now while we are still wrestling with many of our long held insular tendencies. We are a Power. Now we just have to prove we are a Global Power.

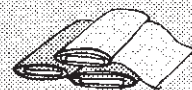
Tangled Trade Talks

Major issues confronting the delegates at the World Trade Organization conference in Doha, Qatar.

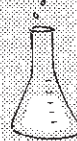
AGRICULTURE Reducing barriers to farm trade is a top priority for the United States, other major food exporters and most developing nations. But Japan and Europe are reluctant to limit support for their heavily subsidized farmers.



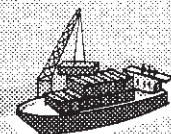
TEXTILES Many poor countries want richer nations to allow more imports of clothing and textiles so they can industrialize faster.



INTELLECTUAL PROPERTY Poorer countries want access to cheaper medicines to fight AIDS and other public health crises, but the United States and other nations with leading drug companies are reluctant to relax patent rights.



DUMPING Japan and many developing countries want to limit the use of anti-dumping laws, which have been invoked by the United States to protect its steel industry.



Illustrations by Jody Emery/The New York Times

The U.S. Economy . . . The Recession That Wasn't . . .

LAST NOVEMBER, the National Bureau of Economic Research finally declared that the U.S. economy had entered a recession. To investors used to a regular diet of falling stock prices and lay-off announcements, this was not exactly big news.

Today, a mere four months later, it appears that this pronouncement may have been a bit premature. Typically, a recession is defined as two consecutive quarters of economic contraction. While few economists were surprised by the 1.3% decline in last year's third quarter, the economy's rebound in the closing months of 2001 was unexpected. Fourth quarter output advanced 1.4% and current estimates suggest that the economy could grow 3-4% in the first half of this year. If these numbers come in on the mark, the latest recession could prove to be the shortest since World War II.

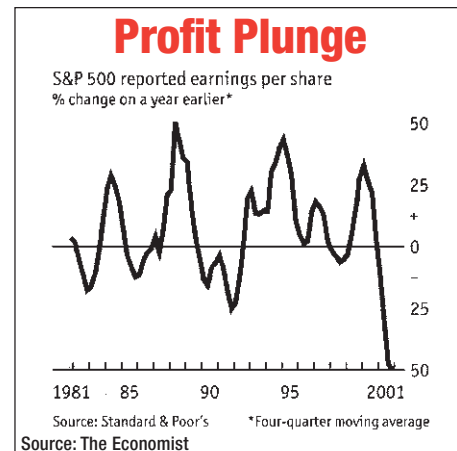
A number of factors are contributing to the economic strength. First, consumer spending, which accounts for two-thirds of economic activity, has held up remarkably well. Sound fiscal and monetary policy can largely be thanked for this result. Tax rebates put as much as \$600 in the pocket of American families last summer just as the downturn was picking up speed. The Federal Reserve's aggressive moves to lower interest rates in 2001 also kept consumers spending. Lower interest rates reduced the carrying cost of consumer debt and paved the way for a record wave of mortgage refinancing. In 2001 alone, homeowner's

spent about \$50 billion of the \$80 billion raised in cash-out refinancings. Lower prices on everything from gasoline to autos to clothing also boosted spending. Fortunately, the downturn had its biggest impact on the manufacturing sector of the economy. Today, this sector represents only about 13% of the total economy, down from a high of 34% as recently as 1950.

While the latest downturn had a limited impact on consumers, Corporate America suffered a somewhat different fate. Take a look at the chart to the right. Severe capital spending reductions and inventory liquidation sent profits to their biggest annual decline since the depression of the 1930s.

Today, an increasing number of economists are predicting a sharp economic rebound. Excessive inventories have been worked off, consumer spending remains robust and productivity growth has resumed. While I too expect economic conditions to improve, I see a number of obstacles to a quick, sustained economic recovery.

Historically, renewed spending on housing and consumer durables has led the U.S. out of recession. But this recovery will be different. While business investment plummeted last year, housing sales remained robust. Consumer sales of big-ticket items such as autos and washing machines also hit peak levels. As a result of this strong spending, consumer debt loads are now at historically high levels. With



their balance sheets already extended, consumers and businesses will be hard pressed to provide the spending and investment needed to fuel strong economic growth.

Despite the recent inventory reductions, a number of industries still suffer from excess capacity. Excess capacity together with stiff global competition is limiting company's abilities to raise prices to offset higher costs. New expenses associated with protecting against terrorist threats, which could total as high as \$151 billion a year, represent just one such cost. Finally, economic growth in the rest of world remains anemic. Japan continues to struggle and Europe, while better off, is also experiencing weak results. U.S. companies, who derive about 25% of their profits abroad, will have a difficult time showing strong growth without some help from foreign markets.

Does all this suggest an end to the current economic rebound? Probably not but it is important to remember that rarely has the U.S. economy moved in one direction for too long. Consider the chart to the left. Five of the seven recessions since 1957 experienced "double-dip" downturns. To be sure, the U.S. economy has proven to be more resilient than expected this time around and there is much room for optimism. Double-dip or not, the economy will continue to experience productivity gains and profits will recover. As famed financier J.P. Morgan put it, "The man who is a bear on the future of the U.S. will always go broke."

Anne Williams Doremus, CFA

