

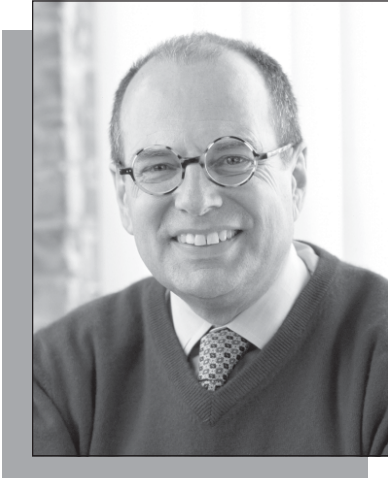
Thoughts from

Hanson Investment Management Inc.

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Some Faces to the Names . . .



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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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WE ARE JUST THREE MONTHS shy now of ten years in business. Wow! Thank you so much. We have been located here in the Maltex Building on Pine Street since we started. We have gone from a small space on the first floor to bigger digs overlooking the lake on the third.

Our team has been together for many years and we are proud of this. In fact we have had only one person leave since 1995. Our first office manager Marykay McCarthy moved five years ago to be closer to her children in Arizona and when she did Debbie Healey came aboard and she has been a wonderful addition. You will probably talk to her when you call and rest assured she knows where everything is. Kristen Audy assists Debbie and anything you get in writing from us comes from Kristen's very fast and experienced typing hands.

Anne Doremus and I have worked together for fifteen years now. We handle all of the investment management and securities research. She is a wonderful person to be associated with.

Finally Mike Reynolds joined us this year from Charles Schwab and previously the Merchants Trust. Mike is learning the ropes, backing up Debbie and taking on investment responsibility.

We are already looking forward to the newsletter ten years from now celebrating our 20th Anniversary. Here's to another decade!



Pictured left to right: Anne Doremus, Mike Reynolds, Eric Hanson, Kristen Audy, Debbie Healey

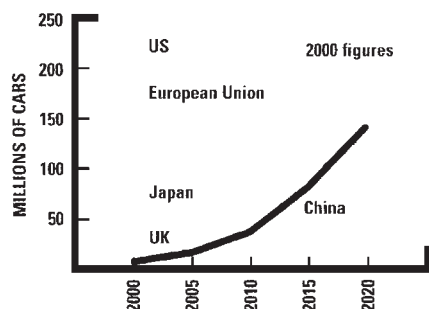
Oil Economies . . .

Who Is Driving this Car Anyway? . . .

TRY CHINA. *Take a look at the chart to the right.* The price of oil has been tracking right with China's import demand. China is only 8% of world oil consumption compared to 25% for the U.S. But the emerging giant accounts for one third of the increase in oil demand each year. China (and India) are booming today but they have very little domestic oil production. They will drive import demand in the future. The pessimists see this as a one-way ride for oil prices – straight up.

CHINA'S CAR MARKET IS GROWING

The Chinese car market is dwarfed by auto sales in the US and Europe, but that will change over the next 15 years.



Source: Wired

I am more suspicious. Things don't grow straight to the sky especially when everyone is agreement about the story. Short and long-term changes can happen quickly when prices jump sharply like today. For instance I wouldn't be surprised to see more production coming from Saudi Arabia or newly developed fields or old fields that are squeezed harder.

Longer-term things can also change. The United States has quietly become a very efficient industrial user of oil. *Take a look at the chart bottom right.* The U.S. now uses 55% less oil to generate a dollar of GDP than in 1973. Chemical and steel companies lead the way here

but others have also done a good job. Unfortunately this doesn't include the consumer. The average miles per gallon for U.S. cars hasn't changed in more than a decade, as gas prices have stayed low.

China is a notoriously inefficient energy user. According to *Business Week* the country needs six times as much energy to produce a dollar's worth of GDP as Japan. But China will get more efficient as the price tag for imports rises.

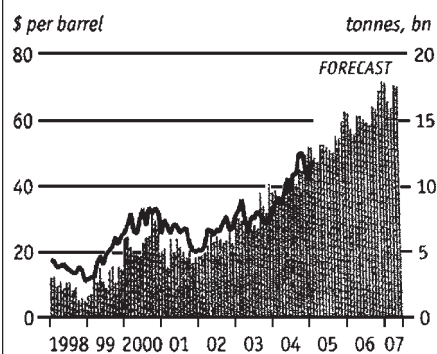
The consumer will drive much of Chinese energy demand. As incomes rise demand for private housing and private cars will soar. This spells big problems for Chinese pollution, which is already bad, and for gas prices. Or so say the Doomsayers. But there is another side to this coin – the recent history of cell phones is a good example. Many emerging markets have state of the art cellular networks today. The reason is they did not have a mature hard-wired phone system to deal with like many developed countries. They could jump immediately to state of the art wireless and they did. Automobiles may be at the same place today. China could decide to move directly to state of the art energy efficient cars rather than let conventional cars clog the streets.

Wired magazine notes that China is already one of the largest markets for alternative fuel vehicles and Beijing is planning to convert all 120,000 of its buses to compressed natural gas by 2008 for the Olympics. China could transform itself from one of the most polluted, energy inefficient countries to market leader in clean cars. Maybe this is why Toyota surprised everyone by building one of its highest tech Prius plants in China. It certainly wasn't for the low cost labor.

Qatar is the Saudi Arabia of natural gas. It has 14% of the world's reserves. Qatar has lured Exxon and others to

CRUDE CORRELATION

West Texas Intermediate price v Chinese oil imports



Source: UBS

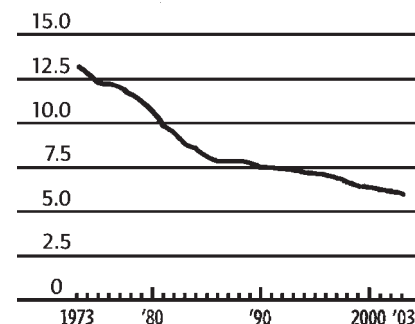
Source: Economist

build enormous gas to liquid (GTL) plants with the idea of producing a liquefied natural gas, which can be used interchangeably with diesel in automobiles right now. This would cut pollution significantly and add a competitor in the fossil fuel space. I wouldn't be surprised if China showed a big interest here.

When life gives you lemons (higher energy costs) the best advice is make lemonade (look for investments which will benefit from the changes). We are trying to do just that.

MORE BANG FOR BUCK

The amount of petroleum and natural gas consumed to produce a dollar of economic growth, in thousand BTUs per dollar of GDP*



*GDP data in chain-weighted 2000 dollars
Source: Energy Information Administration

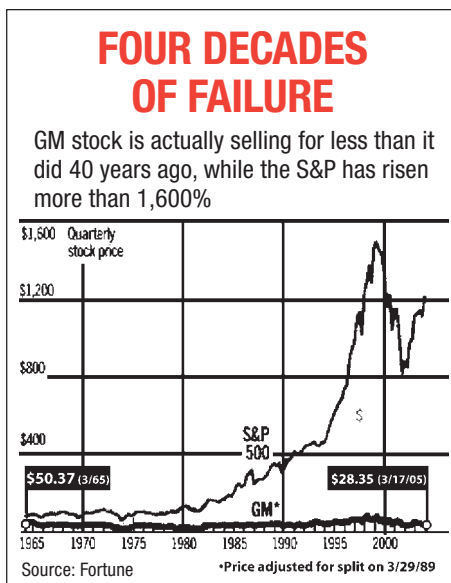
Source: Wall Street Journal

The U.S. Scene . . .

Some Random Thoughts . . .

Is GM a good buy?

THE STOCK IS DOWN from \$50 to \$30 the past year but my reaction is stay away. *The chart below* shows that General Motors has been a dismal investment for more than 30 years. This is no great surprise but the reason may be GM is our version of the Chinese state owned company – a capitalist cradle to grave operation. John Smail, the retired Proctor & Gamble CEO who served as General Motor's lead director, has said that the job of CEO at GM is not to boost the stock price or return shareholder value, but to "sustain the enterprise." Just like the Chinese state company, GM's unstated objective is to keep the ship afloat and as



many of the 460,000 union members gainfully employed as possible. And with health benefits to boot. The GM healthcare plan covers 1.1 million workers, retirees, widow(er)s and children. Union members pay nothing towards the premium and they receive 90% of their wages when they are laid off. General Motors is our state within a state. It out-Europes Europe

How can the company get out of this mess? The short answer is I don't know. The union simply has no incentive to give up enough to make things work. Toyota and the other transplants pay

their current workers about the same as General Motors but the difference is Toyota does not have the legacy cost of 600,000 retirees. GM is in the same boat as the airlines. Unless the company off loads some social costs they will probably sink closer and closer to bankruptcy. I wonder whether it is possible to simply declare bankruptcy now, preserve what is left and move on once the contracts are reconfigured. Probably too radical an idea but something to think about.

All this has not gone unnoticed by the market. Last year GM sold nearly 9 million vehicles but its market cap is now less than Harley Davidson – a company with 3% of the sales of the auto giant!

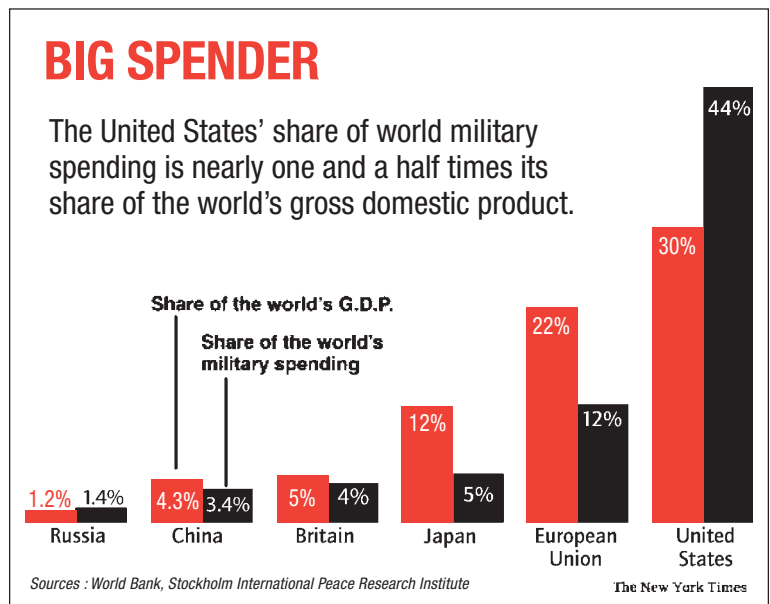
Big kid on the block.

I always knew America spent a lot on defense but *the chart at the bottom is startling*. We are 30% of the world's economy but 44% of the world's defense spending. The rest of the world together just barely spends as much.

Is there room to cut here? The answer has to be yes but it will be difficult. Appropriations take on a life of their own. A year ago President Bush proposed eliminating sixty-five federal programs to reduce the deficit. Only one of these actually was terminated, a small Commerce Department program that provided money for innovative applications of information technology. There is an extremely vocal constituency for every appropriation.

There are also a couple of bigger questions here. First, is Great Power defense sustainable? We don't have a strong economy because we have a strong military. We have a strong military only because we have a strong economy. At some point defense spending exhausts our ability to pay. We overstretch. This happened to England after World War I. They simply couldn't afford an Empire anymore. I doubt we are at this point yet but our incredible reach is still not long enough to act in every local and every regional conflict around the world. If we keep stretching, we will eventually reach the breaking point. The only question is when.

A second point is that a big defense budget allows for dangerous actions. There are a lot of crazy countries and crazy leaders in the world who in effect are not that dangerous because they can't "project." They don't have the military or the weapons to threaten the world. But the fact is we do have the ability to project anywhere and everywhere. Warren Buffett likes to say "I want to own a company that even a fool can run because eventually a fool will run it." A smaller defense budget could actually make for a safer world. It would make it less likely that the world's greatest power would take so many stupid actions.



Economic Trends . . .

The Changing Face of Globalization ...

BACK IN APRIL 1999, *New York Times* foreign affairs columnist Thomas Friedman wrote *The Lexus and the Olive Tree*. This best-selling text described in straight forward language the ways in which markets, nation-states and technologies are being integrated across the globe. Friedman also explored the tension created by globalization's trend toward economic improvement and the age-old desire for community identity. This text, while quite accurate for its time, was written before 9/11, the collapse of Enron and the bursting of the technology stock bubble.

Clearly a lot has changed since then. In his most recent book, *The World Is Flat: A Brief History of the 21st Century*, Friedman chronicles the continuing rise of globalization. From 1999-2001, for example, hundreds of million of dollars were invested in technology stocks here in the U.S. These investments, while ultimately unprofitable for many investors, supported the roll-out of advanced fiber-optic systems around the globe. These telecommunication systems and the related development of software standards and applications allowed intellectual work to be delivered from anywhere in the world. The opening up of political and economic systems in China, India and Russia also coincidentally allowed some 3 billion people to join the free market. These trends, Friedman points out, made the world increasingly "flat" or inter-connected. We are now all on the same playing field. As long as you have an email address and a website, you can be up and running anywhere in the world today.

Friedman is well traveled and has access to some of the most influential players on the global scene today. He also does a good job chronicling globalization and its impact on the U.S. economy. For these reasons, I think he is worth paying attention to. But globalization is a complex process and forecasting its progress is not easy. The global economy is comprised of thousands of interconnected, moving parts and its

evolution will take many unexpected turns. Consider the following trends.

China's emergence as an economic power is a well-accepted fact today. An immense reservoir of low cost labor has helped drive its economic ascent. But Guangdong and Fujian provinces in the fast-growing, southern part of the country are now experiencing labor shortages of about 2 million workers.

As long as you have an email address and a website, you can be up and running anywhere in the world today.

This surprising shift began last year and is partly the result of two decades worth of strict family planning. Because of rules strongly encouraging families to have only one child, China's labor force is expected to decline over the next 15 years. The decrease in eligible workers and technological advances are causing some unexpected behavior. Workers in China are starting to use the Internet to shop around for the best paying jobs.

Shanghai which boasts better pay levels, for example, is attracting workers from lower paying Guangdong. While salaries are up, it is important to remember that they are still comparatively low. In early March, Shenzhen announced that it would raise its minimum wage to \$83/month up from \$74/month.

The combination of technological advances and a well-trained, inexpensive work force has also supported India's emergence onto the world economic stage. *But take a look at the chart to the right.* Wages in India's outsourcing industry are starting to climb. Entry level wages are up 20%

annually over the past 2 years while mid-level managers have seen an almost 40% average annual growth in pay. India's outsourcing industry employs 1 million people and according to Nasscom, India's software industry association, that number is expected to double by 2008. This kind of growth suggests that India's pay levels are unlikely to moderate soon.

These examples illustrate the danger of extrapolating economic trends. Yes, India and China enjoy low cost labor pools. But their relative cost-advantage may not last forever. What is clear, however, is that the global economy remains dynamic. Countries, and increasingly individuals, are now able to compete equally in the global market place for talent and resources. And the competition is not going away. Consider the fact that in 2001, India graduated almost a million more students from college than the United States did and China has six times as many graduates majoring in engineering. In this world, as Friedman states, "...every individual is going to have to run a little faster if he or she wants to advance his or her standard of living." We in the U.S. better start running.

—Anne Williams Doremus, CFA

Wages of Success

India's software outsourcers are paying more for programmers, and a lot more for managers

AVG. ANNUAL SALARIES	ENTRY-LEVEL SOFTWARE WRITER	PROJECT MANAGER
2000	\$4,082	\$13,585
2001	4,213	14,653
2002	4,496	16,319
2003	5,852	25,822
2004	6,628	31,131

Data: Nasscom

Source: Business Week