

Thoughts from

Hanson Investment Management Inc.

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Sometimes we lead . . . Sometimes we follow . . .

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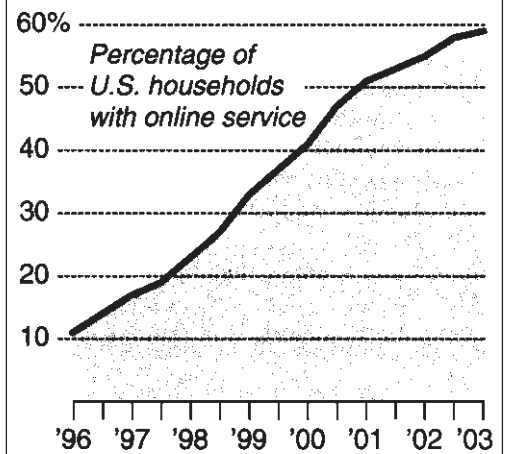
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WHEN YOU THINK OF the most wired country in the world you think of – South Korea? If you don't you should. This country of 46 million has eleven million households or 70% of the country's total, connected to the Internet through broadband connection. Nearly two thirds of all mobile phones are third generation meaning they are connected to the Internet at broadband speed. In the U.S., only 60% of households have the Internet and this is mostly at slow dial up speed. The U.S. has virtually no third generation cell phones yet. These will not be available until 2004 at the earliest.

The world has not seen anything like Korea yet. What can we expect? First, when broadband becomes ubiquitous – through computers, laptops and phones – traffic will soar, in both good and bad

INTERNET SERVICE



Source: International Herald Tribune

ways. Last year e-commerce moved \$150 billion of goods in Korea, 30% of the country's total GDP. Seventy percent of all stock trades are now done online.

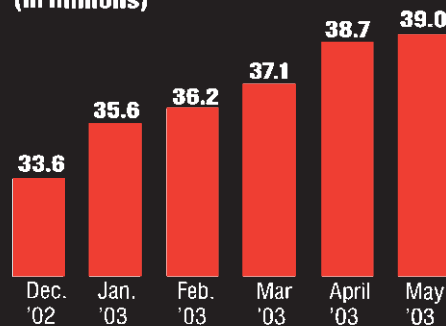
But the downside is the divorce rate is soaring in Korea as online chatting, text messaging and even video chatting has loosened relationships. Prostitution has gone online and the head of the country's professional society for psychologists estimates that 10% of the population and 40% of 13- to 18-year-olds are addicted to the Net. If true this is amazing and alarming.

Korean firms are leading the way in sophisticated online gaming. NCSOFT has already signed up 3.2 million subscribers who pay \$25 a month to play. Eighty foreign companies, including Microsoft have set up shop in Korea to learn about broadband and how to get ready for America's take-off. My guess is the 2000-2003 technology slow down will be seen as one small blip on the wave of Internet growth.

The Digital March Goes On

High-speed connection

Total U.S. broadband users (in millions)



Source: Nielsen//NetRatings

Source: U.S. News and World Report

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.

Investor Behavior . . .

Some thoughts on bonds . . .

and on stocks . . .

BONDS HAVE BEEN IN A BULL Market since 1981. Interest rates have risen from time to time but basically prices have gone up and yields down for two decades now (see chart below). The ten-year Treasury note reached its current low of 3.1% on June 13 this year.

At that time the Federal Reserve was giving a strong signal that it would push short rates as low as necessary to get the economy going. The market also felt that if low short rates didn't do the trick then the Fed would buy longer bonds to push the important mortgage rate lower. This would stimulate refinancing and keep the housing market on a tear.

Some writers including Martin Barnes of the Bank Credit Analysts speculated in the *Financial Times* that the Fed's explicit commitment to short rates gave a virtual license to hedge funds and speculators. They could borrow short and turn around and invest long. A riskless bet, apparently.

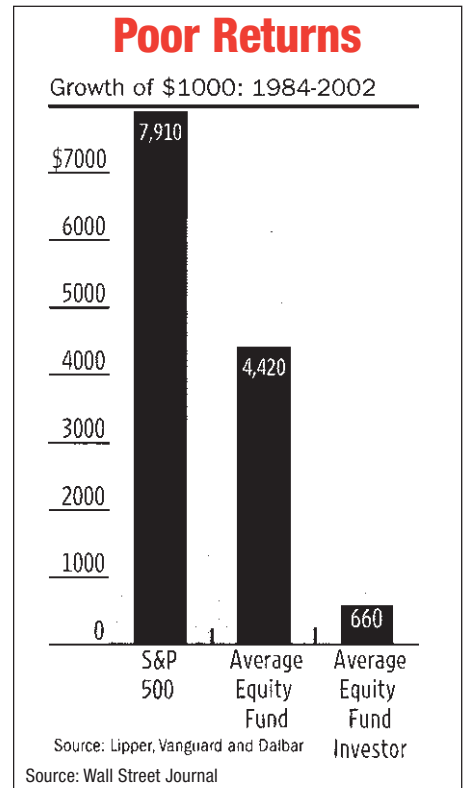
Well, William Goldman, the famous Hollywood mogul, once commented when asked whether studio executives could forecast blockbusters, "Nobody knows anything". The same can be said of Wall Street. Just when the tech stocks looked their best in 2000 and just when bonds looked so solid this summer, that's when lightning strikes. The bond

vigilantes looked at the Federal deficit, the rapid growth in the money supply and the improving economy and suddenly saw higher inflation, not a risk of deflation. So bingo, time to sell bonds and nearly everyone did. The ten-year Treasury note rose from 3.1% in June to 4.5% at the end of July, the biggest three-month loss for the bond market ever (at least dating back to 1927 when numbers were first collected).

What's my point here? Simply, that there are no sure things in the market. And when you do think the stars are perfectly aligned that is when you need to be doubly suspicious. The financial advice here is to stay diversified and stay balanced in all financial matters. Better safe than sorry. Just ask those bond speculating hedge funds.

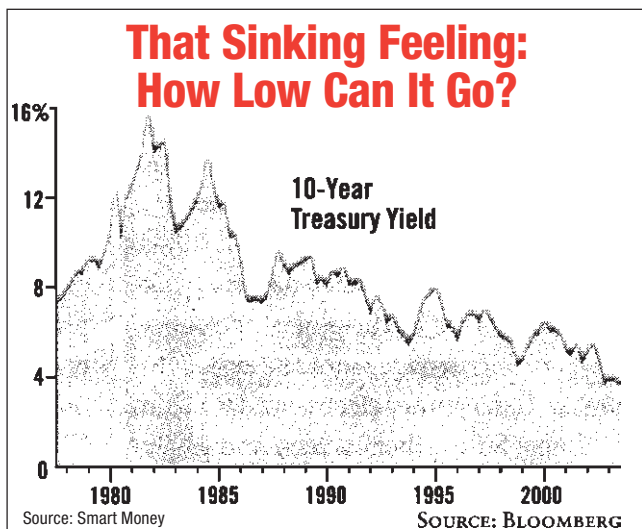
And now on to the stock market. Dalbar Inc. in Boston has done work on what mutual funds earn and how investors in those funds have done. You would think the two numbers were the same – but they are not. The results today show that the Standard & Poor 500 has returned 12.2% annually since 1984. The average equity fund has grown by 9.3% per year. This is what you might expect since funds involve management expenses and there are also trading costs, which take a slice. But the real shocker is that the average equity mutual fund investor earned only 2.6% per year. This hasn't even kept up with inflation.

Why the dismal results? The answer is, investors jumped into the market one day and jumped out the next. They did this over and over. One wrong move cancelled out a right move and the result was no return. Ken Fisher, the columnist in *Forbes*, has studied how markets have



moved and fluctuated in ten-year periods in the twentieth century. A round trip is the swing between a peak and a trough and then back again to a peak. The quietest decade was 1963 to 1972 when the round trip swing (peak to trough to peak) was 34%. The biggest swing was 97% in the 1929 to 1938 decade. This kind of volatility leads to a lot of emotional behavior. We want to sell when things decline and buy when things go up. But it is impossible to time this perfectly so we get stuck with sub par results.

The lesson here is the same as with the bond market example. No one knows how the future will play out so the best strategy is not to make a lot of bets and the ones you do make should be long term and based on solid past percentages. Such as stick to good profitable firms, hold them a long time and don't give much thought to the sometimes very scary news of the moment. We have said here many times – exercise extreme sloth.



The U.S. Economy . . .

The State of Manufacturing . . .

OK LET'S NOT GET TOO hysterical now. We all know we have lost a ton of jobs in footwear, toys and textiles to China and now higher end stuff like technology gear is going there too. We also have heard the stories of good intellectual service sector jobs going to India. Forrester Research in Cambridge, Massachusetts has published a report that says by 2015, 3.3 million high tech and service industry jobs will be overseas.

I don't want to underestimate this threat. I have written about it many times here. The rest of the world is getting smarter and more successful at

Upwardly Mobile

The average annual incomes for some occupations in the metalforming industry, based on a 50-hour week with time-and-a-half calculated after 40 hours.

Tooling supervisor	\$62,539
Senior tool and die maker	\$55,513
Quality supervisor	\$47,120
Machinist	\$44,044
Laser machine setup and operator	\$40,841
Scheduler/production control clerk	\$39,954

Source: Precision Metalforming Association
Source: Wall St. Journal

eating our lunch. But keep in mind some figures. The 3.3 million number Forrester Research talks about is little more than 2% of total American employment today. Yes it does represent high paying jobs but it is just plain wrong to assume that the U.S. won't continue to create good jobs at good pay. *Take a look at the chart to the right.* We are losing manufacturing jobs today but total manufacturing employment is about the same as it was in 1950. It hasn't fallen off a cliff. The industrial production of these workers has soared however.

My prediction is that manufacturing has a future here. It will be more high tech and more sophisticated than it even

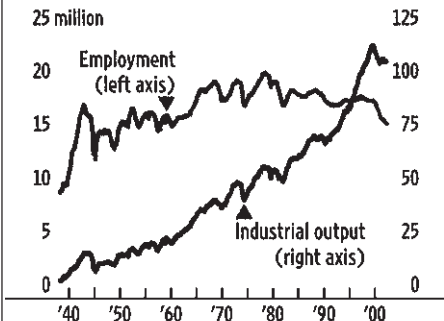
is today. The *Wall Street Journal* recently ran a series of articles on the new blue-collar world. It noted that there are still many high paying jobs in this sector (*see chart to the left*). Specialized tooling supervisors and machinists are tackling more complex jobs today. They manage people, they adjust quickly to last minute changes, they trouble shoot and they change specs on the fly, all talents that are not easily shipped off shore. The biggest change in blue-collar jobs in recent years is the sheer velocity of the work. Everyone is expected to produce more and do it more quickly. This will only intensify.

The short-term problem is we are caught in a bind. On the one hand jobs are being exported for cost reasons. On the other, productivity is advancing so rapidly that companies are able to cut employment or hold employment steady, while increasing output considerably. But the payoff will eventually come. Higher productivity will lead to more jobs.

Where will these jobs be? We are not sure. A story in *U.S. News and World Report* noted that half the jobs in the current Dictionary of Occupational Titles didn't even exist in 1960. The same may be true of tomorrow's jobs. The U.S. Department of Labor has put together a list of manufacturing specialties that are in the top 25% of all manufacturing lines in terms of both productivity and job growth. The list

Clocking in

Despite boom-and-bust cycles in manufacturing, the sector employs the same number as in 1950. The industrial output index for U.S. manufacturing (a measurement of production) and employment:



Note: Output peaked in June 2000 and was down 5% between 2000 and 2002; output index=100 in 1997
Sources: Bureau of Labor Statistics; Federal Reserve Board
Source: Wall Street Journal

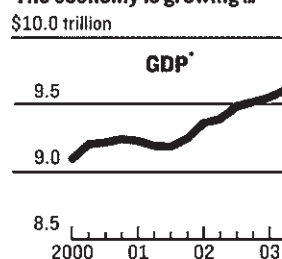
includes computer and mathematical occupations, industrial automation equipment (robots), garden machinery, motor vehicles, metal coating, screw machines and bolts and rivets. There is a lot left we still "make" here.

When the stock market went up earlier this year many people shook their heads. Where's the recovery, where are the earnings? They are correct, things are still weak. But longer-term the 5.7% spike in productivity in the second quarter augurs well for eventual job growth, even in that sector – manufacturing – that many have given up for dead.

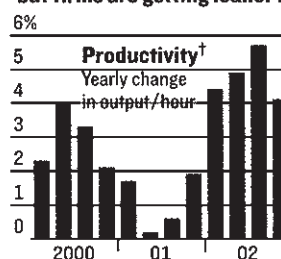
Hard Job: Boosting the Employment Rate

When the economy is humming, rising productivity helps make businesses more competitive abroad and keeps a lid on inflation. In the current slower economy, it's holding back job growth.

The economy is growing ...



but firms are getting leaner ...



so there are no new jobs



*SEASONALLY ADJUSTED ANNUAL RATES IN CURRENT DOLLARS. †NONFARM BUSINESS. SOURCES: U.S. DEPARTMENTS OF LABOR AND COMMERCE.

Source: Newsweek

The Global Economy . . .

The Growing Immigrant Workforce . . .

THE WORLD IS BECOMING a smaller place. This thought occurred to me recently as I was being served dinner at a local resort by a young college student from Poland. Iwona, one of several foreign employees working there, came to Vermont for clearly economic reasons. Two days of waitressing here earns her the equivalent of one month's wages back home.

Iwona, it turns out, is part of a growing trend. Facing a shortage of local help, resorts across the country are increasingly turning to foreign workers. Last year, 253,841 foreign students came to the U.S. on temporary visas, an almost 32% increase from five years ago.

And foreigners are no longer just filling low-end service sector jobs. According to a study by the National Science Foundation, nearly a third of the doctoral degrees awarded in the U.S. each year go to foreign nationals as do 40% of the PhDs in engineering and science. Importantly, the study estimates that two-thirds of these students remain in the United States. In manufacturing, immigrants total 15% of sector employment up from roughly 6% in 1970.

The U.S. remains the leading global recipient of immigrants with net inflows of 16.7 million people from 1970-1995. But a review of the chart below tells a slightly different story. Up until the 1930s, immigrants represented a growing percent of our population. But

the absolute number and percent of foreigners declined steadily from 1930-1970 before rebounding in the 1980s. This ebb and flow reflects an ongoing national debate over the benefits of an open immigration policy.

The growing number of immigrants is straining our country's infrastructure and resources. But foreigner's positive economic impact suggests these costs may well be worth it. Economic growth occurs in only two ways. Economies expand if workers are more productive. While technological innovation can fuel productivity growth, it is generally hard won. An economy can also expand by increasing its number of workers. But low birth rates in developed countries

mean low population growth and in the U.S., the further difficulty of a growing retiree-to-worker dependency ratio. A growing immigrant population helps offset low birth rates and increases the pool of possible workers.

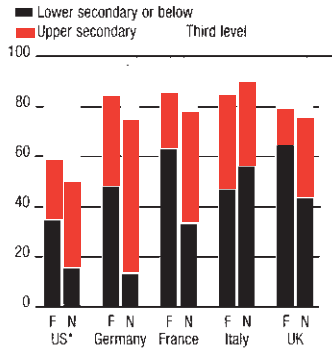
Not surprisingly, immigrants who arrive with specific skills or have strong entrepreneurial drive produce the most economic benefit. Fortunately, 40% of foreigners in the United States have college degrees. Further, the average U.S. unemployment rate of all foreigners in 2000-2001 was about the same as for the population as a whole. But other countries are not so lucky. Take a look at the chart above. In countries such as Finland, Denmark and Sweden, the unemployment rate for foreigners is more than twice as high as the population as a whole.

Immigrants have a long history of contributing to economic growth and innovation in the United States. Currently, foreigners are playing key roles in both the service and research sectors of the economy. These areas could suffer if recent visa restrictions and security requirements stem the tide of new workers. Integrating foreigners into our economy and culture has never been easy. But the U.S. has successfully managed this process in the past and we can do it again.

— Anne Williams Doremus, CFA

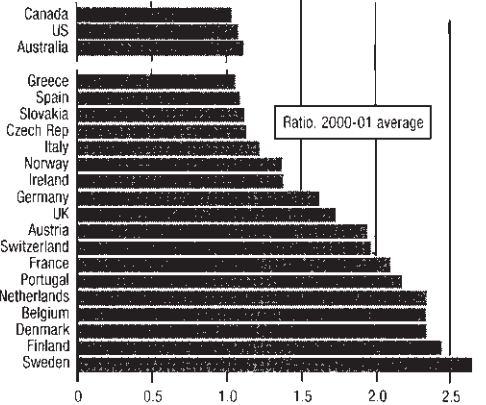
SKILLS AND EMPLOYMENT

Foreign (F) and national (N) adult populations By maximum level of education, 1995-98 average (%)



* Lower secondary refers to education below high school diploma level. Upper secondary refers to high school diploma. Third level refers to at least some level of college education

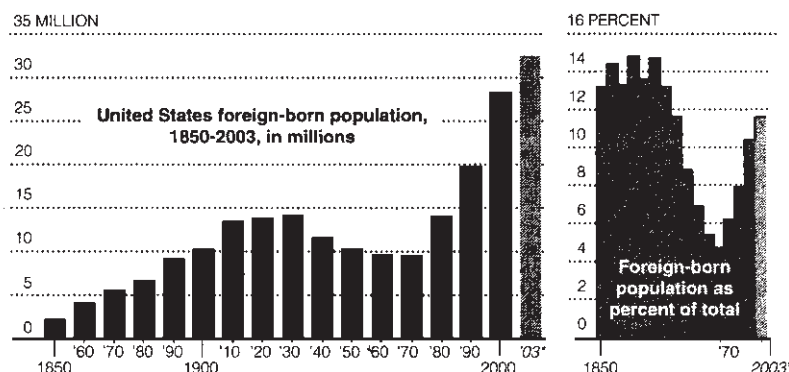
Proportion of foreigners in total unemployment Related to their proportion in the labour force



Source: New York Times

COMING TO AMERICA

Both the percentage and number of foreign-born people in the United States dropped during much of the 20th century, but after 1970, the tide was turning again.



Source: The Financial Times