

Thoughts from

Hanson Investment Management Inc.

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Why Isn't the U.S. Doing Worse? . . .



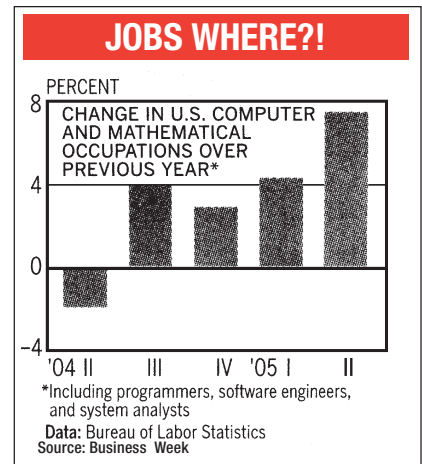
WE HAVE A SAVINGS RATE close to zero, our budget and trade deficits are enormous, the consumer has more debt than ever and the rest of the world is running smarter and faster. We should just hand in the keys and walk away.

Well the reality is the economy is doing pretty darn well. We have had thirteen consecutive quarters now of profits up more than 10%, the economy is growing faster than its "normal" 3% rate and unemployment is down to close to 5%. What's the deal?

To be fair there are a lot of very dark clouds on the horizon. But as Robert Samuelson points out in *Newsweek* we have a history of taking selective economic events like the Sputnik launch in the '50's or the Japanese economic surge in the '80's and creating a full blown theory of economic inferiority.

Outsourcing is an example now. It is an article of faith that every manufacturing job is going to China and every high tech service job to India. So why is the job category "computer and mathematical occupations" (see chart above) which includes many programmers rising by 7.5% or 3.2 million jobs today? China and India and others are pumping out university graduates in big numbers but according to the McKinsey Global Institute only 14% of these are really able to function in multinational companies. This helps explain why hiring here is strong.

Outsourcing and offshoring are scary subjects but they are not destiny. Don't give up just yet on this economic recovery or, for that matter, the U.S.



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The Yuppie Gap

Of 33 million¹ university graduates in low-wage countries with up to seven years' work experience, 4.6 million—less than 14%—are ready to work for a multinational.



EACH FIGURE=1 MILLION WORKERS

That compares to 15 million² young professionals in higher-wage countries.



NOTES

¹ Based on a survey of 28 low-wage countries.

² Based on a survey of eight higher-wage countries: U.S., U.K., Germany, Japan, Australia, Canada, Ireland, and South Korea.

Note: Doctors and nurses are not included.

Source: Fortune

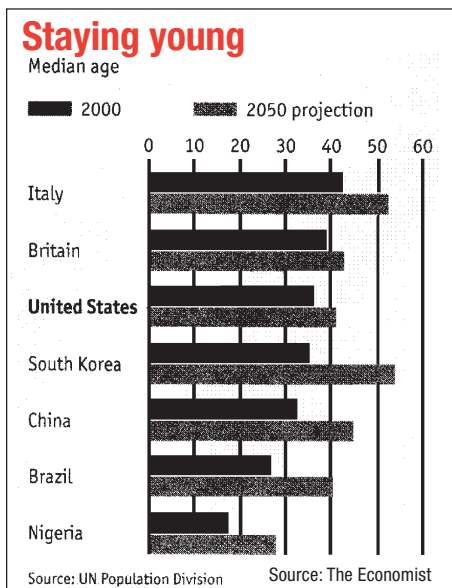
The U.S. Outlook . . .

The State of the Union (from a Modern Day de Tocqueville) . . .

FOR MY MONEY *The Economist* is the single best financial read on the market. The magazine (it calls itself a newspaper) publishes lengthy country surveys periodically. In July it took on the United States.

How did we fare? Surprisingly well. I say surprisingly because there are plenty of skeptics on this subject. For instance Samuel Huntington, the Harvard professor and author of *Who Are We?*, is not optimistic about the current wave of immigration. Hispanics are not “melting in the pot” as previous immigrant groups did. The ghettoization of Hispanics is introducing a whole new dynamic into America.

The Economist looks at a number of issues in its survey: mobility (our enthusiasm for moving around), immigration, equality of opportunity, our love of clubs, and comes to a generally different conclusion than Huntington and others.



We are making headway not backtracking. Victor Vinde, a Swede observed back in 1945 that America’s greatest asset is its belief in progress. We work harder than almost anyone, three hundred hours a year more than the average European and we are not hesitant to move in search of opportunity. Between 1995 and 2000

almost one half of all Americans changed address.

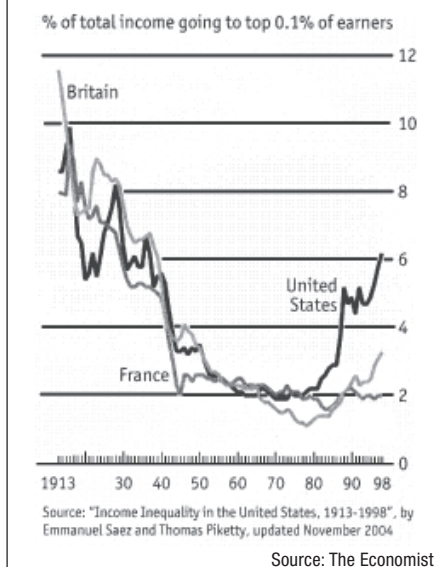
The issue of immigration is going to define us the next twenty to fifty years. Eleven percent of the population today is foreign born. This is down from 15% in 1890 but still high by other country standards. *Note in the chart to the left* how immigration will keep us a very young country.

And as far as the melting pot issue, *The Economist* is optimistic. Almost 1/3 of all marriages today involve a Hispanic or Asian partner crossing racial lines. Also, the cities with the fastest growing Hispanic population are not the traditional ones, like Los Angeles or New York but out of the way locations like Greensboro, Raleigh and Charlotte, North Carolina and smaller cities in the Midwest. The melting pot lives.

America has always been a country of joiners. Recent books like “Bowling Alone” questioned this. *The Economist* argues that traditional growth of Rotary and Lions clubs is slowing but in its place more focused action groups like Sierra Club and NARAL and new “mega-churches.” Faith based mega-churches of more than 2,000 members are a new phenomenon. In 1960 there were fewer than 10 of these. Today there are 1,200. These churches go far beyond Sunday services. They sponsor community groups in every imaginable shape and form.

While *The Economist* is upbeat about much of America it is not so on one topic – income. *As the charts in the upper and lower right suggest,* America is becoming more and more unequal. The rich are benefiting from global opportunities but the lower classes are struggling. *The Economist* hopes education is the answer here. This is what will give the less advantaged a fighting chance in the global market. But the data here is not that encouraging. Education is becoming more stratified not less. Only one in thirty students at the most selective U.S.

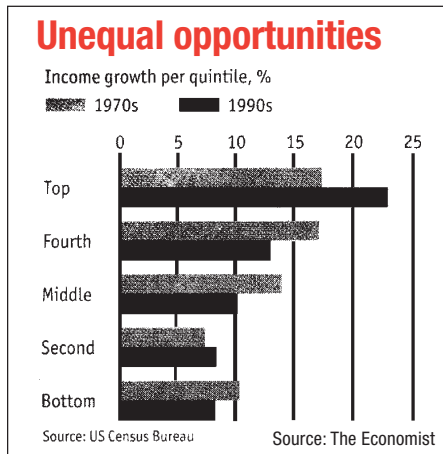
America's super-rich get richer



colleges comes from the poorest quarter of households. Ability is a factor in education but income seems to be just as important.

The secret to better education has to include some healthy political horse trading. Republicans need to loosen the strings and allow more education spending and Democrats need to be less wedded to the teacher unions, demand higher standards and experiment with school vouchers.

American has its faults today but from my reading of *The Economist* survey, we still get a solid B/B+. I’ll take that.



Emerging Markets . . . Is The Going Still Good? . . .

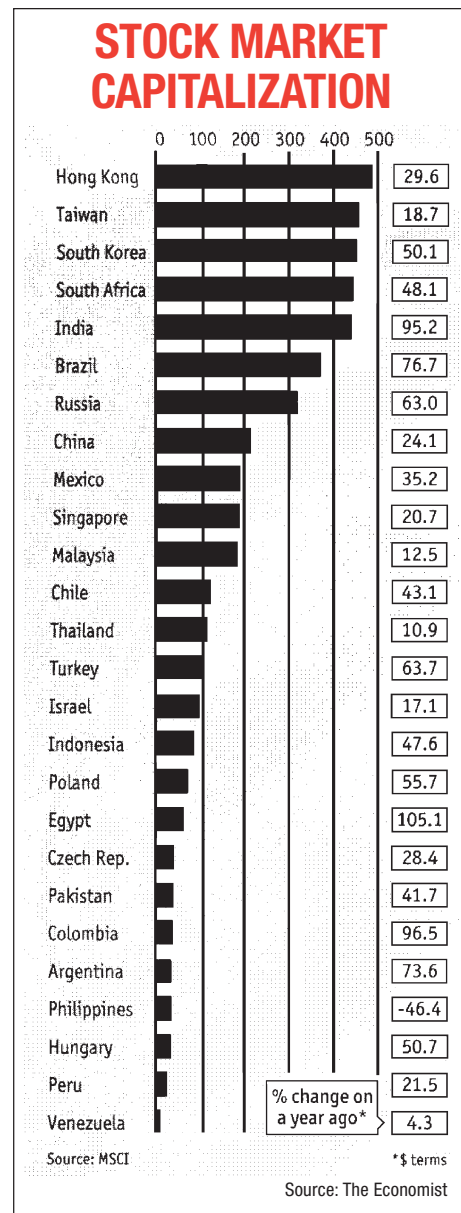
I MUST CONFESS I REALLY LIKE Emerging Markets. It is not because they have had the very best returns, they haven't. The U.S. has outperformed the Emerging Market Index the past 15 years and been less volatile to boot (see chart below). No, my interest has to do with the really big issues.

First, Emerging Markets are great fun to visit. South America, Asia, Africa and the Indian subcontinent are incredibly different and interesting places. Second, Emerging Markets are big. Their strength is their size. Sixty-eight percent of the world's six billion people are in developing nations and the buying power there is rising dramatically. This includes both the demand for turbines and excavators as well as consumer demand for houses, scooters, cars and tourism. And it also is the demand coming from even the poorest classes. Unilever is selling single portion packets of shampoo and detergent in India and doing it profitably. The Emerging world has buying power.

Third, the new countries have talent. China and India will produce between them nearly one million engineers this year compared to our 70,000. Not all of these are ready for prime time as we note on page one but more and more will be. Also Emerging countries are developing companies. It is estimated there are 25 world class multinational companies in Emerging Markets today. In 15 years there will be over 100.

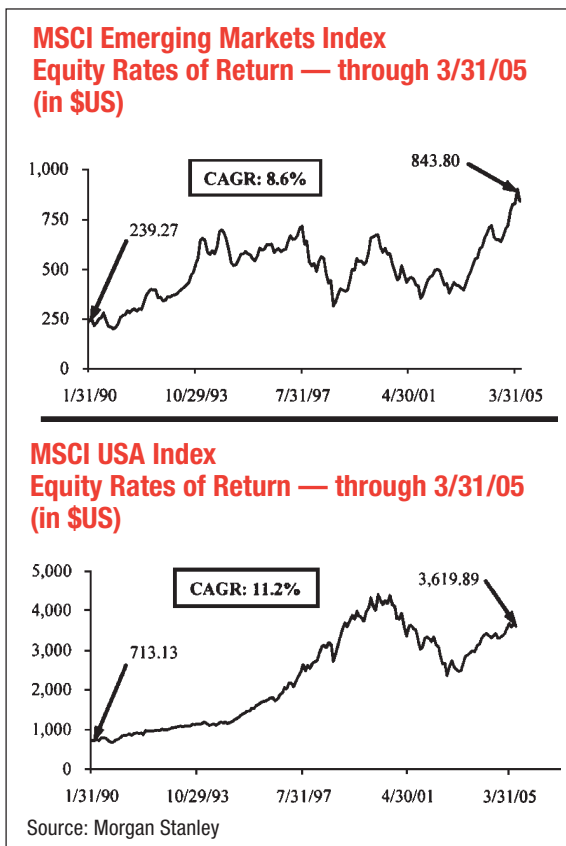
How do you play all this expected growth? Mutual funds are the single best way. I am surprised no one has come with an idea I have. I call it the Emerging Giants Fund with investments in just four countries: China, India, Brazil and South Africa. Most people would agree with the first three. But usually the final one is Russia. I favor South Africa for its big internal market and developed infrastructure and also for its central position in Africa. If and when the rest of Africa takes off (a big if to be sure) South African companies will supply much of the capital.

Critics will argue that limiting a portfolio to just four countries is risky. This is true but my four have a wide wing span. The China region consists of not just the Mainland but Taiwan and Hong Kong as well. India includes the diaspora of Overseas Indians and their capital and companies. Emerging Markets are not well correlated to the U.S. You want portfolio assets that doesn't zig and zag at the same time. Emerging Markets still march to their own drum. The four markets I favor, China, India, Brazil and South Africa are still quite small. Their stock market capitalization (see chart to the right) totals only \$2.5 trillion. This pales next to the U.S. market capitalization of the



\$12.2 trillion. But investing is not about the rear view mirror of past results. It is about the future. You can get a lot of exposure to Emerging Markets through U.S. multinationals but you need the local markets and local companies to get the extra dollop on the sundae.

The biggest risk to this story is that Emerging Markets will simply stay emerging. As the old wag about Brazil goes, "it is the country of the next twenty years, and always has been." My bet is, this time is truly different.



Economic Trends . . .

Ten Years Ago This Month . . .

MOST INVESTORS TRY HARD to forget the dotcom bubble. Perhaps that is why few remember when Internet start-up Netscape burst onto the scene in August 1995 with its first public stock offering. The shares, which opened at \$28, hit a high of \$75 that day and by December of that year were changing hands at over \$170. But Netscape's impressive technology, financial backing and management team were not enough to ensure its success. Competition from Microsoft's Internet Explorer, which came loaded on every new Windows PC, turned profits to losses and by 1999 the firm was gone.

This riches to rags story tells us a good deal about how technology and the businesses that support it evolve. At its start, the web was just a loosely linked system of viewable pages that you could access only with the help of a computer programmer. The need for some kind of software to connect websites was clear

but its development was stymied by two commercial concerns.

First, if you could come up with this "browser," how would you get people to pay for it? Marc Andreessen and Jim Clark, the original founders of Netscape, solved this problem by originally giving their browser away with server software. And instead of shaking out all the program's bugs in house, they decided to launch a beta version of the product to users and ask them to test it. This open sharing of software was relatively new and became instrumental in the Internet's development. Instead of developing a list of customers, Netscape created a community of participants with a vested interest in the success of their product and the web.

The second and more confounding dilemma centered on the viability of the web itself. Who would create content (movies, data etc...) that people would want to access and how would they get

paid for it? This concern led most futurists to consider interactive T.V., not the Internet, the wave of the future. But Netscape's ability to link thousands of users together through hyperlinks helped create a culture based on the sharing of data. Today, the web connects over 1 billion people or 1/6th of the world's population and each of these users can access over 6 billion separate pages. Interestingly, much of the content has been fabricated by users

themselves. Participation, it turns out, is as central a motivator as profit. Today, only 40% of the web is commercially based.

If you have any doubt about the growing interest in creating and sharing data consider the blog phenomenon. Today over 50 million blogs, or consumer created channels, are up and running and a new one is being created every 2 seconds. And while this technological phenomenon makes no economic sense, it does seem to fulfill some basic human need to be heard, create and share.

Thanks in part to Netscape, the Internet has become a kind of mega-computer. This supercomputer runs through the interaction of hundreds of participants. Every time you log on, create a web page or post a blog, you are contributing to the system's learning and evolution. And this system, like your brain, has the ability to organize, store and recall immense amounts of data. Where will this system lead us? My guess is that the Internet's future remains as difficult to predict today as it was 10 years ago. However it evolves, it is clear that the system will increasingly connect more and more participants.

This process is already in the works. This week Baidu, China's leading search engine, launched its first IPO. Like many things in China, the firm's growth potential is huge. Today, just slightly over 7% of China's population uses the Internet compared to 67% in the U.S. and China has 1.3 billion people. But the firm's success is far from assured. Chinese authorities are prone to heavy and often unpredictable regulation of the media and, like Netscape, Baidu faces growing competition. My guess is that the same forces that have driven the Internet's success in the U.S. will hold sway in China. Ten years from now Netscape will be a tiny footnote in the Internet's history but its contribution should not be forgotten.

— Anne Williams Doremus, CFA
Vice President



"Are we thinking here, or is this just so much pointing and clicking?"