

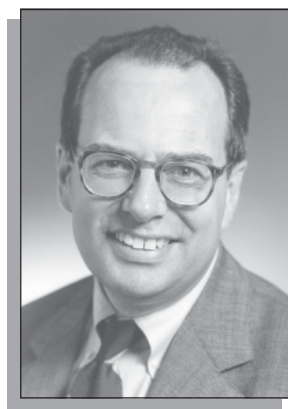
Thoughts from

Hanson Investment Management Inc.

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Whoever Said The Best Gift of All Is Giving . . .



... **I**S RIGHT ON. For the last six years we have given you as our annual Holiday gift a chocolate dessert. We have covered the waterfront from chocolate mousse, to chocolate brownies, chocolate soufflé, chocolate covered profiteroles, chocolate maple pecan pie and last year Chocolate, Chocolate cake.

This year we are drawing from some

home grown talent, the editors at *Eating Well*, the magazine of Food and Health published right here in Vermont. *Eating Well* is proving successful and will shortly go from four issues a year to six. All of us here at Hanson Investment Management wish you a very Happy Holiday and a Safe and Successful New Year. Enjoy!

Chocolate Thumbprint Cookies

(recipe by Bruce Weinstein & Mark Scarbrough, February/March 2005 issue of *Eating Well*)
Printed with permission from *Eating Well*, the magazine of Food & Health, www.eatingwell.com
Prep time: 20 minutes, start to finish: 1½ hours

Thumbprint cookies are an old-fashioned treat, a little cookie well holding a dot of jam. Here, they're reinterpreted with walnut oil and whole-wheat pastry flour for today's healthier eating standards – and, of course with chocolate, simply for the taste.

¾ cup all-purpose flour
½ cup whole-wheat pastry flour
½ teaspoon baking soda
½ teaspoon salt
1 cup toasted walnut pieces
4 tablespoons cold unsalted butter, cut into pieces
¼ cup walnut oil or canola oil

½ cup granulated sugar
½ cup packed light brown sugar
1 large egg
2 teaspoons vanilla extract
5 ounces semisweet or bittersweet chocolate, chopped, or chocolate chips, melted
6 tablespoons apricot jam
(see *Enhancements*, below)

1. Position rack in the center of the oven; preheat to 375°F. Line a large baking sheet with parchment paper or a silicone baking mat.
2. Whisk all-purpose flour, whole-wheat flour, baking soda and salt in a medium bowl until well combined. Grind walnuts in a food processor until they resemble coarse meal.
3. Beat butter, oil, granulated sugar and brown sugar in a large bowl with an electric mixer until almost creamy – the mixture may still be a little grainy. Beat in egg and vanilla; scrape down the sides and beat in melted chocolate and the ground nuts. Stir in the dry ingredients with a wooden spoon until just incorporated.
4. Roll 1 tablespoon batter into a ball, place on the prepared baking sheet and flatten slightly until it looks like a deflated basketball. Continue with the remaining batter, spacing

the cookies 2 inches apart.

5. Bake the cookies for 6 minutes. Remove from the oven and gently press your thumb or the end of a wooden spoon in the center of each cookie. Place ½ teaspoon jam in each indentation. Bake until the jam is melted and the cookie is set but still a little soft, 8 to 10 minutes more. Cool on the pan for 2 minutes, then transfer to a wire rack to cool completely. Let the pan cool for a few minutes before baking another batch.

per cookie: 109 calories; 6g fat (2g sat, 1g mono); 9 mg cholesterol; 14g carbohydrate; 1g protein; 1g fiber; 53 mg sodium.

Enhancements

Use any flavor jam you want, just don't use preserves (the pieces of fruit may be too large) or jelly (it will melt too quickly and run).

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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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The Washington Report . . .

Taxing Times . . .

WE DO OUR BEST TO STAY away from politics in this newsletter but if you want to talk taxes you have to jump into the thicket. President Bush has said his two top priorities are to reform the U.S. tax code to make it “simpler, fairer and pro-growth” and to tackle the Social Security mess.

In 2001 the Congressional Budget Office estimated the U.S. budget surplus, that’s right, the surplus over the next ten years would be \$5 trillion. Today just three years later we are



looking at a deficit of \$5 trillion. Quite a swing. The tax cuts in the first Bush term combined with continued spending has opened up a fiscal deficit with a capital D (see chart above for country comparisons). Now the President wants to extend his tax cuts while reducing the deficit by half. This will take some doing.

So what are the tax change choices we are looking at? One is a National Retail Sales Tax (NRST). Proponents say a tax of 23% on sales would eliminate the need for the income tax. No more lengthy tax forms or complicated deductions. But opponents say that the actual rate to replace the income tax would need to be as high as 60%.

A second proposal is a consumption tax or Value Added Tax (VAT) used by many European countries and Canada. Here companies pay the tax based on the value they add at each stage of the production cycle. Collection is easy and avoidance difficult. But the problem as many European countries have discovered is it is easy to keep raising the rate.

A third proposal is a flat tax, which would eliminate most deductions and lower the rate on income. Some say a flat tax of 22% combined with fewer deductions would raise the same amount as our present complicated 10% to 35% system. We will have to wait and see which if any of these ideas develop traction in Washington in 2005.

The Economist made an interesting suggestion on taxes recently. The Alternative Minimum Tax (AMT) was introduced in 1969 as a way to ensure that rich Americans pay some tax and not just pile on the deductions and avoid all payments to the government. The rate was set at two levels, 26% and 28%. Over the years more people have triggered the AMT because it was not indexed well to inflation. In 2000 only 1.3 million people paid AMT. The number today is 3 million and by 2010 it is estimated to reach 30 million.

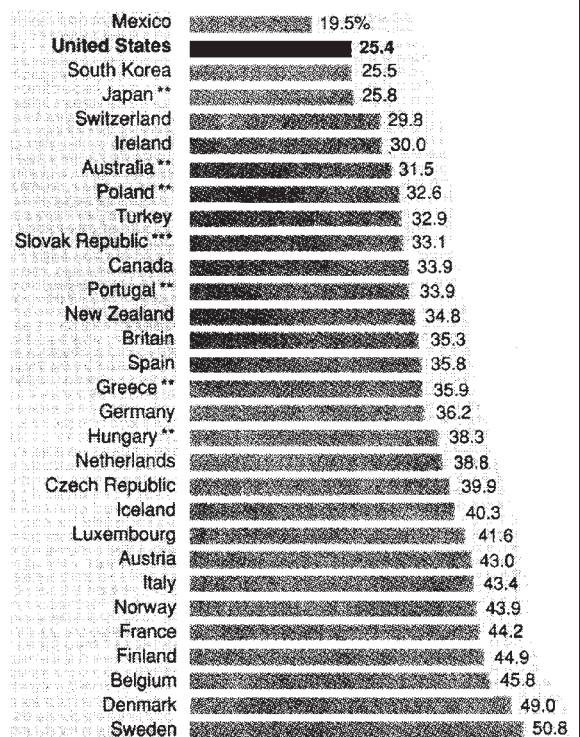
Conventional wisdom says we need to “fix” AMT by indexing it more aggressively so that just the wealthiest earners are subject to it. Michael Graetz of Yale University however thinks a better idea is to keep the AMT with its fewer deductions (mortgage interest, gifts to charities and a few others) and flatter rates and phase out the present income tax. Interesting. He proposes we exempt the first \$100,000 of family income from any tax, then levy a flat 25% AMT against the

rest and make up for any current revenue losses with a smaller value added tax of between 10% and 15%.

A big problem with any tax legislation is that once a benefit or deduction is in place it is very difficult to defeat the constituency that is there to defend it. A better course may be to keep in place the devil we know – the AMT – and do some minor tweaking rather than come up with something brand new. But in the final analysis I think all this talk of “fair and simple” taxes will give way shortly to the more pressing need of where are we going to come up with the funds to narrow the yawning Federal deficit. You don’t want to hear this but our total tax take is still rather modest compared to other developed countries (see chart below). Ronald Reagan cut taxes in his first term only to raise them in his second. The Bush record may very well be the same.

United States: a low-tax leader

Tax receipts as a percentage of GDP in 2003



Note: Taxes include national, state and local levies, but do not include fees for services. Source: OECD (for US), International Herald Tribune (for others)

Washington Report . . .

Dreaming of Retirement . . .

I HAVE TO ADMIT I AM suspicious of all this talk about an “ownership society” and reforming Social Security to allow for “private accounts.” I need more convincing.

President Bush created a bi-partisan commission in 2001 to look at reforming Social Security. His instructions were that any reform must include voluntary personal accounts and no new taxes. The commission came up with three possible models (see chart below). Model #2 is the one the most people are talking about.

Social Security is a pay as you go system. Workers today pay taxes, which go directly to beneficiaries or into Treasury bonds in the Social Security Trust fund. The number of retirees relative to workers is growing (see chart to the right) and the system will begin to pay out more in benefits than it takes in after 2027. Any long-term fix needs to reduce benefits, push out the normal retirement age or increase taxes. Model #2 includes Private Savings Accounts and also changes the index, which in effect reduces benefits. Right now benefits are determined by wages. Wages tend to increase with productivity, which historically has gone up faster than inflation. By changing the index from wages to inflation you decrease the rate of growth of future benefits.

Private accounts would allow participants to divert 4 percentage points of payroll taxes into investment accounts up to \$1,000 a year. Social Security benefits for these investors would be reduced to take into account the amount of funds diverted. The proponents argue investors would need to earn only 2% to do better under the proposal than the present set up.

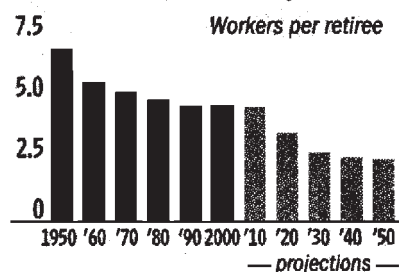
I joined the investment business in the early 1970’s just prior to the peak in stock prices in 1973 and the subsequent sharp decline in the market. I remember a decade of sharply rising inflation and interest rates and a go nowhere stock market from 1966 to 1982. I am suspicious about a program that takes retirees’ income and subjects it to the vagaries of the market.

Private accounts are somewhat similar to 401(k) accounts. Individuals would be taking control of and be responsible for their own retirement. All well and good. But the history of 401(k) plans is not encouraging. Participants have never invested as much as they are allowed under the law or as much as they need for retirement. This is not the important point here. What is important is how well 401(k) investors have invested their funds. The record on this is very mixed. 401(k) investors have a long history of moving in and out of markets at exactly the wrong time and choosing investments that aren’t appropriate for them. For instance in the \$3.6 billion JCPenney 401(k), 38% is invested in JCPenney stock which is a highly concentrated bet and another 38% is in a conservative interest-bearing account. Only 24% is invested in broad based stock and bond funds, which over time have been the best performers. Employees are confused by the number of investment choices in 401(k)s and by the complexity of investment decisions in general. I fear this would be the same under the Social Security plan.

Jonathan Clements, the writer of the weekly “Getting Going” personal investing column in the *Wall Street Journal*, recently summed up his first ten years of articles: “My confidence in the investment acumen of ordinary investors has been shaken. I have come across too many serial blunderers... replacing traditional pension plans with 401(k) plans has been a mistake. Similarly, I feel that the privatization of Social Security will be a disaster unless it is accompanied

Senior Moments

By 2050, there will be just 2.6 working-age people for every person age 65 or older, down from 7.2 a century earlier.



Source: Social Security Trustees Report

Source: Wall Street Journal

by a slew of safeguards.” The AARP, the nation’s largest seniors organization, has also recently come out in opposition to Private accounts.

Retirement income is so crucial to so many that there is something to be said for the secure floor of Social Security. The present system is not perfect but it is what we know. James Surowiecki, the financial writer for the *New Yorker*, noted in a recent piece that “the result (of private accounts) would be Social Security without the security. Freedom of choice is a beautiful thing. But the Bush plan is asking you to swap an insurance policy for a lottery ticket.” Let the debate begin.

Specifications of commission reform models

Personal accounts	Model 1	Model 2	Model 3
Personal account size	2%	4% up to \$1000 annually (indexed to wages each year)	1% of new contribution plus 2.5% up to \$1000 annually (indexed to wages each)
Additional contributions required	This is a generic 2% plan that can be done with or without contributions	None	1% of wages required to participate (subsidised through income tax)
Real return that makes person better off with accounts than without	3.5%	2.0%	2.5%

Source: Financial Times

Source: President’s commission to strengthen Social Security

Investing 101 . . .

Going Back to Basics . . .

WITHOUT A DOUBT, the markets have weathered a few tough years. Accounting fraud at WorldCom and Enron, the NASDAQ crash and post-war tensions have shaken even the most seasoned investors. But at times like this it is important to revisit the following basic investment guidelines and remember that investment success is more often determined by simple common sense and emotional control than raw intelligence.

1. Know your investment goals.

A clear investment goal helps define your time horizon and risk tolerance. These are the underpinnings of any investment strategy. While risk tolerance can be tricky to assess, your time horizon should be fairly clear. A long time horizon offsets much of the risk of owning stocks. If you plan to retire in 20 years, for example, don't spend too much time worrying about last month's market performance.

2. Develop an investment strategy and then stick to your plan.

An investment strategy is the road map you use to reach your goal. It defines what kind of stocks you are willing to buy and importantly, how much you will pay for them. Defining your strategy is the easy part – sticking to it can be hard. In the run-up of the technology bubble, many people bought internet stocks, not because they thought they were good investments but because the stocks were going up. Sticking to your strategy in the face of market swings requires great discipline. Abandoning it leaves you subject to the whims of crowd behavior.

4. Focus first on the company and then the stock.

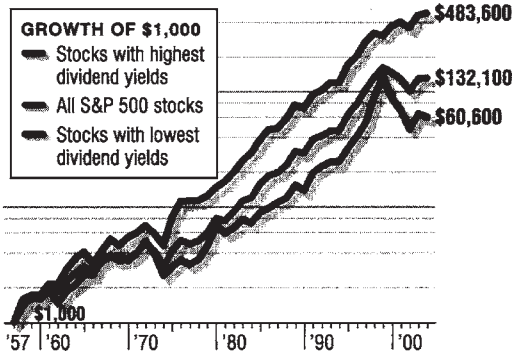


"Now we'll all close our eyes and cover our ears, and the person who took the four hundred and twenty-eight million dollars will put it back."

Source: The New Yorker

THE LONG RUN'S WINNERS

According to Jeremy Siegel's latest research, stocks with the highest dividend yields are history's victors. (His numbers assume that dividends were reinvested in the stocks.) The big dividend payers are often less exciting growth stories than those with little or no dividend yield. But they also tend to be cheaper relative to their earnings.



Notes: As of Oct. 15. Assumes annual rebalancing and reinvested dividends. Highest is top 20%; lowest is bottom 20%. Sources: Standard & Poor's, Jeremy Siegel.

Source: Money Magazine

Share prices are determined by only two factors. First, equity investors are part owners in a business. The better the business, the more money it earns and the higher the stock price. But how much investors are willing to pay for those earnings also influences prices. Typically, we gauge this willingness by valuation measures such as the P/E ratio. Investors with a long time horizon are best served by focusing first on the quality of the business. After all, there is no price cheap enough for a bad business. Once you find a sound business, make sure you are not overpaying for it.

5. Patience, Patience, Patience.

The important point to remember here is that stocks rarely advance in a straight line. If you buy a stock today and the share price declines, then provided the company's fundamental outlook hasn't changed, you should be willing to buy more. Good investment ideas usually take time to work out and you may lose money before you make it.

Jeremy Siegel, University of Pennsylvania professor and author of *Stocks for the*

Long Run, has long been a proponent of the buy and hold approach to stock investing. He is also a strong believer in dividend paying stocks. *Take a look at the chart above.* In his recent research, Siegel found that the 100 highest-yielding stocks in the S&P 500 have outperformed the Index over the past 50 years by almost 4 to 1.

We also think this strategy makes sense. Stocks are now fairly fully valued, so moving forward we expect prices to move more or less in line with earnings growth (6%-8%). At these return levels, dividends' contribution becomes a more meaningful percent of total return. Historically dividends have often accounted for more than half of stock's total return.

While traditionally high dividend payers have been in low-growth industries such as utilities and banks, this is starting to change. The recent economic rebound has left U.S. companies flush with cash. Many of these firms, recognizing their limited investment opportunities and the now favorable 15% dividend tax treatment, are choosing to pay their excess funds out to shareholders. To date, companies as diverse as Microsoft, Mueller Industries and local Merchants Bank have boosted regular dividends and instituted special one-time payouts to shareholders. We expect that more companies will follow suit. This is good news for shareholders and will help restore confidence in the market at large.

— Anne Williams Doremus, CFA