Thoughts from
Hanson Investment Management Inc.

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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.

Who would have ever thought this could happen this quickly?

POPULATION CONTROL has been a policy mantra for much of the world for years. Developed economies have seen their growth rates slow but the emerging world, where the vast majority of people live, has been a different story.

The last decade however has seen a change in direction almost everywhere. The old wisdom was that a country needed to get wealthy first before the birth rate came down. Wealthy countries see bigger families as simply a bigger cost. Developing countries however see more mouths in a family as a way to take care of the elderly in the waning years. But today even the emerging world has come around to smaller families. *(See chart.)* The U.N. forecasts that the world's population could level off at about 9 billion by mid century from 6 billion today. A decade ago the U.N. was projecting peak population of 12 billion. This is quite a turnaround and quite a big deal.

What accounts for the slowdown in fertility rates? No one really knows but women worldwide are getting more education and this is leading to greater employment opportunities and greater financial independence. The move towards urbanization also makes it harder to sustain large families and greater availability of contraceptives has helped.

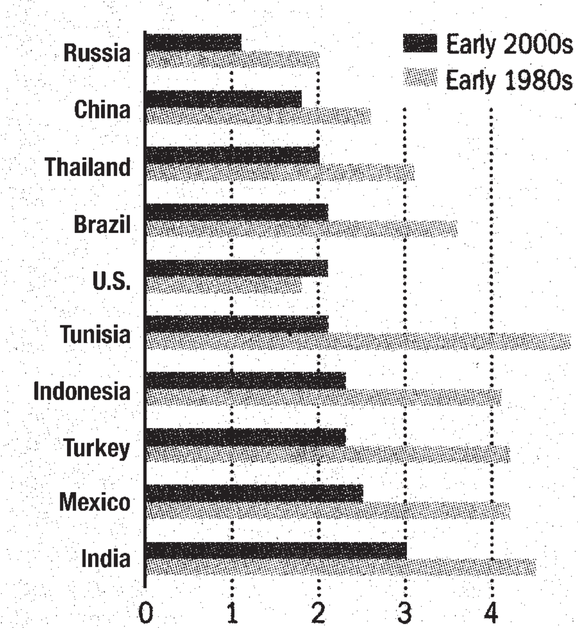
Then there are the more oddball theories. In Brazil where Telenovelas or soap operas are the rage, TV families have fewer children to keep the plots simple. This seems to have accidentally contributed to a slow down in fertility. Don't knock it. It could very well be true.

There is a "demographic bonus" to a declining birth rate. When you have a greater percentage of the population in the work force you get lower labor costs. And national income increases as more people earn a paycheck and get out and spend.

But the biggest winner in all this is us. A smaller world population has to mean less pressure on resources and the environment. This hopefully will lead to a healthier and also a safer planet.

DRAMATIC DROP

The average number of children born per woman has decreased in most countries.



Source: Wall Street Journal

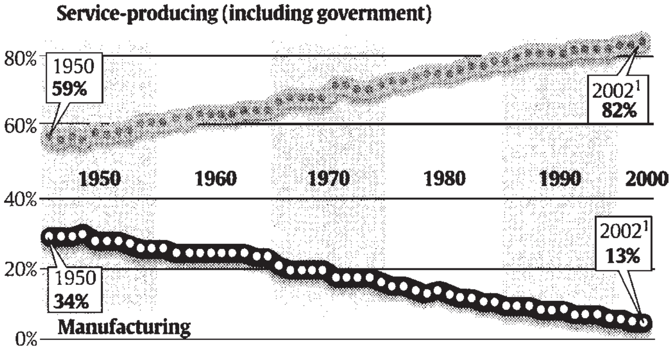
The Global Scene . . .
We are the target . . .

THE UNITED STATES TODAY is 4% of the world's population and nearly 30% of the world's output. We have wealth and we have the high paying jobs and everyone is trying to get their hands on these – especially emerging markets, which are chipping away at us relentlessly.

We have been losing manufacturing jobs for many years now *(see chart)*. Recently the pace has picked up and one country specifically is on everyone's mind. China has become the world's manufacturing machine. The area between Hong Kong and Guangzhou – the Pearl River Delta – is about the size of Belgium. It has an astounding 30 million manufacturing workers today. Forty percent of the world's microwaves come from here, 70% of the world's photocopiers and most of the running shoes and hiking boots. Pou Chen, a Taiwanese company alone employs 110,000 people in the region making 100 million pairs of Nikes, Adidas, Timberland, etc.

Manufacturing Share of U.S. Jobs Declines

Percentage of non-farm workers employed in manufacturing and service jobs:



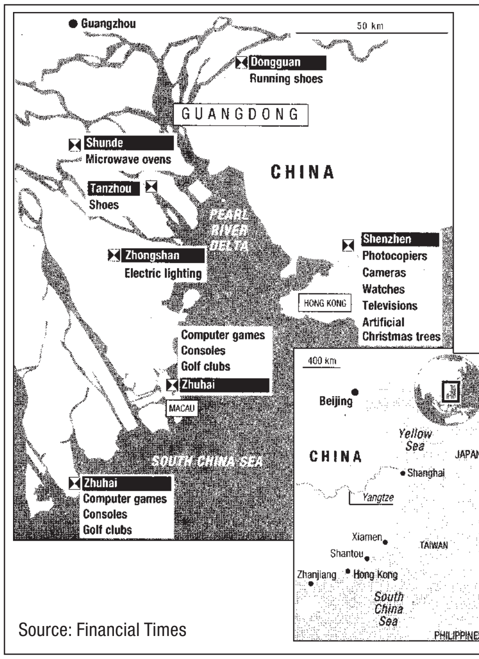
1 – to date; 2 – primary metal industries, such as steel; 3 – private education institutions; 4 – services to businesses such as advertising, data processing, credit reporting, etc.

Source: USA TODAY analysis of Bureau of Labor Statistics data

The new news is that emerging markets are also starting to chip away at our strength in services. India is in the lead here. Originally Indian companies were "body shoppers" sending Indian workers to the U.S. to write software code. Now things are heating up and India and other countries are doing more sophisticated product development in offshore labs dedicated to specific firms. And business process outsourcing (BPO) is becoming a bigger deal. This includes running call centers and doing consulting. It is estimated that the U.S. may lose half a million high tech software jobs to low wage countries by 2005 and 3.3 million by 2015.

There could be an upside to this however. The optimists say we are getting rid of the routine services and jobs and will be able to re-deploy our work force and capital to higher value industries and cutting edge R&D. Let's hope it works out like this.

If Asia and the subcontinent are growing rapidly, then U.S. investors need to pay attention. China and India are difficult to play on an individual stock basis but there are closed end mutual funds (the India Fund, the China Fund and the Greater China Fund) that are attractive and also foreign companies that are riding the wave of the region. For instance Flextronics, a Singapore company listed on the NASDAQ, does contract manufacturing. They employ workers throughout Asia including 12,000 in the Pearl River Delta making photocopiers for Xerox, PlayStations for Sony and Nintendo game consoles. Outsourcing is a trend with legs today and a leader like Flextronics should benefit.



Source: Financial Times

The problem with being an economic Superpower is everyone is always gunning for you. China and India are threats today but they are also opportunities. When life gives you lemons, get on with making that lemonade.

GLOBALIZATION GOES WHITE COLLAR

A global pool of skilled workers . . .

NUMBER OF NATURAL-SCIENCE AND ENGINEERING COLLEGE GRADUATES

	BAs 1989	BAs 1999	MAs and PhDs 1989	MAs and PhDs 1999
CHINA	127,000	322,000	19,000	41,000
INDIA	165,000	251,000	64,000	63,000
PHILIPPINES	40,000	66,000	255	937
MEXICO	32,000	57,000	340	63,000
U.S.	196,000	220,000	61,000	77,000

Data: National Science Foundation, *BusinessWeek*

. . . is drawing more Western companies

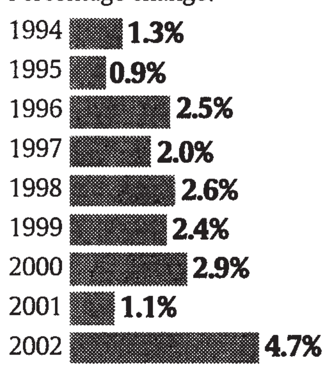
COMPANY	NO. OF WORKERS AND COUNTRY	TYPE OF WORK MOVING
ACCENTURE	5,000 in the Philippines by 2004	Accounting, software, back-office work
CONSECO	1,700 in India, 3 more centers planned	Insurance claim processing
DELTA AIR LINES	6,000 contract workers in India, Philippines	Airline reservations, customer service
FLUOR	700 in the Philippines	Architectural blueprints
GENERAL ELECTRIC	20,000 in India alone by yearend; big China R&D center	Finance, IT support, R&D for medical, lighting, aircraft

The U.S. Economy . . .
The mood of the moment? . . . It's actually pretty simple . . .

WE ARE <u>AFRAID</u> AND WE ARE <u>uncertain</u>. This comes from a piece by Barton Biggs at Morgan Stanley. Biggs notes that the long Bear Market has sapped investor optimism. When you add this to the Iraq situation you get a market that is completely stuck.

Productivity surge

U.S. worker productivity grew at its fastest pace in more than 50 years in 2002. Percentage change:

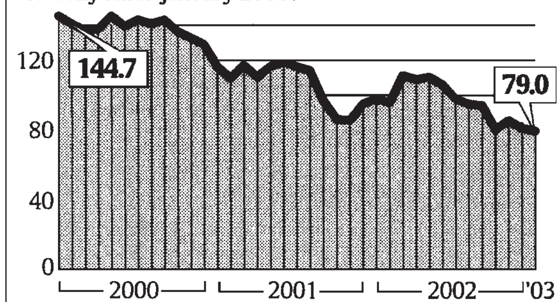


Source: Bureau of Labor Statistic
By Angie Wyatt, USA TODAY

The economy last year was actually quite strong. GDP was up 3% although the quarter-to-quarter performance was very choppy. Interest rates remain low, inflation is under control and the consumer continues to spend. Many of the traditional signals of recovery are in place. But the big negative holding us back now is jobs or more specifically the complete lack thereof. *Take a look at the chart to the right.* No new jobs at all were created last year even though the economy grew. We discuss this further on page 3 but one big explanation is productivity. Last year productivity grew at the fastest rate in fifty years. Employers are moving quickly to cut employees at the first sign of a downturn and computer technology and other efficiency increasing tools are starting to kick in. Long term, this productivity surge is very positive. It will lead to new jobs at higher wages. But short term it means a continued loss in confidence. *See chart to the right.*

Confidence declines

The Consumer Confidence Index has fallen steadily since January 2000:



Source: The Conference Board
By Adrienne Lewis, USA TODAY

But there are still reasons to be optimistic today. Thomas Friedman in the *New York Times* paints a positive picture of what might happen in the Middle East. If Saddam Hussein is overthrown and if a more market oriented economy is put in place in Iraq and also in Iran, which is moving in that direction, then the whole region could gain economically and politically. This is a big if and a lot of things have to fall in place first but it is quite feasible.

On the home front any pick up in confidence either from a settlement in the Middle East or further gains in the economy could break the dam holding back business spending and inventory rebuilding. Business spending has to come to the aid of the consumer eventually if we are to move to new high ground. We may be closer to this than we think. We have had three years now of pretty sluggish business spending after the party days of the late 1990's.

And finally valuations are back to more realistic levels now. The price to earnings ratio on operating profits this year is just about the long term average of 15. We don't need pie in the sky growth to justify today's valuations. We just need reasonable earnings and we are getting this now. In the near term the market will be driven by corporate profits, the pace of the economy and the wild card of Iraq and geo-political events. The first two appear to be growing albeit slowly and if we can get some settlement on the third, markets could make solid headway. This is how we are betting.

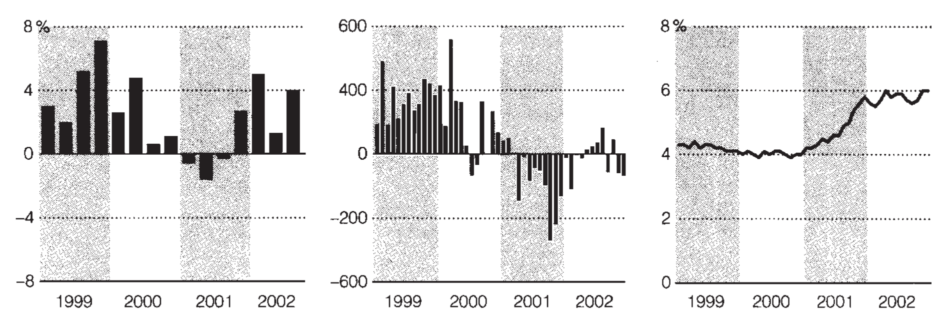
DID YOU SAY RECOVERY?

Experts estimate that in 2002 the economy recovered from the recession of 2001 and grew at a healthy 3 percent. But that growth produced no new jobs, which means that recovery is just a word for many, while uncertainty and unemployment are the reality.

Growth is back . . . Percent change in gross domestic product, seasonally adjusted at annual rates.

. . . but jobs are not . . . Monthly net change in payroll employment, seasonally adjusted, in thousands.

. . . driving unemployment up. National unemployment rate, seasonally adjusted.



Sources: Bureau of Labor Statistics; Bureau of Economic Analysis
The New York Times

Investment Trends . . .

The Outlook for Value Investing . . .

THE ARCANE WORLD OF stock research has received a lot of negative press over the last year. Evidence of conflicts of interest has resulted in heavy fines for most the country's large brokerage houses and calls for industry reform. But behind these headline-grabbing events, the business of securities research is changing in other ways as well. *Take a look at the chart to the right.* According to First Call, a research tracking firm, the total number of analyst recommendations has fallen 18% over the last three years.

To a great extent this decline is a bear market phenomenon. The business of writing and selling equity research reports has never been profitable by itself. As is now patently clear, research departments have traditionally supported brokerage's lucrative investment banking operations. With downsizing the order of the day on Wall Street, research departments have been some of the first areas to come under the knife.

Many investors will respond to this trend with a resounding "Good Riddance!" After all, given the questionable value of research reports, fewer of them should hardly be a problem. But the drop in research is likely to impact equity markets in other ways as well. Consider the role that analysts play in company efforts to raise capital. Objectively written research reports help firms attract capital and investors make sound decisions. Less research effectively increases costs for both investor and issuer alike. Fortunately, as is typically the case with free markets, new suppliers in the form of independent research firms are beginning to fill the void. Whether these new entrants will provide better quality, less biased product remains to be seen.

In the meantime, the fall-off in equity research should work to the benefit of value investors. In their efforts to reduce costs, big brokerage firms are concentrating their research coverage on widely held, large, growth stocks. This concentration plays right into the hand of investors hunting for value in the neglected areas of the market. Fewer analysts covering fewer companies means more neglected stocks.

Focusing on undervalued stocks has historically proven to be a profitable approach. A recent article on the relative returns of growth and value stocks by the American Association of Individual Investors illustrates this point. The AAII study is based on James O'Shaughnessy's original work showing that stocks trading at low prices relative to sales and earnings outperformed more expensive stocks. To test O'Shaughnessy's original hypothesis, the AAII calculated the price-to-sales and price-to-earnings ratio of over 2,300 shares. They then broke these shares into ten different groups sorted by the lowest to highest ratios and examined the annual returns generated by these companies over a 45 year period. *The chart below outlines what they found.* Stocks sporting the lowest price-to-sales and price-to-earnings ratios produced, on average, the best subsequent one-year returns. Interestingly, the ratio of a stock's price to its sales proved the superior predictor of future returns of the two measures.

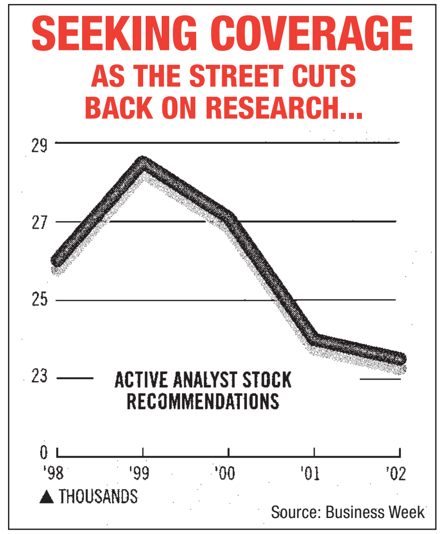
THE PREDICTIVE POWER OF PRICE-EARNINGS AND PRICE-TO-SALES RATIOS

(Historical Period: 1/1/52 to 12/31/96)

Decile	Average Annual Return for Following Year Based on Prior Year Ratios (%): Predicted by P/E Ratios	Predicted by P/S Ratios
1 (Lowest Ratio)	14.89	17.63
2	16.70	16.52
3	15.40	16.50
4	13.60	15.64
5	12.92	13.91
6	11.79	13.18
7	10.84	11.62
8	10.34	9.93
9	10.93	7.78
10 (Highest Ratio)	10.98	5.12
All Stocks	**13.23**	**13.23**

This table includes only stocks with market capitalization greater than $150 million, adjusted for inflation over the 45-year period. The price-earnings ratios use earnings per share from continuing operations.

Source: AAII Journal



Source: Business Week

A recent study by finance professors Eugene Fama and Kenneth French may further support this conclusion. These academics discovered that over the 1927-2002 period, value stocks outperformed growth stocks by an average of 3.7% a year. But the two fall short of fully endorsing value investing instead concluding that value stocks performance advantage may relate to the higher risk associated with owning them. This point remains heavily debated given the difficulty of measuring the relative risks of growth and value stocks.

I suspect that the debate between the growth and value camps will continue for quite sometime. In the meantime, the current weight of evidence supports the value case. In the past, focusing on neglected, under-covered areas of the market has yielded profitable results. The current paucity of research provides a good environment for those willing to seek out good, solid companies selling at a discount to perceived value.

– Anne Williams Doremus, CFA