

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.

Free Lunch? We'll Settle for a Cheap Lunch...

THIS MARKET HAS BEEN on a tear. The NASDAQ Composite is up nearly 100% since October 2002. This is a big move. The broader market indexes have also done well. The Standard & Poor 500 has gone more than three hundred days without a decline of even 5% from any peak. This is the eleventh longest such market rally since World War II.

There are fewer and fewer cheap stocks in the market today. *Take a look at the chart at the bottom.* Value buyers like us often look at book value as a measure of a stock's attractiveness. There are not many low price to book choices now. This doesn't mean we are sellers however. Our policy is to be 100% invested and we still are. We are just having a harder time finding attractive opportunities.

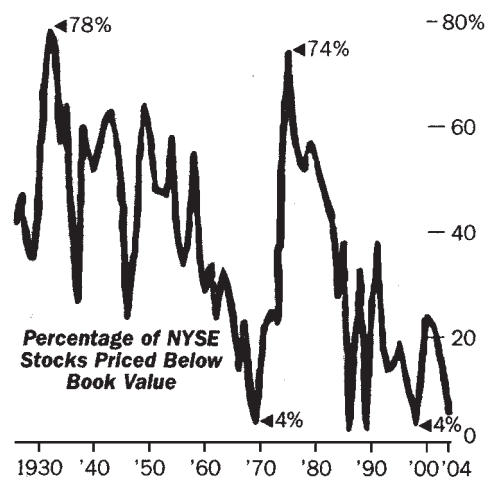
Tech stocks are especially pricey. eBay is one of the real success stories of the Internet. Mark Hulbert the newsletter writer commented on it recently in a *New York Times* piece. eBay's P/E is just over 100 now. If we assume the company's price to earnings ratio falls back to 40 by 2009 and the stock grows 8% per year in price (which the stock market ex dividends historically has), then earnings per share would have to grow 30% annually for five years to justify the current price. Thirty percent annually is an enormous number even for something as exciting as eBay. And there are over 100 companies today mostly techs expected to have earnings growth

of 40% or more the next five years. Growth of this magnitude for this number of years has never before happened in the market and is unlikely to this time.

Steve Galbraith, the recently departed market strategist at Morgan Stanley, says that the most powerful force in finance is reversion to the mean. We agree. The stock market is always going from overvaluation to under valuation and then back again. We are somewhere in the overvaluation stage now. How far until a fall? We don't know. Every market is dysfunctional in its own way. We are staying invested but very careful about what we buy. The low hanging fruit has all been picked.

Bargains Scarce

► Only 6% of the companies listed on the New York Stock Exchange now trade below book value, down from 25% in early 2000. At historic markets lows in 1932 and 1975, about 75% traded below book.



Sources: Kenneth R. French Data Library; Source: Barron's; Moody Aldrich Partners

The Real World . . .

If Life Is So Good, Why Am I Feeling So Bad? . . .

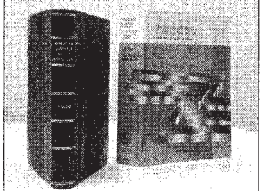
OR AT LEAST SO STRESSED and unsatisfied. By most measures Americans have never been doing better. Since World War II the typical person's real income has more than doubled and since 1993 alone per capita disposable income is up 2% a year meaning our real income will double again in thirty-six years. The average home is 38% bigger than it was in 1975, even though we have fewer people living in it. So things are good.

But when you ask Americans how happy they are, only one third say they are "very happy". This percentage has not changed over the years. What gives? The obvious answer is the economy isn't

everything. People have more but more doesn't mean happiness. Statistics show that once you have earned as little as \$10,000, more money has very little bearing on happiness. In fact "more" can create its own problems. We have so many choices today that we are often overwhelmed and unsatisfied with whatever decision we make. Just go and try to buy a digital camera and see if you don't agree.

But happiness does have economic components. Daniel Kahnemann of Princeton University and a recent Nobel Laureate notes that people judge their well-being and happiness not by where they stand but rather whether they think their circumstances and income will improve in the future. With the work-week getting longer and busier (*see chart*), with more dual income families juggling life and work and with the job market so fraught with uncertainty it is easy to see how the average person can feel less than happy.

So what can we do to be happier? Probably lots of things but ironically happiness is one of those crazy things where, if you are looking for it, you won't find it. The happiest people did not start out to be happy. It just happened. John Stewart Mill observed: "those only are happy who have their minds fixed on some object other than their own happiness... aiming thus at something else they find happiness by the way." How can the economy help? Mihaly Csikszentmihalyi (extra points for correct pronunciation), a Professor of Psychology at Claremont Graduate University in California, studies work and workplace satisfaction. He has found that the activities that foster the most happiness involve the successful performance of challenging tasks. Exploring, imagining, discovering and creating, these are the things that make people most happy. Unfortunately too many of us are trapped in non-satisfying work.



Statistical Abstract of the United States: Abstracts from 1900 and 1999, side by side

By Jocelyn Augustino

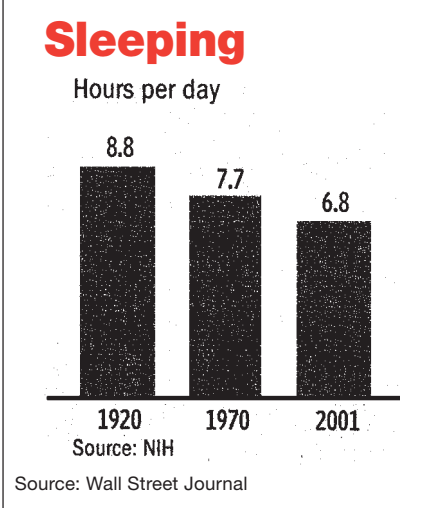
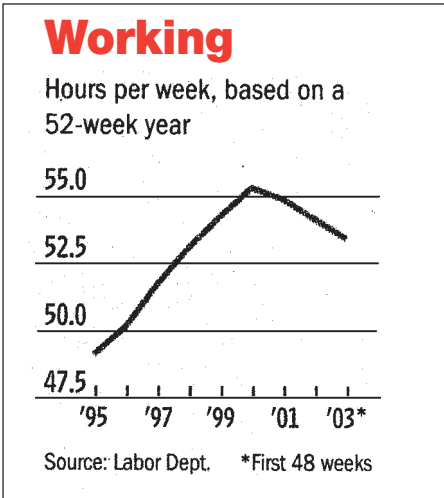
Century of change

Changes in American life in the 20th century, from comparisons between the earliest data available this century and the most recent findings:
(The changing nation, 1A)

<p>Population</p> <p>Age distribution</p> <p>Under 35 1900 70% 1997 50%</p> <p>35 or older 1900 30% 1997 50%</p> <p>Fewer people living with us</p> <p>Average size household 1900 4.8 1998 2.6</p> <p>Cause of death</p> <p>Deaths per 100,000 people from these causes</p> <p>Influenza and pneumonia 1900 202 1997 33</p> <p>Tuberculosis 1900 194 1997 0.4</p> <p>Malignant cancer 1900 64 1997 201</p> <p>Motor vehicle accidents 1910 2 1997 16</p>	<p>Spending</p> <p>Portion of income spent on these items</p> <p>Food and tobacco 1929 27% 1997 15%</p> <p>Housing 1929 15% 1997 15%</p> <p>Clothing 1929 15% 1997 6%</p> <p>Transportation 1929 10% 1997 12%</p> <p>Recreation 1929 6% 1997 8%</p> <p>Medical care 1929 4% 1997 17%</p> <p>Life expectancy</p> <p>Projected life expectancy if born that year</p> <p>Men 1900 46 years 1997 74 years</p> <p>Women 1900 48 years 1997 79 years</p>
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Source: Statistical Abstract of the United States, 119th Edition
By Dave Merrill, USA TODAY

Source: Wall Street Journal



The World Economy . . . Globalization Just Won't Stand Still . . .

IF YOU SUBSCRIBE TO THE *Economist* – in my view the best single magazine (they call themselves a newspaper) on the market today – you have seen their annual review, “The World in 2004”. One of the articles is titled, “The Third Age of Globalization”. Tim Hindle, the Business Features editor, writes that the first stage of globalization consisted of domestic companies discovering foreign markets and exporting. The second phase saw the further development of multi nationals and the move to offshore manufacturing. The definition of exporting started to change here. IBM might ship computers from the U.S. but they might also produce them in Japan for shipment to Taiwan or China or back to the U.S.

This second phase of globalization was driven by a desire to cut costs. Anti-globalist groups took shape here worried that the multi national agenda was the only blueprint for global development.

Globalization continues to morph further today. In the third stage of globalization distinctions between national and global will be harder to discern. Headquarters will begin to move around the globe. Hong Kong Shanghai Bank now HSBC and Ikea and BHP-Billiton have already uprooted headquarters from their home countries. Delphi Automotive in the United States says it has “headquarters in Troy, Michigan, Paris, Tokyo and Sao Paulo”.

Outsourcing and offshoring will continue as a strategy but the goal will

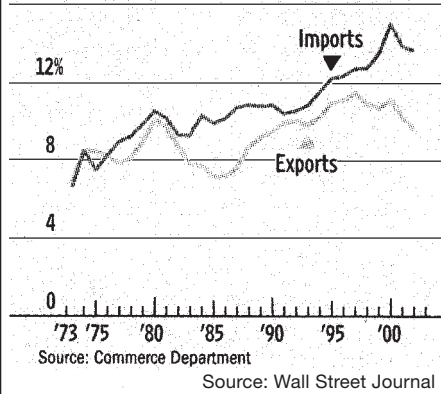
not just be cost cutting but improving processes and getting closer to the customer. The Swiss-American company Logitech makes its wireless mouse, “Wanda” in China. A big win for China you might think. Well it's not so clear. The mouse sells for \$40. Logitech takes \$8 and distributors and retailers another \$15. Fourteen dollars goes to suppliers such as Motorola in Malaysia where the mouse chips are made and Agilent in the U.S., which supplies the optical sensors. China ends up with just \$3 for wages, power, transport and overhead. A win for emerging economies? Yes maybe but globalization is getting more and more complicated and confusing.

If headquarters of multi nationals stay put as most will, it still could be that whole divisions such as human resources or accounting get shifted to different countries. And competitors from very different parts of the world will start to look more alike. *Take a look at the chart below.* As recently as ten years ago, Infosys was a small Indian software company. It is now starting to compete with the Big Boys in high tech consulting. IBM and Accenture are moving some jobs to India to stay competitive while Infosys is beefing up its hiring in Europe and the U.S. in order to sell better into the multi-national consulting market. In ten years they will all look more alike.

The *Economist* is optimistic that the next stage of Globalization will be more harmonious than the previous two.

Trade Trend

Exports and imports are a growing percentage of U.S. gross domestic product



Globalization it turns out is not about a race to the bottom where everyone is chasing the absolute lowest cost. Globalization is about getting the best R&D, designing the most unique product; redesigning to specific customer needs, supplying quickly and finally doing it all at a low cost. This is not easy. It will require the seamless integration of a company's global workforce. India will have to talk to the U.S., which in turn will have to talk to Europe. It will require the coordination of R&D worldwide. GM recently introduced a car which burns both gasoline and ethanol. For the engine the Detroit giant turned to U.S. supplier Delphi that in turn looked to its R&D lab in Brazil for the answer. Global collaboration is the future of nearly everyone's business.

Tech Turmoil

The large U.S. tech-services companies are overhauling their businesses to compete with emerging challengers from India. Here's how three top players stack up:

Source: Business Week

COMPANY

IBM GLOBAL SERVICES

Armonk, N.Y.

ACCENTURE

Hamilton, Bermuda

INFOSYS

Bangalore, India

EMPLOYEES/ % OVERSEAS*

170,000/7%, including 6,000 in India

86,000/1%, including 4,800 in India

22,000/77% mostly in India

PROSPECTS

EXCELLENT. With its combination of products and services knowhow, Big Blue should thrive in consulting and outsourcing. It plans to hire more than 4,000 in Asia this year.

GOOD. It is leveraging its vast global reach to deliver an array of tech services. Business-process outsourcing helped raise revenues 12% last quarter.

EXCELLENT. It's moving from software development and systems maintenance to consulting and systems integration, focusing on a handful of industries.

* In low-cost countries

Economic Trends . . .

Trade Deficit Dilemma . . .

DEFICITS SEEM TO BE THE order of the day. The current slugfest between Republicans and Democrats over the escalating federal budget deficit is receiving a great deal of attention and the issue is well understood by most Americans. But ask them their opinion on the current state of the trade deficit and you are likely to get a blank stare.

Confusion around the trade deficit is easy to understand. First, the mechanics of international trade can be complicated and second, even respected economists disagree on whether this deficit is a serious problem. But the topic is worth exploring as it impacts everything from how much you pay for your next car to the level of interest rates.

For much of the last fifty years, America experienced a trade surplus selling more goods to foreigners (exports) than it bought from them (imports). *As the chart below shows*, this trend started to reverse back in the mid-1970s and today the U.S. trade deficit totals over 4% of our total output. America finances this “excess consumption” by selling financial (treasury bonds, stocks) or real (factories, land) assets. Today, as a result of the escalating trade deficit, foreigners own about \$2.5

trillion more of the U.S. than we own of other countries.

Opinion on the seriousness of this problem is indeed mixed. Many, such as famed investor Warren Buffett, feel the escalating trade imbalance causes both short and long term problems. In the long term, Buffett worries that today’s trade deficits are being financed with IOUs (mostly treasury debt) that will have to be repaid by future generations. In the shorter term, although how short is anyone’s guess, he worries that the current level of the trade deficit is simply unsustainable. The concern here is that foreign investors will become reluctant to buy more U.S. debt if they sense that a falling dollar or low interest rates may translate into poor returns. If this happens, the rising interest rates required to attract foreign investors could cause a sell off in both stocks and bonds.

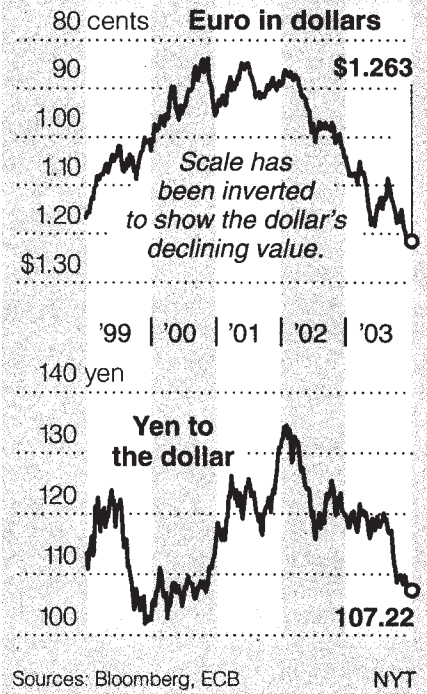
But other quite respectable economists, such as Wharton professor Jeremy Siegel, see the current trade imbalance as a natural consequence of our nation’s aging demographic profile. Developing countries around the globe will experience a sharp increase in the number of productive workers age 30-50 just about the time that baby boomers retire in the U.S. This global age profile, he concludes, will necessarily translate into a trade deficit for aging nations but also stronger worldwide economic growth, which will benefit all.

In theory, foreign currency adjustments are supposed to automatically correct the trade deficit problem. As creditor countries tire of owning U.S. debt, the dollar should fall in value making imports more expensive and exports cheaper. As exports increased and imports fell, the trade deficit would narrow and perhaps even disappear.

To an extent this is already happening. Since early 2002, the dollar has fallen about 30% against the euro, 19% against the yen and 23% against a basket of 23 currencies. This trend has benefited American firms who now find their products more competitive abroad. But

Losing value

The dollar, which weakened against the euro and the yen over the last two years, is now below its value at the start of 1999, when the euro was introduced.



Source: New York Times

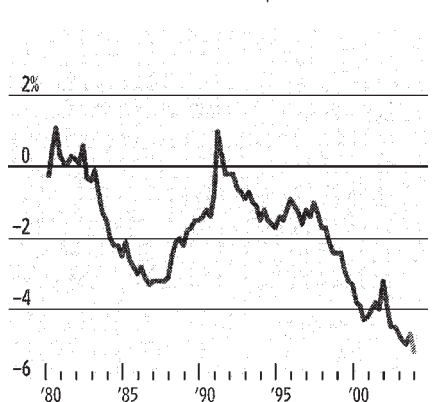
for many of our trading partners, especially the Europeans, the dollar’s weakness has been a harsh development as they now find their goods increasingly less competitive in world markets.

The consensus today is that the dollar must fall much further to bring the U.S. trade gap back in line. This expectation is driving private investors, such as Warren Buffett, to buy foreign currencies. But Asian central banks, anxious to keep their currencies weak to support export growth, should continue to buy dollars and invest in U.S. debt. A further dollar decline, as long as it was gradual and not a crash landing, would be a good thing both for the U.S. and the world economy.

– Anne Williams Doremus, CFA

Deeper Hole

U.S. current account deficit as percent of GDP



Note: Data for fourth quarter 2003 is estimated

Sources: Commerce Dept. via Economy.com; Goldman Sachs

Source: Wall Street Journal