

Thoughts from

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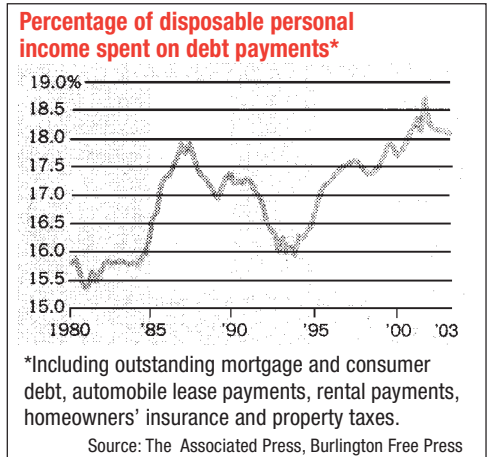
Lessons Learned . . . Or Not Learned . . .

CHILDHOOD OBESITY HAS some of its roots in the lessons a child learns from his parents about food. So also, how a person handles money is influenced by what he learns as a child. In the last decade consumers have taken on a lot of debt to pay for spending (see below).

This is old news but what shocked me was how early new consumers are learning to take on debt. The *Washington Post* reports that 83% of college students now have credit cards compared to 67% in 1998. I would venture to say when I was in college in the late 1960's the percent was under 10%. The average student balance on credit cards in 2001 was \$2,327 and the average graduating senior carries credit card debt of \$3,300.

Then you add in what students have borrowed for tuition. Nellie Mae, the student loan financing organization, says the typical student graduating from a four-year college has close to \$19,000 in student loans. Quite a load when you figure the job market is weak and there is pressure on starting salaries from low wage areas like India and China.

The *Christian Science Monitor* notes that this is not just a U.S. phenomenon. In Britain one quarter of parents expect to help their offspring financially through their 30's and 40's and in fact there is a new term in Britain for this: Kippers, or Kids In Parents' Purses Eroding Retirement Savings! How much debt can we take on (and how early can we do it) before it really pinches? Good question. Maybe we are in for some years of below average growth. We'll see.

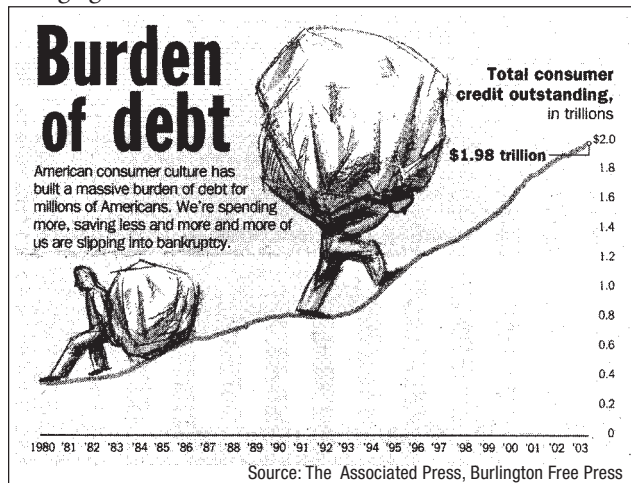


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Hanson Investment Management is an investment counsel firm managing portfolios for individuals and institutional clients. The firm also consults with individuals on financial planning and works with self-directed retirement plans on investment options.



U.S. Policy . . .

Yes, Do Cry for Me Argentina . . .

THE U.S. BUDGET DEFICIT IS close to 5% of GDP now. Among developed countries only Japan has a higher ratio. We are closing in on Banana Republic territory where historically economies start to implode and interest rates soar.

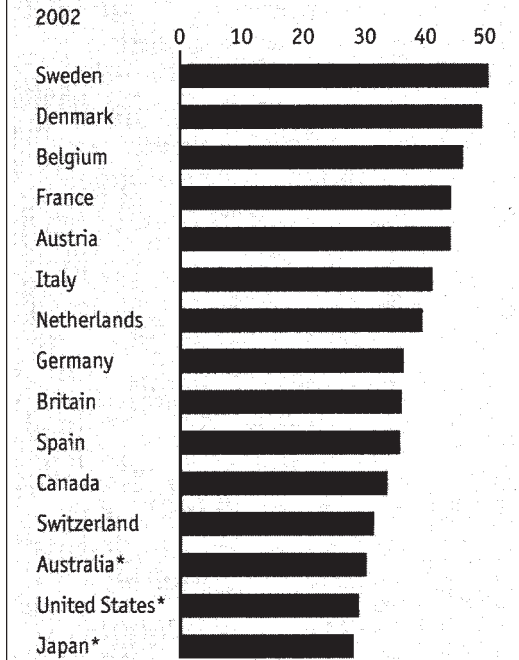
I am not forecasting this now but the signals are flashing. We have never dealt specifically with the Federal deficit in

ment. It is hard to find any middle ground. But it is middle ground we are going to have to find soon.

The trends today all seem to be going in the wrong direction. The *Christian Science Monitor* recently reported that federal government spending per household in constant dollars is now at a level exceeded only by the World War II years of 1943, 1944 and 1945. We are spending \$20,399 per U.S. household versus an average of \$18,000 a year in the 1990's. On the other side tax revenue as a percent of GDP (see chart in upper right) is stable or shrinking. Our tax burden is at the low end of a list of developed countries. Now certainly it could be argued that the other developed countries are taxing their citizens far too much but this is another subject.

Our recent record on fiscal policy is contributing to these trends. On the spending side we are expanding Medicare, we have enacted a major Farm bill and are increasing education funding through the No Child Left Behind program. At the same time we have put in place one of the major tax cuts of all time. Something has to give. Maybe it will take the bond vigilantes smelling higher inflation to refuse to buy bonds without much higher rates. So far no panic in the

Total tax revenue as % of GDP



Source: OECD

*2001

Source: The Economist

bond market but how much longer can this go on?

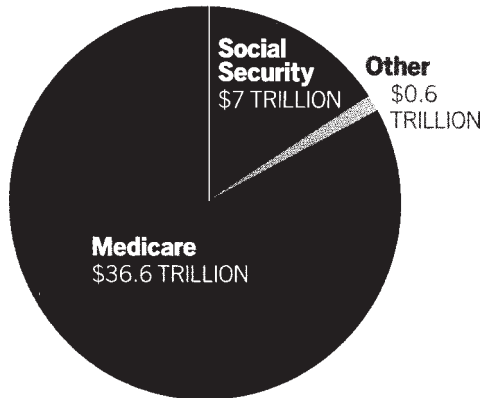
There is a new form of accounting today that is gaining acceptance – “Generational Accounting.” It adds up everything the government expects to spend in the future and compares it to what total income is expected to be. The result today is a gap of \$44.2 trillion or 1½ times the size of the entire world

economy. As the country gets older spending on Medicare and Social Security will grow enormously. We will have to do something about this, either cut benefits, increase taxes or a combination of the two.

There is no way interest rates (or inflation) won't increase dramatically if we let our fiscal house continue as is. So listen closely to what the candidates are saying on fiscal policy this election year. And one hint, there will definitely be no free lunch on this one.

Generational Accounting

How the expected budget shortfall of **\$44.2 TRILLION*** breaks down



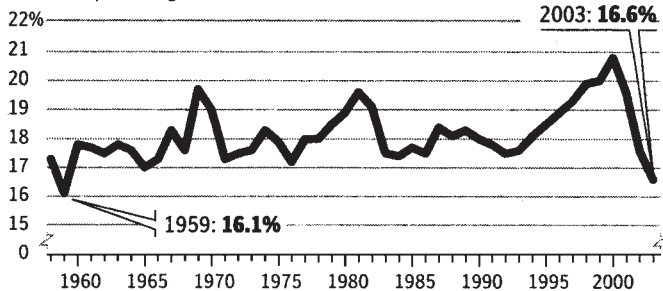
*Based on current government revenue and spending. Source: Fortune

this newsletter. The reason is the subject is so politically charged. Either you are a bleeding heart liberal in favor of more spending and higher taxes or you are a cold-hearted conservative interested only in cutting taxes and the size of govern-

Fiscal Mismatch

Federal tax receipts have fallen to their lowest level since 1959. . .

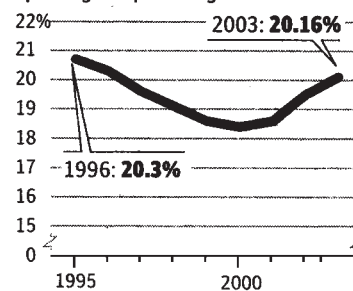
Taxes as a percentage of GDP



SOURCES: White House, Congressional Budget Office

. . . while federal spending is back to where it was 1996.

Spending as a percentage of GDP



BY TOBEY FOR THE WASHINGTON POST

The Mutual Fund Industry . . .

Guarding the Guardians . . .

PLATO SAID A SOCIETY should be run by perfect guardians. Juvenal is reputed to have replied, "And who will guard the guardians?" This is where we are with mutual funds today. Mutual funds have always been seen as the great leveler, allowing Main Street to play on the same field and with the same rules as the big guys. Now the fund industry stands accused of allowing market timers to run rampant, allowing some large investors to place trades after hours in return for large deposits in the fund and allowing portfolio managers to

The Scandal in Perspective COST

Investor (Mis)timing	(\$1 trillion)
Excessive Fund fees	(\$20 billion)
After hours trading	(\$10 million)

Source: Forbes

short term trade their own funds for personal profit.

These ethical lapses need to be cleaned up quickly and decisively. A related issue is what is the cost of all these missteps? The answer here is a real eye opener. *Forbes* magazine estimates the cost of the scandalous after hours trading is \$10 million. Certainly a lot of money but not that significant relative to an industry with \$7 trillion of assets. A much bigger cost is excessive fees that funds charge. *Forbes* estimates that investors pay \$20 billion a year more for management than they would if they were invested in simple index funds. The fact is mutual funds costs have been ratcheting up for years now (see chart in upper right).

One reason is investors don't like to pay sales charges so funds have figured out how to bury these in annual operating expenses (see chart above). Unfortunately this shifts costs from a one-time basis to a fee that is paid over and over every year. A very expensive change. And the biggest cost to investors is – yes you might have guessed – us. We reported back in August the results of a survey done by Dalbar Inc of Boston on mutual

fund returns and investor results. Between 1984 and 2002 the Standard & Poor 500 returned 12.2% annually. The average equity fund grew 9.3% a year. The difference of approximately 2% reflects operating expenses and trading commissions, which are paid by investors.

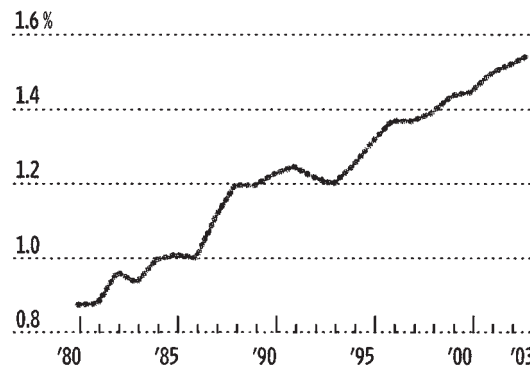
Individual investors earned a return far less than the average 9.3% that funds made. How much less? Try 2.6% per year. How come? The reason is buyers moved dollars into funds when the excitement was great and prices were high and then moved right back out when sentiment dropped and prices were lower. Not the best timing strategy. Mutual funds are long-term investments. Investors get broad diversification in many industries and many different size companies. This is something they wouldn't be able to do by themselves with limited assets. But mutual funds have become more like trading vehicles today. The average equity fund turns its portfolio over 100% a year. This is hardly long term investing. Then the mutual fund buyer compounds the problem by turning his group of funds over 40% a year. *Forbes* estimates all this excessive trading has

led to missed profits of \$1 trillion over the past ten years.

There are really only a few things you need to do to be successful in mutual funds. First watch your expenses. A low cost fund will invariably have a higher long-term return than a high cost one. Second look for a sensible investment strategy and a decent track record. You don't need a fund that shoots the lights out. In fact avoid these, they are just following the latest investment fad and you will invariably get in right at the peak. And finally buy funds with low turnover. If your objective is long term growth why pay a manager to churn your holdings?

Charges Rise Over Time . . .

Median expense ratios of stock funds



Sources: Lipper; Morningstar

Source: Wall Street Journal

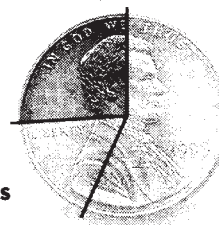
Adding It Up

Last year investors paid a total of \$35.2 billion in mutual fund fees.

SOURCE: FundExpenses.com

26.1%
12b-1 fees
\$9.2 billion

17.3%
Administrative fees
\$6.1 billion



56.5%
Advisory/
management
fees
\$19.9 billion

- Fund prospectuses must disclose in the first few pages how much the fund manager charges in fees in percentage terms. Investors who want to calculate the impact of fees on their returns can use a program on the SEC Web site. The "mutual fund cost calculator" is at www.sec.gov/investor/tools.shtml.

- The Investment Company Institute, the main mutual fund trade group, has a series of guides that discuss fees and other mutual fund issues at www.ici.org/funds/inv/index.htm.

—Brooke A. Masters

Source: Washington Post

The New Economy . . . Creative Destruction . . .

BACK IN THE 1940s, economist Joseph Schumpeter coined the phrase “creative destruction” to describe the way new industries in capitalist systems destroy old ones. You don’t have to think hard to come up with some pretty powerful examples of this process. Consider the economic dislocation caused by the automobile, electricity and personal computers. Few people today earn their living selling buggy whips, whale oil or typewriters.

Today, newspapers are spending a lot of time covering the painful, destructive part of this economic process. Destroyed industries translate into the bad news of lost jobs and, as we all know, bad news sells. The job creating role of innovation, however, typically receives little attention.

Consider the following fact. A quarter of Americans now work in jobs that were not listed in the Census Bureau’s occupation codes in 1967. And just fifteen years ago, you would have been unable to design web sites, make Mocha Lattes at Starbucks or be the digital camera guru at Best Buy.

So where will tomorrow’s jobs come from? Former Labor Secretary Robert Reich points to two sources. First, technological developments will increase demand for workers who can analyze, interpret and communicate through numbers, shapes, words and ideas. Reich calls this “symbolic analytic” work and it covers such areas as research & develop-

ment, engineering, high-level sales and marketing. This group of workers will do just fine as long as they stay away from routine tasks that can be outsourced to cheaper labor markets abroad.

The jobs being created in the wake of eBay’s success provide a good example of this trend. Today, an estimated 30,000 people are employed as independent eBay trading assistants. For a commission, these entrepreneurs offer their experience selling on eBay to individuals who don’t want to be bothered with the online auction process. And consider the legions of eBay PowerSellers, entrepreneurs who gross over \$1,000 month in sales and make the jump to full-time merchants. True, this may not be genetic research, but these folks are turning their mastery of a new technology into a thriving new business.

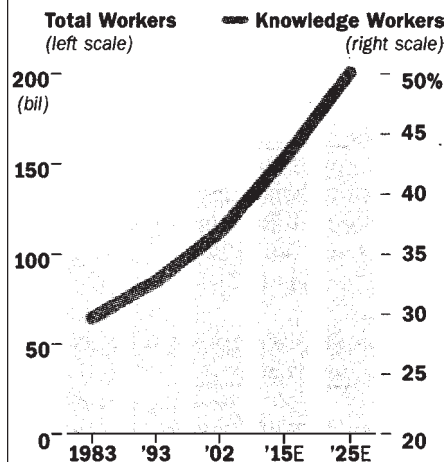
The second growing category of workers involves personal services. Generally, these jobs require a high level of personal attention and for this reason they are somewhat insulated from global competition. While some of these jobs require high levels of education (physical therapists, nurses) many require almost none. Pay levels here are low and falling as the supply of workers from displaced factory jobs and immigrants outstrips demand.

I would add that the retiring baby-boom generation represents a third source of future job creation. Today, there are 63 million U.S.

residents age 55 and older. This number is expected to jump over 60% by 2025. This development will impact our labor markets in two significant ways. First, as baby boomers retire, the demand for skilled, experienced workers will soar. Second,

Working Knowledge

►The share of “knowledge workers” in the labor force will continue to rise. These are jobs that rely on brainpower and creativity, rather than on machinery. Executives, scientists and advertising copy writers are all among the nation’s knowledge workers.



Sources: Bureau of Labor Statistics and Barron's
Source: Barrons

the retiring older population will place great demand on specific sectors of the economy such as healthcare and financial services. *Take a look at the chart below.*

Fully half of the fast growing job categories listed are in one of these two fields. Some of these jobs will fall into Reich’s symbolic analytic definition and be high paying. Many, however, will fall into the lower compensated personal services area.

Business strategy expert Tom Peters claims that our economy’s strength lies in its ability to withstand and even nurture change and chaos. Between 1980-1988, the U.S. economy destroyed 44 million jobs at firms such as Chrysler, AT&T and IBM. But these were offset by 73 million new jobs at places like Dell, CNN and Genentech for a net job gain of 29 million. Over the same time period Europe, with a much greater population, added just 4 million net new jobs.

As these statistics suggest, our nation has a strong track record of creating new jobs. Tomorrow’s challenge will be to insure that our workers have the skills needed to fill the growing number of high quality jobs.

—Anne Williams Doremus, CFA

Where the Jobs Will Be

►Over the next 10 to 20 years, skilled jobs will be firmly on the rise, offering opportunities to old and young. Manufacturing will probably follow agriculture as an ever-shrinking employer.

FAST GROWING:

Registered nurses
Physicians' assistants
Mental-Health workers
Health-Services entrepreneurs
Biologists
Neurologists
Web designers
Marketing professionals
Advertising writers

Computer programmers, systems analysts
Financial planners, personal bankers
Assistant morticians
Television personalities
Actors and directors (movies, TV)
Athletes, coaches, umpires, referees
Gaming industry croupiers

DECLINING:

Butchers
Barbers
Manufacturing workers
Agricultural workers
Secretaries
Clerks

Source: Barrons