

Thoughts from

Hanson Investment Management Inc.

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In Alan Greenspan We Trust...



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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.

WHEN THE FED CUT SHORT-TERM RATES by ½% on January 3, the NASDAQ Composite soared 14%, the biggest one-day jump in history. Everyone is hoping Mr. Greenspan can pull one more rabbit out of the hat. My take is, rate cut or no, the economy is headed for tough times, if not recession. The seventeen tech stocks below have lost a combined \$1.2 trillion in market value in a year. The total market is down \$3 trillion. With 61% of our financial wealth now tied up in stocks versus 31% ten years ago, we are going to feel a lot poorer and spending is going to get cut back possibly by a lot. Combine this with higher oil prices and a probable slowdown in technology spending by corporate America and you get a pretty bleak picture.

But so what? Business cycles come and go. The surprising thing to me is how long the current upturn has lasted. I think the downturn we are facing now will be short. We don't have the excesses like feverish overbuilding in property to contend with. Maybe overspending in technology will be our yolk to bear, but excess inventory should be worked off quickly.

What are the keys to the next upturn? Stephen Roach of Morgan Stanley Dean Witter, one of the first economists to call this a recession, says there are three: monetary policy, fiscal policy and energy prices. If we get speedy relief by the Fed (it's already happening) and speedy relief from Congress (tax cuts and spending bills are already on the docket) and if energy prices fall, then the next upturn could come sooner than later. I agree but in the meantime expect to hear a lot more of the R word.

Tech Tumble	Market Capitalization End 1999 (\$ billions)	Market Capitalization End 2000 (\$ billions)	Close Dec.29, 2000 (\$)	Percentage Change in 2000
Lucent Technologies	222.78	45.69	13.50	-80.96
WorldCom	150.86	40.49	14.06	-73.50
Apple Computer	16.53	4.99	14.88	-71.06
Dell Computer	129.69	44.90	17.44	-65.81
Microsoft	596.48	229.15	43.38	-62.85
Motorola	90.23	44.23	20.25	-58.74
Qualcomm	113.84	61.45	82.19	-53.34
America Online	167.84	80.61	34.80	-54.14
Compaq Computer	45.84	25.66	15.05	-44.39
Hewlett-Packard	89.18	62.41	31.56	-28.89
Cisco Systems	365.35	273.03	38.25	-28.59
Sun Microsystems	120.39	89.76	27.88	-28.01
IBM	192.47	149.12	85.00	-21.21
Intel	274.43	202.32	30.06	-26.96
3Com	3.61	2.98	8.50	-13.96
Advanced Micro Devices	4.30	4.33	13.81	-4.54
Oracle	160.38	162.68	29.06	+3.74

Source: Bloomberg

Source: International Herald Tribune

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The Sage of Omaha . . .

Half of Wall Street's Wizards Don't Know Where Stocks Are Going . . .

THE REST DON'T KNOW they don't know. This past year has been a difficult one for investors. It has almost been impossible to avoid one or more landmines. In times of trouble it often makes sense to turn to the Deans of the Profession for some sage advice. None is more appropriate today than Warren Buffett, the Chairman of Berkshire Hathaway. Buffett has been much criticized for missing the New Economy and the high tech boom of 1998-99. But recently he has been vindicated. Berkshire stock was up 27% last year versus a drop of 39% in the Nasdaq Composite. Buffett has written extensively about his investing style in the *Berkshire Hathaway Annual Report*. When he was asked at the 1998 annual meeting for the best book on his investment style, Buffett replied, "Larry Cunningham has done a great job collating our philosophy. It is far better than any biographies written to date. If I were to pick one book to read, this would be the one."

So here is Buffett in his own words on the investment process. I have taken

the liberty of piecing together some of the quotes but have kept the intent very much intact.

"Mr. Market"

Ben Graham, my friend and teacher, long ago described the mental attitude toward market fluctuations that I believe to be the most conducive to investment success. He said that you should imagine market quotations as coming from a remarkably accommodating fellow named Mr. Market, who is your partner in a private business. Without fail, Mr. Market appears daily and names a price at which he will either buy your interest or sell you his.

At times he feels euphoric and can see only the favorable factors affecting the business. When in that mood he names a very high buy-sell price because he feels that you will snap up his interest and rob him of imminent gains. In other times he is depressed and can see nothing but trouble ahead for both the business and the world. On these occasions he will name a very low price, since he is terrified that you will unload your interest on him.

Mr. Market does not mind being ignored. If his quotation is uninteresting today he will be back with a new one tomorrow. But like Cinderella at the ball, you must heed one warning or everything will turn into pumpkins and mice: Mr. Market is there to serve you, not to guide you. You are free to either ignore him or take

The Essays of Warren Buffett: Lessons for Corporate America

Essays by

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advantage of him, but it will be disastrous if you fall under his influence. Indeed, if you aren't certain that you understand and can value your business far better than Mr. Market, you don't belong in the game. As they say in poker, "if you have been in the game thirty minutes and you don't know who the patsy is, you're the patsy."

On Intelligent Investing.

Intelligent investing is not complex, though that is far from saying that it is easy. What an investor needs is the ability to correctly evaluate selected businesses. Note that word "selected": You don't have to be an expert on every company, or even many. You only have to be able to evaluate companies within your circle of competence. The size of that circle is not very important; knowing its boundaries, however, is vital.

Your goal as an investor should simply be to purchase, at a rational price, a part interest in an easily-understandable business whose earnings are virtually certain to be materially higher five, ten and twenty years from now. Over time, you will find only a few companies that meet these standards —



"Something's happened, Doug. I've lost touch with the Warren Buffett in me."
Source: The New Yorker

so when you see one that qualifies, you should buy a meaningful amount of stock. You must also resist the temptation to stray from your guidelines: If you aren't willing to own a stock for ten years, don't even think about owning it for ten minutes. Put together a portfolio of companies whose aggregate earnings march upward over the years, and so also will the portfolio's market value.

On valuing a business.

Our equity investing strategy remains little changed from what it was when we said in the 1977 annual report: "we select our marketable equity securities in much of the way we would evaluate a business for acquisition in its entirety. We want the business to be one (a) that we can understand; (b) with favorable long-term prospects; (c) operated by honest and competent people and (d) available at a very attractive price.

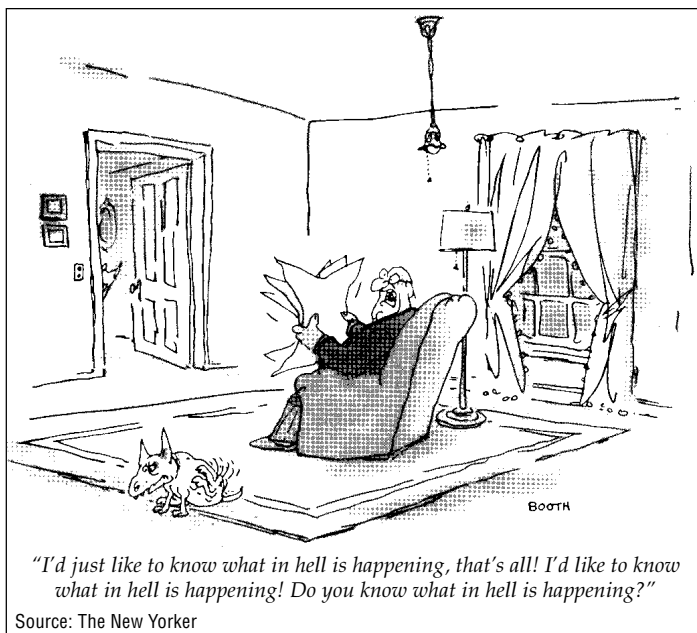
We favor businesses and industries unlikely to experience major change. The reason for that is simple: Making either type of purchase, we are searching for operations that we believe are virtually certain to possess enormous competitive strength ten or twenty years from now.

And equally important, we insist on a margin of safety in our purchase. If we calculate the value of a common stock to be slightly higher than its price, we are not interested in buying. We believe this margin of safety principal, so strongly emphasized by Ben Graham to be the cornerstone of investment success.

On risk and turnover.

The true investor welcomes volatility. A wildly fluctuating market means that irrationally low prices will periodically be attached to solid business. It is impossible to see that the availability of such prices can be thought of as increasing the hazards for an investor who is totally free to either ignore the market or exploit the folly.

Instead of focusing on what businesses will do in the years ahead, many prestigious money managers now focus on what they expect other money managers to do in the days ahead. For them, stocks are merely tokens in a game, like the thimble and flatiron in Monopoly. When we own portions of outstanding businesses with outstanding managements, our favorite holding



period is forever. We are just the opposite of those who hurry to sell and book profits when companies perform well but who tenaciously hang on to businesses that disappoint. Peter Lynch aptly likens such behavior to cutting the flowers and watering the weeds.

On mistakes.

My first mistake of course was buying control of Berkshire. Though I knew its business — textile manufacturing — to be unpromising, I was enticed to buy because the price looked cheap. If you buy a stock at a sufficiently low price there will usually be some hiccup in the fortunes of the business that gives you a chance to unload at a decent profit, even though the long term performance of the business may be terrible. I call this the "cigar butt" approach to investing. It is far better to buy a wonderful company at a fair price than a fair company at a wonderful price.

That leads to a related lesson: good jockeys will do well on good horses but not on broken down nags. The same managers employed in a business with good economic characteristics will achieve fine records. But they are never going to make any progress while running in quick sand.

A further related lesson: easy does it. After twenty-five years of buying and supervising a great variety of businesses, Charlie (Charles Munger, Berkshire Vice Chairman) and I have not learned how to solve difficult business problems. What we have learned to do is avoid them. To the extent we have been

successful, we have concentrated at identifying one foot hurdles that we could step over rather than because we acquired any ability to clear seven footers.

On market timing.

We will continue to ignore political and economic forecasts, which are an expensive distraction for many investors and businessmen. Thirty years ago, no one could have foreseen the huge expansion of the Vietnam War, wage and price controls, two oil shocks, the resignation of a President, the dissolution of the Soviet Union, a one day drop in the Dow Jones of 508 points or Treasury Bill yields fluctuating between 2.8% and 17.4%.

But, surprise, — none of these blockbuster events made the slightest dent in Ben Graham's investment principals. Nor did they render unsound the negotiated purchases of fine businesses at sensible prices. Imagine the cost to us, then, if we had let a fear of unknowns cause us to defer or alter the deployment of capital. Indeed, we have usually made our best purchases when apprehensions from some macro event were at a peak. Fear is the foe of the faddist but the friend of the fundamentalist.

Stock prices will continue to fluctuate — some times sharply — and the economy will have its ups and downs. Over time, however, we believe that it is highly probable that the sort of businesses we own will continue to increase in value at a satisfactory rate.

Investing Trends . . .

The Return of Value . . .

WITHOUT A DOUBT, 2000 will be remembered as the year the Technology Bubble burst. Even today, investment publications are filled with articles covering the demise of e-commerce or the blow-up of some previously high-flying "New Economy" stock. To be sure there are good reasons for this heightened attention. The technology laden NASDAQ Composite finished the year off 39% having fallen approximately 50% from its March 10th peak. Clearly, a lot of money was lost in technology stocks last year and investors are still feeling the pain.

This rather astonishing decline marked the end of an extended period of outperformance by growth stocks. For the last five years, investors favoring growth-oriented strategies were well rewarded while value oriented approaches lagged behind. Investor's love affair with growth continued into last year as "growth at any cost" became the key to investment success.

With the benefit of hindsight, it is easy to see that valuations in select sectors of the market had gotten out of line. On March 24th of last year, Ned Davis published a list of 25 blue-chip stocks with a total market value of \$541 billion. Included in the line-up were such industry leaders as Aetna, Ford, Texaco and Caterpillar. At the same time one stock, Cisco, sported the same

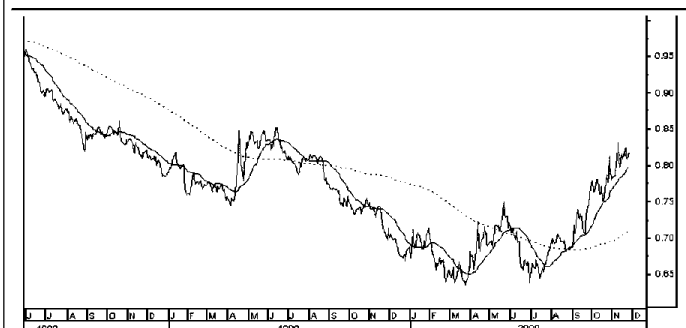
\$541 billion market value. Cisco had a P/E ratio of 213 while the 25 blue chips had an average P/E ratio of less than 15. Why were investors willing to pay such seemingly impossible prices for growth?

One answer to this question has to do with how investors react to technological innovation. Emerging technologies, such as the Internet, open up a wide range of opportunities. While high risk, many of these new developments offer the promise of great return. In an environment of easy credit, the lure of great upside potential can cause investors to pay excessively for growth. The 1990s are not the first time that technological innovation has caused such a period of overpricing. During the 1920s, the advent of electrification and the radio and improved transportation created much of the same enthusiasm that the Internet has today. During this time, prices of growth stocks, the supposed beneficiaries of the new technologies, were bid up to excessive levels. As the chart below shows, when the real profit potential came more clearly into focus, valuations corrected.

Today, investors are once again facing the business realities of the latest technological innovations. A year ago companies such as Amazon.com and Yahoo were heralded as leaders of the New Economy. Today, the future of these companies remains in doubt. While technology will continue to evolve, who will benefit from its adaptation and by how much has become much less clear.

Meanwhile, money

Value Relative to Growth



S&P BARRA value index divided by the S&P BARRA growth index

Source: Bloomberg

Source: Morgan Stanley Dean Witter

flowing out of technology stocks has found homes in value oriented financial, utility and food shares. The chart above shows that investment trends have changed. Beginning last spring, value investors began outperforming growth investors. For the full year, value stocks in the S&P 500 were up about 6% while growth issues fell 21% and the trend has continued into this year. Investors today want to know how long this period of out-performance will last?

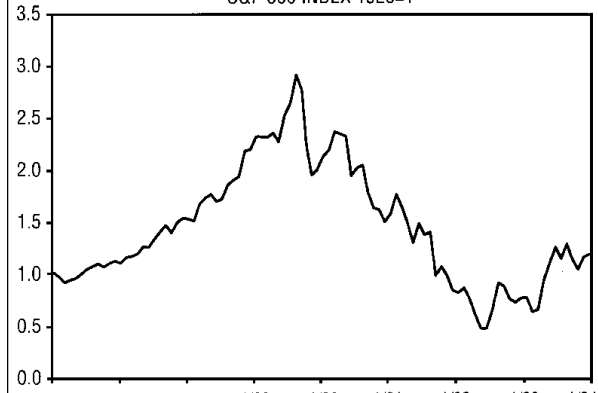
My guess is that value stocks will continue to do well for several reasons. First, investment sectors and strategies go in and out of favor. In the 70s, oil stocks were the place to be. In the 80s it was consumer staples and in the 90s, you guessed it, technology ruled. While technology shares will continue to play an important role in the financial economy, the latest trends suggest that investors are once again rotating into sectors that reflect new investment strategies.

In addition, there is no doubt that investors have been badly burned by the latest meltdown. While many technology stocks have corrected sharply, valuations in much of the group remain high. The combination of high valuations and weak profits could spell more trouble for technology stocks. In this kind of environment, value strategies that seek out reasonably priced stocks with good earnings potential should continue to outperform growth.

— Anne Williams Doremus

Investors Have Favored Growth at any Cost Before

S&P 500 INDEX 1926=1



Source: The Babson Staff Letter