

Thoughts from

Hanson Investment Management Inc.

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The Shape of Things to Come ...

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OK WE'VE WORRIED PLENTY about this economic slowdown. Now we want to know what the next upturn will look like. Will it be a classic "V" with a nice sharp bounce or will it be a more drawn out "U."

Stephen Roach, chief economist at Morgan Stanley, is a very smart guy. Unfortunately he is also a pessimist now. Roach sees an "L" recovery the next few years. Ugh. This will not be the grinding 10 year "L" of Japan but it will mean sub par growth of only 1-2% a year.

Why the sluggish growth? For three reasons, Roach thinks. The first is the economy has to work off excess supply in high tech. Secondly layoffs are going to continue and they will be concentrated in white collar jobs where the bulk of the employment gains the past 5 years have been made. White-collar salaries are the highest so the economy needs time to absorb a lot of lost income. The third reason is the consumer needs to rebuild their balance sheet, pay down debt and increase savings. This means little growth in consumer spending.

The good news however is the stock market won't wait for all this bad news. Bear markets tend to last 12 months (*see below*) and more importantly, the stock market starts to go up mid-way through a slowdown. If this current downturn started last fall, as seems likely, then the market can easily start discounting the next upturn shortly. This is how we are betting. It's too late to sell now. It's time to start shopping for the next up leg.

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.

In the Bear's Den

A bear market, generally defined as a market decline of 20 percent or more over at least a two-month period, has occurred on average every five years—and has lasted on average about 12 months.

Bear markets since 1956

Duration	% drop	Duration in months	Recovery period in months
Aug. 2, 1956-Oct. 22, 1957	21.6	14.7	11.1
Dec. 12, 1961- June 26, 1962	28.0	6.4	14.3
Feb. 9, 1966-Oct. 7, 1966	22.2	7.9	6.9
Nov. 29, 1968-May 26, 1970	36.1	17.9	21.3
Jan. 11, 1973-Oct. 3, 1974	48.2	20.7	
Sept. 21, 1976-March 6, 1978	19.4	17.5	17.3
Jan. 6, 1981-Aug. 12, 1982	25.8	19.2	2.3
Aug. 25, 1987-Dec. 4, 1987	33.5	3.3	19.7
July 16, 1990-Oct. 11, 1990	19.9	2.9	4.3

SOURCE: Standard & Poor's

THE WASHINGTON POST

The Recent Past . . .

The NASDAQ Bubble . . . R.I.P. . . .

THE NASDAQ COMPOSITE peaked at just over 5000 in March 2000. Today it is down more than 50%. The following tidbits are from an article "Burning Questions, Final Answers," in *Forbes ASAP*. Some are interesting, some are amusing and some are just downright painful.

1 A lot of companies got hit when the technology bubble burst. Which company got hit the hardest? That's easy. Cisco lost \$325.7 billion of its market cap between 1999 and 2000. To put this in perspective, the lost market capitalization in Cisco is nearly equal to the entire market cap of Microsoft today (\$348 billion). Not chump change at all.

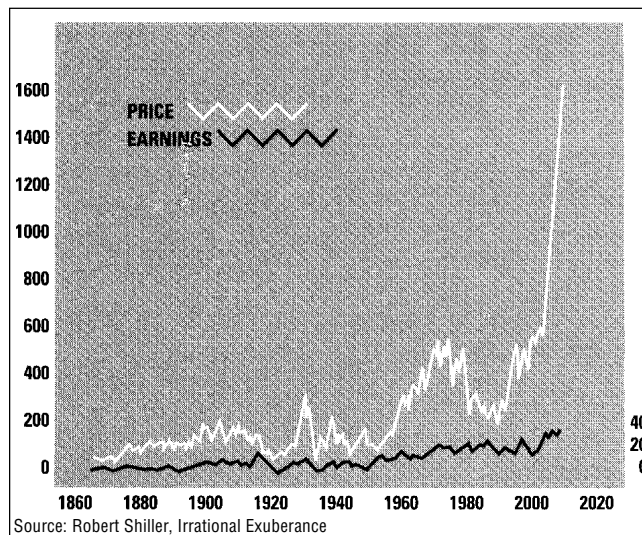
2 What has proved to be the most inaccurate prediction in technology? Without question the promise of the paperless office. According to the PaperCom Alliance, a non-profit that studies the future of paper based products, electronic communication actually increases paper use in virtually all market sectors.

3 What was the worst high tech merger? Mattel's purchase of the Learning Company, an educational and entertainment software company for \$3.6 billion in May 1999. Executives were hoping to become a significant factor in children's software gaming but unfortunately the whole market became a commodity very quickly. Two years after the acquisition the toy maker sold the Learning Company for practically nothing.

4 What is the biggest failure in tech history? Iridium, the global satellite telephone company, must be near the top. Its demise last year cost investors some \$5 billion and its assets were bought for pennies on the dollar by Iridium Satellite LLC, which launched its service in April.

5 What was the biggest high tech layoff? You might think Motorola, which recently announced plans to lay off 26,000 workers. But this is not even close. IBM continues to hold the layoff distinction. Big Blue shed 63,000 workers in July 1993 just as Louis Gerstner was beginning his restructuring.

6 What chart best sums up the NASDAQ's recent 50% fall?



Lessons to be learned. Rule #1: In the long run stocks always follow earnings. Rule #2: Don't forget Rule #1.

7 How does an e-mail get from San Francisco to New Delhi? First your computer breaks the message down into digital bits about the size of sixteen characters. These chunks are wrapped in envelopes with address information. Press Send and these electronic fragments zip through a series of routers in places like San Jose, New York, Santa Barbara and Tokyo. Routers are intelligent devices that sit at gateways connecting the wires that make up the Internet.

The Router sends the tiny packets of information via the quickest route which often means the least congested one. The "Dear John" packet might travel from San Francisco to San Jose veer over to Tokyo and finally land in New Delhi. Meanwhile, "the I love someone else" packet could travel from San Francisco to

Honolulu to Mumbai and then on to New Delhi. They typically arrive within milliseconds of each other, still heart breakingly coherent. Depending on countless factors the total time involved in sending the e-mail is anywhere from a second to an hour.

8 What's the worst tech decision ever made? There are lots of contenders but early in Intel's life, a

Japanese calculator company called Busicom enlisted Intel, then a memory chipmaker, to develop a new, multipurpose chip to make calculators cheaper. Intel responded by inventing the micro-processor. But calculator prices fell and Busicom let the rights revert to Intel. Estimated lost revenues: \$170 billion.

9 Does the elevator's Close Door button actually do anything? Whether the button works is largely a matter of traffic flow, according to Michael Jordan-Reilly of Otis Elevator. In a hotel lobby, for instance, where people often are waiting with their luggage, the elevator is programmed so the Close Door button will work to help passengers get up to their rooms faster. But in a busy office building where companies want to jam as many people as possible into one elevator to keep their lobbies clear, the Close Door button won't work.

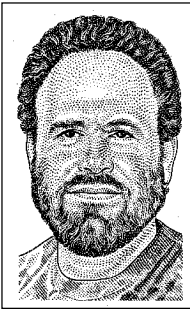
10 What's the difference between a Ponzi scheme and the Internet stock bubble? A Ponzi scheme is a premeditated fraud in which a con artist hypes a nonexistent or overvalued investment. The fraud is sustained for a while by paying "dividends" to early investors from funds collected from later ones. By contrast, the "Internet bubble" was about buying and selling overvalued stock in companies with dubious or nonexistent business plans. The run-up in value was based on the fact that many other investors had bought in earlier. As you can see, there's a BIG difference.

Economics 101 . . .

Why don't people save more for retirement? . . .

INVESTING FOR RETIREMENT is probably the single most important economic decision people make. But look at the chart in the upper right. Over half of the respondents to a recent survey said they are a little behind or a lot behind in saving for retirement.

Why are we doing such a bad job? Traditional economics says people save



Matthew Rabin

too little because they lack self-control. But practitioners of the new school of behavioral economics say it is more complicated than this. People behave rationally – that is they make decisions that are in their best interest – most of time but not

all of the time. Our idiosyncrasies get in the way to screw things up.

One of these is procrastination. Matthew Rabin is an economist at the University of California, Berkeley. This past month he was awarded the John Bates Clark Medal, which is awarded once every two years by the American Economics Association to the best economist under the age of forty.

Rabin's research has focused on why people don't do a good enough job saving for retirement. Most people do indeed plan to invest wisely for retirement but then procrastination gets in the way. Conventional wisdom has it that people procrastinate because the cost of delaying a decision is very small. You put off until tomorrow what you could do today because the extra cost of doing it tomorrow is very small. But putting retirement off until tomorrow is very costly. Rabin's research has found that not only do people put off things when the cost is very small but they are even more likely to put things off when the cost is very great.

For instance, those who might have little problem investing \$10,000 might

procrastinate horribly investing \$100,000. Rabin also found the number of decisions people are given affects procrastination. For instance if your retirement fund is invested in a zero yielding account and you are offered a 5% alternative at little or no cost you will probably take it. But if you are also given a choice of a 10% investment that you will have to do research on then the procrastinator may well put the decision off because of the extra cost.

Rabin found also that the procrastinator may very well put off moving the funds from the zero interest investment to the 5% one just because he is waiting to do the work on the 10% investment. This is not rational at all, but it is very human. How many of us have sat for months or years with excess cash in our retirement account just because we are waiting for the very best investment.

Rabin's work is important for its policy implications. One of his findings is that deadlines tend to cut down on procrastination. Lawrence Summers, the former Secretary of the Treasury and the soon to be President of Harvard University found that nearly 50% of all IRA contributions are made in the year after the funds are earned. For instance you make your IRA contribution for 2000 earnings just before April 15, 2001. But this is not very rational. You could have made that same contribution on January 1, 2000 and earned an extra year of interest. But we procrastinate. So deadlines are helpful to make us focus. We respond to the "use it or lose it" aspect of April 15 by making our contribution then.

An example of a deadline Rabin thinks would help is the use of less

Stashing the cash: Where do you stand?

Many workers fear they're falling behind in their retirement savings

	56 and older	47-55	37-46	25 or younger
On track to save enough for retirement	39%	30%	32%	33%
Ahead of schedule	6%	5%	5%	7%
A little behind schedule	21%	27%	24%	28%
A lot behind schedule	30%	37%	37%	30%

Source: Employee Benefit Research Institute

Source: USA Today

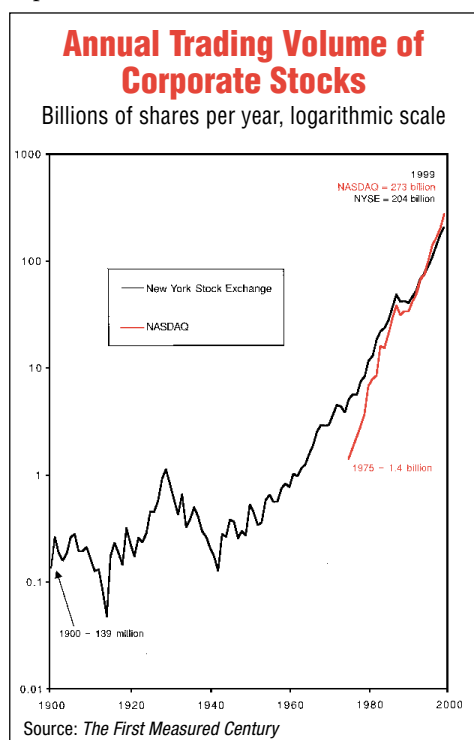
frequent transaction dates in 401(k) plans. If a participant could only sign up for a plan every 30 days or transfer investments once a month then the first day of the month would loom as a costly deadline, not to be missed. But this change is probably not likely to happen. We are transfixed now by daily valuations in our 401(k)'s and the ability to switch funds instantly. We discuss the downside of this trend on page 4.

Another policy recommendation that might reduce procrastination is automatic enrollment of all employees in retirement plans. If employers signed everyone up automatically on day one and also arbitrarily set initial savings levels and possibly even default investment strategies based on age, i.e. younger employees invested for more growth, older ones for more stability, procrastination could be eliminated and plan participation increased. Workers who wanted a different allocation could make a change later.

Just understanding procrastination is helpful. If you know what it looks like you will be better able to see it coming and possibly avoid the pitfalls. Here is one other pointer. When I find myself procrastinating I like to keep the following saying in mind: "take care of what is difficult while it is still easy". No matter how hard something is today, it will get even harder tomorrow. So get on with it. When it comes to retirement saving Nike does indeed have it right, "Just do it".

The U.S. Investing Scene . . . Exercise Extreme Sloth . . .

THE PROLONGED BULL MARKET of the 1990s certainly had a profound impact on investing. During those heady days, online trading firms sprang up like daffodils and stories of highly paid professionals quitting their day jobs to trade stocks were not uncommon. Today, most signs of that speculative period are gone. The number of investors buying stock on margin is down sharply and individual's return expectations are more realistic.



Surprisingly, one vestige of the bull market remains intact. More than a year after the market's peak, investors continue to trade in and out of stocks at unprecedented rates. Take a look at the chart above. This graph, which comes from a great book titled *The First Measured Century*, shows the exponential rise in share trading volume.

While some of this increase can be chalked up to a larger number of shares available for sale, there is more at work here. Turnover, or the rate at which shares change hands, is also up dramatically. Last year, the average stock on the New York Stock Exchange turned over nearly once while a typical Nasdaq stock

had an average holding period of just 120 days. And the recent market downturn has not dampened investor's enthusiasm for trading. So far this year, volume on the NYSE is averaging 1.2 billion shares daily, up from 1 billion in 2000 and 674 million as recently as 1998.

So what is making investors so hyperactive? Record market returns and share price volatility in the 1990s has certainly helped fuel speculative behavior by individual investors. But the excessive trading has not been limited to retail investors. Increasing performance pressures and rapidly declining commissions have contributed to high turnover levels among mutual funds and other institutional investors. The large disparity in individual stock performance has helped fuel frenetic trading activity as well. A recent study by Morgan Stanley found that over the past 10 years, only about one in six stocks in the S&P 500 beat or trailed the index by at least 15 percentage points annually. In the last two years, however, nearly 50% of all stocks topped or lagged the S&P 500 by 15 points.

Market timing, or the practice of nimbly jumping in and out of the market, has long been appealing. Most investors dream of the perfect trade, buying at a stock's exact bottom and deftly selling at its peak. As the chart below shows, the market's tendency to move in brief, unpredictable spurts

CAN IT LAST?

► Turnover for stocks traded on the New York Stock Exchange and Nasdaq has surged in recent years with the average Nasdaq issue now held for just 120 days. If equity returns become more subdued, trading activity could slow, hurting the profits for securities firms.

Annual Turnover	1991	1995	1999	2000
NYSE	48%	59%	78%	88%
Nasdaq	111	179	267	316
Total Turnover*	65	92	131	160

*Estimated. Sources: NYSE, Nasdaq, Morgan Stanley
Source: Barron's

makes this approach difficult. Consider that an investor who remained fully invested over the ten years ending December 31, 2000 earned an average annual total return of nearly 14.9%. An investor who missed just twenty of the market's best days over the period saw his return cut by more than half.

So what is an investor to do? First, recognize that trying to predict market movements over short periods of time is a difficult, if not impossible effort. Second, look for opportunities to use the market's volatility to your advantage. Market declines often present investors with the opportunity to buy good, solid companies at cheap prices. Finally, keep your eyes focused on the long-term. Develop a sound investment plan, revisit it periodically and exercise extreme sloth.

— Anne Williams Doremus

Trying to Time the Market Can Be Costly

Time Period: 10 Years Ended 12/31/2000

Period of Investment	Average Annual Total Returns	Growth of \$10,000
Fully Invested	14.87%	\$39,982
Miss the 10 Best Days	10.33%	\$26,713
Miss the 20 Best Days	7.04%	\$19,731
Miss the 30 Best Days	4.31%	\$15,244
Miss the 40 Best Days	1.89%	\$12,058

Source: Bloomberg, MSDW Advisors. The stock market is represented by the Standard & Poor's 500 Index (S&P 500). The S&P 500 is a broad-based index, the performance of which is based on the average performance of 500 widely held common stocks. The performance of the Index does not include any expenses, fees or charges. An investor cannot invest directly in the Index. Past performance is no guarantee of future results. This graph is not intended to represent the performance of any Morgan Stanley Dean Witter product.

Source: Morgan Stanley Dean Witter