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.

Remember it's still just 7% . . .

CONVENTIONAL WISDOM HAS IT that you get what you pay for. So if you pay your Chief Executive Officer more you will get better results. But does this work? Jim Collins, the author of *Good to Great: Why Some Companies Make the Leap… and Others Don't,* says it doesn't. His research of 112 companies found no link at all between executive compensation and corporate results. Managements say they can produce blockbuster results but they rarely do. The 1990's were a wonderful time for corporate performance but only one out of eight large companies managed to achieve continuous, year upon year, earnings growth for the decade. The average earnings increase for all companies was 7%, not a bad result but no better than the average increase in corporate earnings the last 50 years.

While corporate earnings were doing only average, CEO pay was soaring. In 1990 CEOs received 130X the wage of the typical worker (up from 30X in 1970). It has now grown to 575X! The *New York Times Magazine* did a story on June 9th about the pay of the Chairman of SBC, Edward Whitacre. SBC is a solid upstanding company. It is certainly no Enron. In 1992 Mr. Whitacre received cash income of $3.1 million. Last year his total take from salary, stock options, bonus and a "special retention grant," totaled $82 million. And how did shareholders do? Since 1990 SBC stock went up 11.5% per year versus 12.8% for the S&P 500.

The general counsel of the firm defended the compensation saying SBC ranks in the top third of a group of 20 peers and Mr. Whitacre's pay was less than the median for the group. So the moral is we are not paying more for superlative performance. We are paying more just to keep him equal with everyone else. CEO pay is a mess today. At some point all the stakeholders (workers and shareholders) have to say enough is enough.

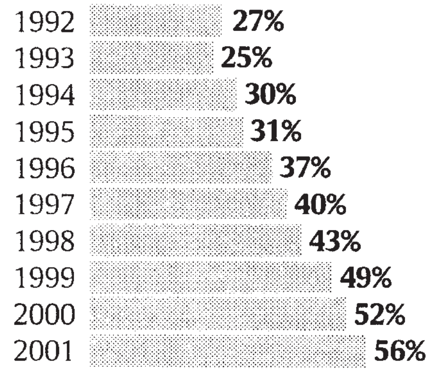
CEOs vs. workers

The average rise in CEOs' pay dwarfs the average increase for production workers.

	CEO	Worker
1970	$182,500	$6,230
1980	$673,350	$12,230
1990	$2,356,210	$17,960
2000	$14,397,660	$24,670

Stock options soar

The use of stock options to compensate CEOs has grown rapidly over the past decade. The percentage of total CEO pay made up by stock options:



Source: Kevin Murphy, University of Southern California

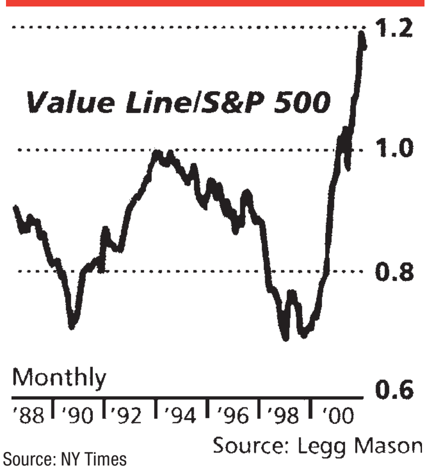
By Julie Snider, USA TODAY

The U.S. Scene . . .
Is the going still good? . . .

THE STOCK MARKET is on everyone's mind today. Is the Bull Market just napping and soon to take off again or are we in a whole new . . . and far more negative . . . environment today? Wouldn't we all like to know?

You don't have to be Alan Greenspan to see what the problem with the market is. It is uncertainty. Geopolitically we don't know when or where or if terrorists will strike again in the U.S. and in South Asia the focus has shifted from Afghanistan to the India/Pakistan border and the very real possibility of conventional or even nuclear war.

LITTLE GUYS WIN



Source: NY Times

On the economic front we don't know whether this economic recovery is for real. Manufacturing has bounced back and inventory restocking is going on as we speak but job growth is sluggish and confidence is low. The double dippers, those who feel we will slip back into recession soon are still banging their drum.

And there is a wild card here too. The Enron fiasco, the subsequent earnings quality questions at GE, IBM, AIG etc. and the whole issue of analyst objectivity is fueling a growing mistrust of Wall Street today. Will Main Street turn against Wall Street? Will the legion of 401-k investors whose mantra is "in stocks we trust" start to see the game as rigged and move off in another direction? These have big implications for any future rally.

So what does the future hold for stocks and bonds? Historically stock returns have tracked the growth in corporate profitability. Earnings tend to go up 6% to 7% every year and if you add in dividends of 2% or so you come up with an expected rate of return of 8% to 9%. This may not be as exciting as the 10% to 12% long-term average or the 15% to 20% we got used to in the 1990's but it may be what we are looking at. And it may not be all that bad. Warren Buffett and Barton Biggs at Morgan Stanley are a lot more negative than this. They are estimating returns in the 5% to 7% range *(see chart)*

The New World View

In the late 1990s, the world seemed to many investors a near-perfect place. Today, many of the positive factors that lay behind the stock boom have changed for the worse.

Then

- Cold war over
- Government surplus
- Companies buying new technology
- Inflation fears fading
- Interest rates low
- Dollar strengthening
- Oil prices low
- Foreigners eager for U.S. stocks
- Stock investing is cool

Now

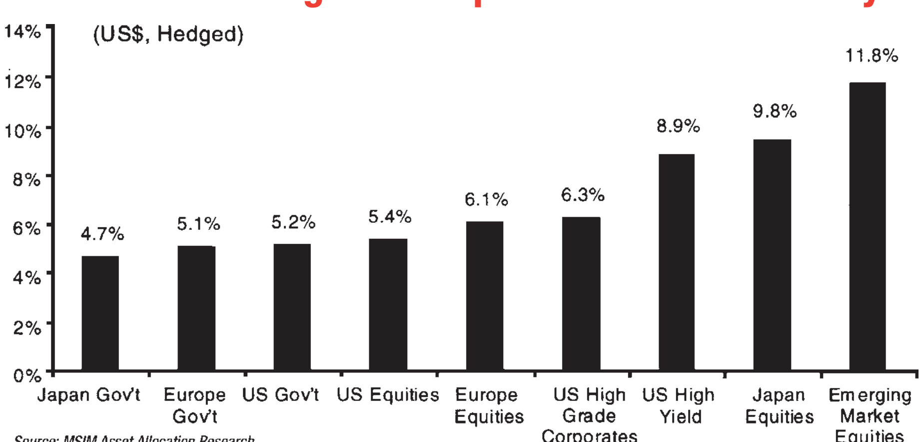
- War on terrorism begins
- Government deficit
- Companies delay tech investment
- Inflation fears rising
- Interest rates expected to rise
- Dollar weakening
- Oil prices rising
- Foreigners pull back from U.S. stocks
- Stock investing is passé

Jon Krause

Source: Wall Street Journal

We will stick with 8% to 9%. If bonds return 6% and money market funds 2% to 3½ % then stocks will be an important and valuable part of an investment portfolio. But which stocks? Value stocks, which sell at inexpensive prices relative to earnings and assets, have had a major move relative to growth and large capitalization blue chips *(see chart)*. The Value Line Index is equal weighted meaning small companies have the same percentage effect as larger ones. These smaller and less well-known issues have been doing very well. They still look good to us but the run-up means we have to look at a broader field of investments now. This includes former growth stocks, blue chips and also foreign stocks. Many people think emerging markets will be the real winners. See the chart to the left and our discussion of China and India on page 3.

Slim Pickins! Long-Term Expected Return Summary

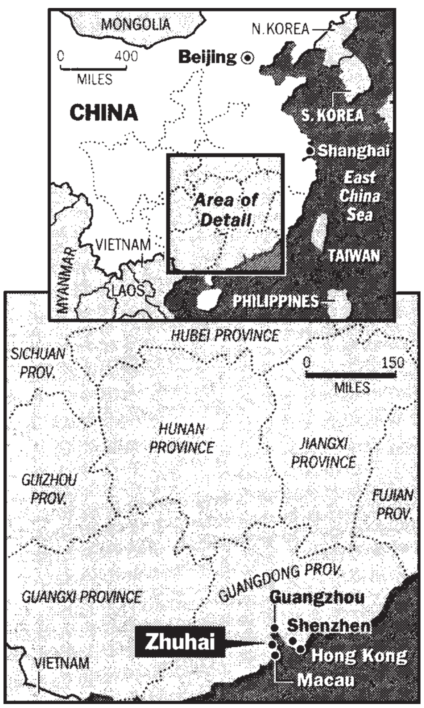


Source: Morgan Stanley

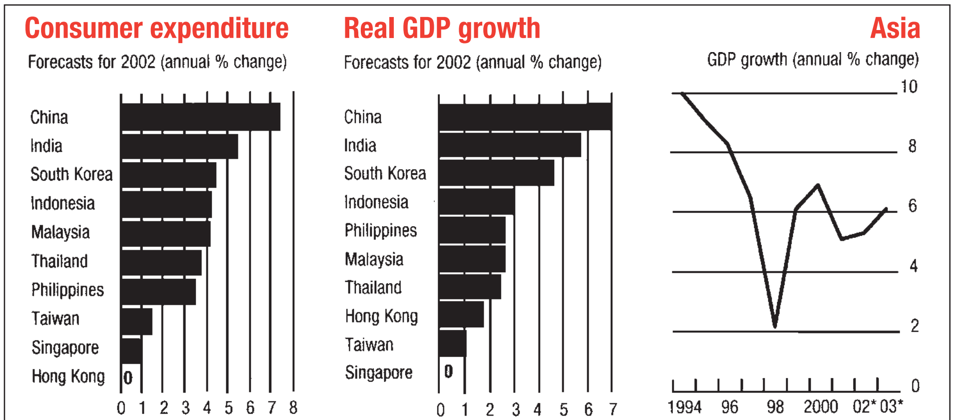
Global Trends . . .

OK let's see what's under the hood . . .

ONE OF THE BIG QUESTIONS about the world economy today is what is going to be the engine of growth for the recovery? The U.S. is trying to get itself out of recession, Europe is in about the same position and Japan, well, Japan is doing its own thing, continuing to flounder away. There is no obvious engine out there now.



Source: Wall Street Journal



Source: Financial Times

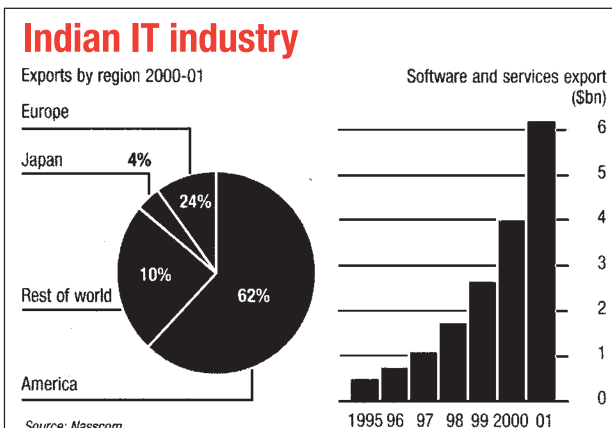
This brings us to China and India. These two countries make up a third of the world's total population. Many Chinese and Indians are desperately poor but many also are rising into the middle class and have big consumption appetites. They could be just the help we are looking for today. Take a look at the chart in the upper right with the consumer spending forecasts and GDP growth. Impressive.

China is known more as an export platform today than as a consumption giant. The east coast of the country and especially the southern province of Guangdong has become the world production center for running shoes, toys, clothing and electronics. Increased production has meant more jobs and more income. But there are down sides here too. China has such a well of workers that even as employment has increased wages have stagnated. The going rate for an unskilled production worker in Guangdong province is $60 a month. This has not changed in two or three years. Worker frustration may eventually grow.

Another problem is that as the Chinese economy moves from state owned companies to the private sector labor unrest has increased. State companies in many areas are closing faster than the private sector can absorb workers and clashes between police and labor are increasing. The unemployment rate has reached 25% in some urban areas and the government is concerned. Like many countries China is experiencing growth in both the haves and the have-nots.

But China is emerging as a dynamic consumption center. India also has the potential. Its middle class is fueled by the growth in software services. Successful Indian companies like Infosys (Nasdaq: INFY) got their start "body shopping" or sending inexpensive Indian software graduates on contract to the U.S. Today the trend is for U.S. and foreign companies to bring business to India where thousands of software engineers are performing an ever-expanding list of services. Indians are working on accounting problems and production layout design and logistics tracking and network management and remote email help desks. The country could parlay this into a major middle class consumption sector.

China and India will not replace the United States or Europe anytime soon as major engines but they could be just the extra dollops of demand we need now to boost this recovery. The emerging markets live!



Source: Wall Street Journal

Investing Trends . . .

"We have met the enemy and he is us." Pogo

BELIEVE IT OR NOT, things in the stock market are not all that bad. Sure the S&P 500 is off over 10% this year but consider the fact that more than 50% of the companies in the index are trading above their January 1st levels. Further, the Dow is up over 20% from where it traded in early 1998. So if the news is so good, why do most investors feel so bad?

A recent study by financial research firm Dalbar Inc. sheds some light on investor's current malaise. From January 1984-December 2000, the S&P 500 produced an eye-popping average annual return of 16.3%. But by examining cash flows into and out of funds, the folks at Dalbar determined that mutual fund investors earned only a 5.3% return over the period.

Two simple facts are behind this rather dismal performance record. First, financial markets by their very nature are volatile. Second, as the study reveals, investors react rather poorly to volatility. Most people would rather be associated with a winning strategy and will avoid, at great cost, the pain associated with loss. For this reason, most investors jump into market sectors only after they have shown sustained price appreciation.

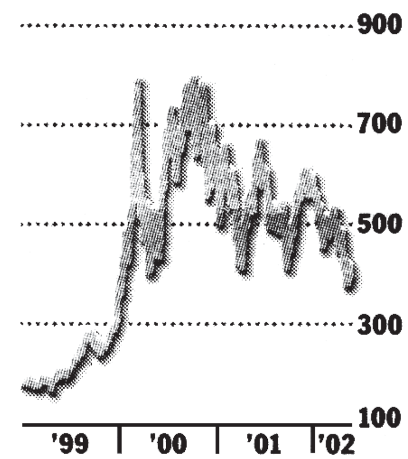
This "bandwagon" psychology is all too familiar to investors still licking their wounds from the recent sell-off in technology stocks. In the late 1990s, promising new developments fueled massive buying across the technology sector. But take a look at the chart below. Most technology investors bought into these funds after the bulk of the price rise had occurred. In fact, more than 50% of the total inflows came in over just 9 months. The buying continued as prices began to decline in March of 2000 and only after the NASDAQ had plummeted 60% did net cash flows turn negative.

Investor's tendency to follow "hot" money has other unintended negative consequences. Since 1984, the holding period for individual mutual fund investors averaged just 2.8 years. This is a ridiculously short period of time considering the average mutual fund investor is 46 years old and has a time horizon of at least 20-30 years. Professional investors are also subject to this force. Today, the average mutual fund has a turnover rate of approximately 90% and a holding period of only slightly more than one year.

So how can you avoid getting swept up in the market's emotional highs and lows? The first step is to recognize that short-term fluctuations in the market are almost impossible to predict. Second, develop a long-range plan that includes spreading your bets and stick with it. Finally, try to avoid the herd mentality and "hot" sectors of the market.

Biotechnology stocks are anything but hot today. Back in 2000, investors rushed into biotech stocks as experts predicted that the mapping of the human genome would revolutionize the industry. As investor's expectations soared, so did biotech share prices. But growing investor risk aversion and disappointing results for many new drugs led to a prolonged sell-off in the shares. Since January, the Amex Biotech Index is off 38% and now stands at less than 50% of its 2000 peak. Further, the 500 companies in the global biotech sector now have a market capitalization less than the combined value of Merck and Eli Lilly.

Amex Biotechnology Index (BTK)

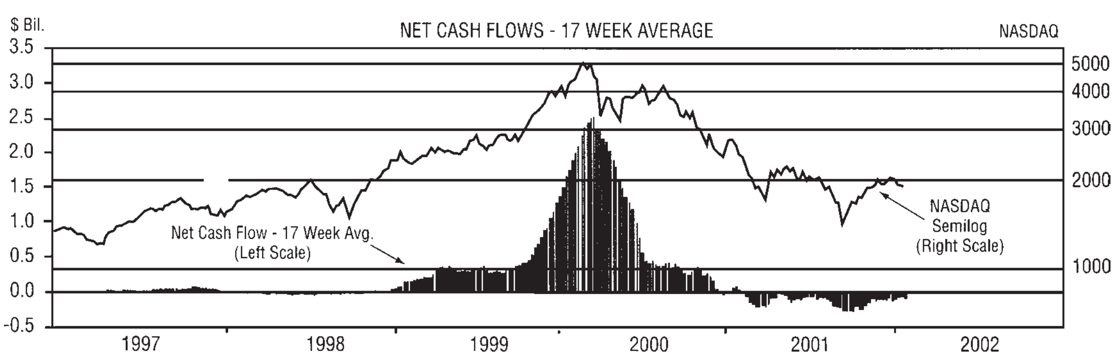


Source: Barron's   Source: Bloomberg

But a sound investment case cannot be based on large share price declines alone. While it is true that many biotech companies sell only on the promise of earnings, several industry leaders are profitable and have attractive product profiles. Further, the demand for effective treatments for diseases ranging from cancer to psoriasis will not go away anytime soon. Without a doubt, biotech investing remains a tricky business. But the sector's broad sell-off may be creating opportunity for investors willing to step off the bandwagon.

Anne Williams Doremus

TECHNOLOGY SECTOR FUND



Est. based on AMG Data through 1-30-02
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Source: Babson Staff Letter