

Thoughts from

Hanson Investment Management Inc.

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Some Odds and Ends ...



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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.

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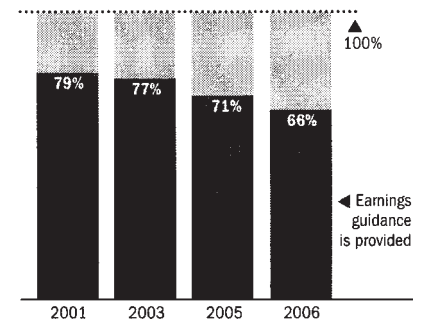
A PICTURE CAN INDEED BE worth 1,000 words. *The two here are quite interesting.* First the capital gains tax rate. Did you realize that gains today are taxed at the lowest rate since World War I? Things are good in the world of investing for capital appreciation. If you have big gains maybe this is the year to take some. Who knows how long the low rate will continue. The tax cut on both capital gains and dividends was instituted in 2003 but it has to be extended or will revert back to a higher rate. With the cost of Iraq and Katrina etc, the budget deficit isn't getting any smaller. I can't imagine the gains rate going any lower but I can see it going higher.

The second chart shows fewer publicly traded companies giving guidance about quarter to quarter earnings. Guidance is a relatively new phenomenon. In 1994 only 100 companies told analysts each quarter what their expectations were. That number jumped to 1,200 by 2001. The justification for guidance is that it prepares investors better and sooner for bad news and this means less volatility in the stock price and greater investor confidence.

But studies show it really doesn't work this way. Companies with no

GUIDING LIGHT

Fewer publicly traded companies are offering either quarterly or annual financial forecasts, known as guidance.



Notes: Different number of companies surveyed in different years; no surveys in 2002 and 2004

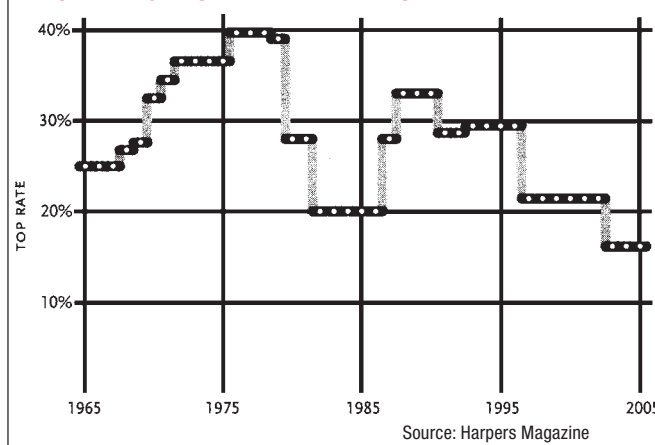
Source: National Investor Relations Institute
Source: Wall Street Journal

guidance are no more volatile in terms of stock price than companies with guidance. On the down side guidance leads to a lot of "short termism" where management focuses on very near term results instead of the longer term health of the business. It also leads to gamesmanship, guiding analysts to a quarterly figure that is slightly below what the company can actually do, then miraculously "beating" the estimate at quarters end.

I would just as soon see all companies drop quarterly earnings guidance. In the U.K. companies report results only every six months and in much of Asia it is still the norm to focus on annual results.

Analysts will have to work harder researching companies if they don't get guidance but that's not such a bad thing. I would like to see a world where analysts work harder on their estimates and companies work harder on their longer term results.

CAPITAL GAINS ARE TAXED AT A LOWER RATE THAN EVER



Source: Harpers Magazine

U.S. Market . . . The More Things Change . . .

YOU KNOW THE DRILL... The more they stay the same. The Dow Jones Industrial Average sank 38% after the tech bubble burst in early 2000. It is now back almost to its high of 11,727. This is both symbolic and historic but on another level it is just another day at the salt mines. Markets go up and markets go down and the 2000 correction is no different.

The important thing is, did we learn any lessons from all this? First a little perspective. The Standard & Poor 500 and the Dow, heavily weighted in big blue chip stocks are still down 13% and 1% respectively from the 2000 highs. But if you were invested in mid cap, small cap or baby cap stocks you are up anywhere from 25% to 70% over this same time span. Where you stand definitely determines where you sit in this market.

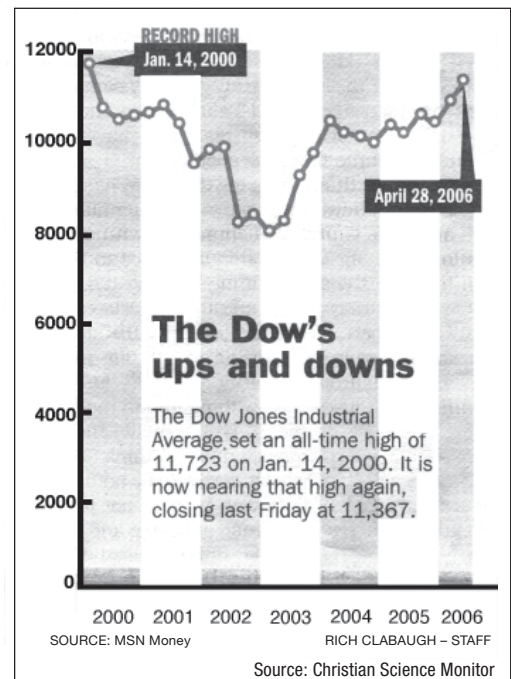
In its monthly *Staff Letter*, Babson Capital of Boston recently listed five key components to investment success. These are very apt lessons for the high tech market debacle of 2000.

1. Markets are unpredictable. When technology was flying high in the late nineties the sky was the limit. Prices went to much higher levels than anyone expected. Alan Greenspan

spoke of 'irrational exuberance' in 1996, three years before the peak in prices. The important thing here is, if the future is so uncertain make sure you don't pay too much for it.

2. The market is all about long term fundamentals. Stocks will ultimately move in lockstep with corporate profits. As a shareholder you are an owner of a business and your shares will be worth more if earnings go up. Historically corporate profits have increased an average of 6% per year and dividends have added on another 4% to bring the long term total return to 10%. With dividends today at 2% you should figure on stocks returning 8% or so. If dividends increase in the future at the same rate as in the recent past I wouldn't be surprised if the long term return of 10% continues to hold.

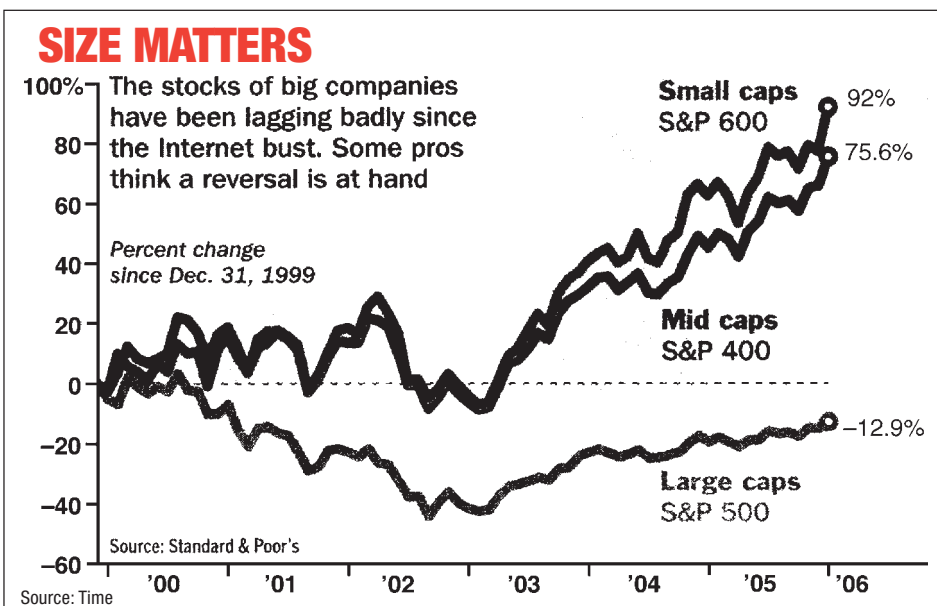
3. Watch those emotions. The tech mania was all about building castles in the air. Secretly we wanted to be carried away and we were. Ray DeVoe a long time market observer has said, "the stock market is only indirectly related to economics. It is a reflection



of human greed, fear and apprehension all overlaid on a business cycle". He is right. Watch market fundamentals but also watch your emotions. We are all hardwired to make the same emotional mistakes over and over.

4. Markets are all about the discipline of sticking to your strategy. We are value investors. We like stocks that sell cheap relative to earnings and assets. Back in the late nineties these were not the popular kids on the block. Tech was flying and it was tempting to switch to them to keep up with the best and the brightest. What a mistake that would have been but it happens all the time. The real test of Wall Street is how you react when things go badly.

5. Perspective and Patience. Time is the unheralded hero of investment success. It takes time for the miracle of compound interest to work, for the next investment return to build on the last. But time moves so slowly when your investments are out of favor. The temptation is to "do something" to jump start things. This is almost always the wrong thing at the wrong time. Be patient.



The U.S. Economy . . . Keeping Score . . .

THERE ARE MORE AND more tables out there these days telling you which country is hot and which is not. It is hard to know what is wheat and what is chaff. Every ranking is arbitrary to one extent or another but as the *Financial Times* noted recently the same countries tend to be at the top regardless of who is doing the measuring. These include the U.S., the U.K., the Nordic countries, Switzerland and Singapore.

I have been a glass half full kind of guy on the U.S. for quite some time. I do not see anything that leads me to believe the country can't or won't be competitive in the future. There are

Who's No. 1?

The World Economic Forum's competitive index, based on economic indicators and surveys of executives:

1 Finland	9 Norway
2 USA	10 Australia
3 Sweden	11 Netherlands
4 Denmark	12 Japan
5 Taiwan	13 United Kingdom
6 Singapore	14 Canada
7 Iceland	15 Germany
8 Switzerland	

Source: Wall Street Journal

plenty of problems out there I admit but so far we have navigated the waters without running over too many submerged logs. The recent technology ranking from the World Economic Forum (WEF) is encouraging. The U.S. leads because of its excellent infrastructure and high levels of business and government usage of the latest technologies, says the WEF. Overall, considering technology and other factors, the Forum ranks the U.S. second only to Finland in global competitiveness. Not too shoddy and certainly not a picture of a country in decline.

Another nice signal is a recent change of opinion on Wall Street. My favorite Wall Street economist is Stephen Roach at Morgan Stanley. He is intellectually

rigorous and global in perspective. He also has been dead wrong since 1999. (As Gilda Radner would say – whatever). Roach has been Wall Street's most persistent pessimist, arguing that our big imbalances such as the trade deficit and budget deficit, the overextended consumer and the precarious state of the dollar, will eventually come home to roost.

Well now the tune has changed. International policy setters are making the right noises that our imbalances need to be addressed at the global level. Second, global inflation is effectively under control as long as low cost producers in Asia continue to dominate manufacturing. Third, central banks almost everywhere are increasing interest rates to slow global momentum and fourth, the U.S. housing market is turning out not to be a bubble but instead a cycle that will gradually deflate. And finally China is succeeding at cooling its economy without recession and moving effectively from an export driven platform to one that emphasizes both exports and internal consumption.

I realize Mr. Roach's about face could be short seller's delight. If he has been wrong the past seven years maybe today's switch to optimism is the real reason to worry! But I give him the benefit of the doubt and call his change of tune a good sign.

All is not bliss in this world however. Thomas Friedman pointed this out in a recent *New York Times* column. Neither political party is addressing what ails us. Friedman would like to see a new "American Renewal Party" which would step up and push for the changes that need to be made.

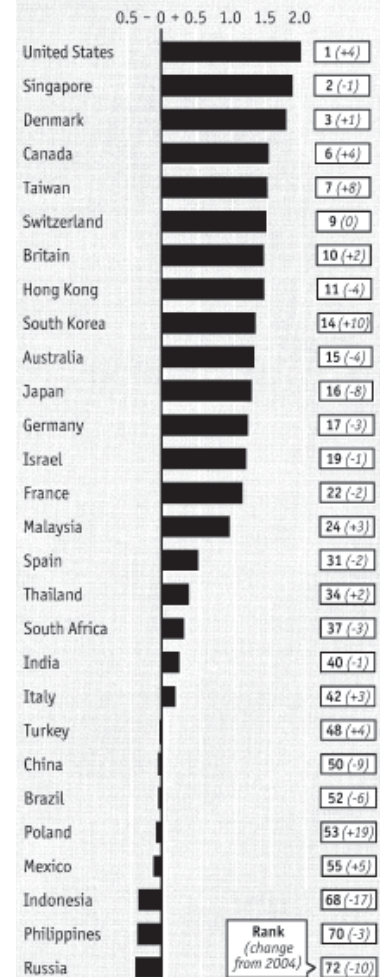
For him these include weaning us off imported oil. We are playing right into the hands of the world's worst regimes by buying more and more oil at higher and higher prices. A gas tax would not only reduce consumption but also address our yawning budget deficit. Friedman would also push to keep us technologically competitive by investing in clean energy

and pressing the world on higher pollution standards which would lessen climate change. And finally we need to encourage more young people to study math and science. Obviously one person's solution is another person's nightmare but there is no doubt we need to address the mega problems if our competitiveness and economic leadership is to continue.

Information Technology

America has returned to the top of the World Economic Forum's fifth annual "networked readiness index", which measures countries' ability to benefit from computing and communications. The rankings assess a country's economy, regulatory conditions and infrastructure, as well as its adoption and usage of technology. Japan, India and China all slipped down the table.

Networked Readiness Index, 2005, average* = 0



Source: The Economist

Financial Planning . . .

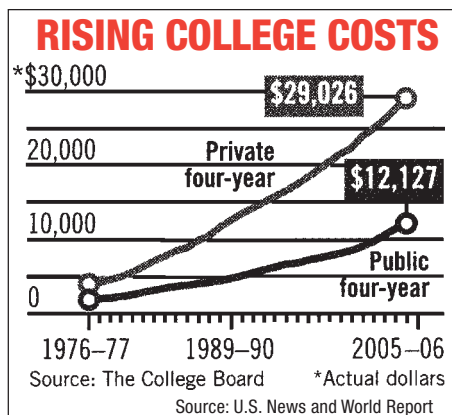
An Update on 529 College-Saving Plans . . .

ANYONE WHO THINKS inflation is dead has not sent a kid to college recently. *As the chart at the right shows,* inflation adjusted tuition at public universities has nearly tripled since 1980 and private school costs have escalated at an even higher rate.

Back in 1997, the Federal Government created 529 savings plans to help parents combat rising college costs. These plans come in two flavors. First, there is the prepaid variety that lets you lock in future costs at today's prices. About 20 states and a consortium of private colleges now offer these plans. The second, and more popular option, is a state sponsored savings plan that allows parents to invest money in tax-deferred investment accounts.

Prepaid plans have not enjoyed the popularity of their College Savings cousins. Many parents, while attracted to the option of locking in education costs, are reluctant to commit their 2 year-old to a specific college. *But as the chart to the right shows,* College Savings Plans have gained wide acceptance. Today, parents (and grandparents) have invested over \$70 billion in 85 different state sponsored plans.

While popular, 529s are by no means perfect. Originally, these plans only offered tax-deferral. This means that you had to pay taxes on withdrawals. Then, in 2001 Congress enacted legislation that gave 529s a big boost by making all withdrawals exempt from taxes. This provision, along with many other tax breaks, is set to expire in 2010. We are not



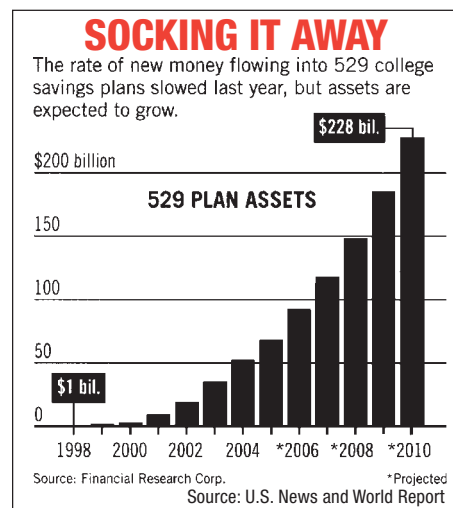
too concerned about this possible loss. First, over 6 million taxpayers hold 529 accounts and there will be a lot of political pressure to extend the tax exemption. Second, even without the tax exemption, 529s offer an attractive range of benefits including tax-deferral, tax credits and professional money management all in one package.

My main complaint with 529s is that they are too complicated. Today, every state in the nation offers a 529 plan and many of them offer several. Each of these plans provides different tax credits, investment vehicles, expense structures and investment managers. We look at 3 different factors when assessing 529 plans for clients. First, we examine the tax breaks offered by the home state plan. Today, 27 states and the District of Columbia offer state tax deductions or credits to residents who put money into their plans. Some states, such as New Mexico, allow residents to deduct the entire contribution from their tax bill. Other states, such as Vermont, limit the

credit to 5% of the first \$2,000 annual contribution.

Second, we take a look at the expenses of each plan. These expenses, which generally

include fund management and administrative fees, can vary widely. Combined fees in the Arizona plan, for example can range from 0.77%-1.16%. By contrast, the Utah plan charges between 0.28%-0.39%. This may not seem like a big deal but the expense difference between these two can add up over time and in some cases outweigh the benefit of available tax credits. We also, generally, avoid broker-sold plans where the upfront sales charge can total over 3%.



Finally, we review each plan's investment options. We think the age-based portfolios offered by many 529s make good sense for most investors. These portfolios include both stocks and bonds. For young children, stocks will outweigh bonds. As the child nears college, the allocation shifts to a more conservative weighting favoring bonds. Finally, we favor plans offering a broad mix of bond, stock and international index funds.

Finding the right 529 remains no easy task. But investors should avoid becoming paralyzed by the vast array of choices. Websites, such as *savingforcollege.com*, do a good job of summarizing the various plans. This information plus an understanding of your own risk tolerance and time horizon can help you make the right selection.

— Anne Williams Doremus, CFA

Some Top 529 Selections

	New York	Utah	Vermont
Fund Manager:	Vanguard	Vanguard	TIAA/CREF
Annual Expenses:	0.56%	0.28%-0.39%	0.80%
Age-Based Portfolio:	Yes	Yes	Yes
Number of Other Fund Choices:	12	4	2

Source: Hanson Investment Management