Thoughts from Hanson Investment

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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.

Take a Break . . .

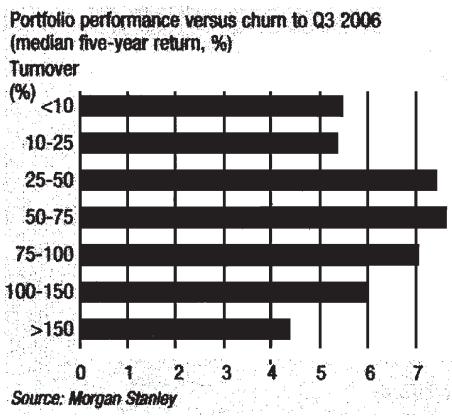
Wall Street pros are often very smart. But this does not mean they are any more right. We all suffer to one degree or another from overconfidence. What do they say about drivers? Seventy percent of most large groups when asked about their driving skills, consider themselves above average. But how can 70% be above average? We are obviously overconfident.

In investing most of us also think we are better than we actually are. Over long periods only about 30-40% of mutual funds beat an unmanaged index like the Standard & Poor 500. Why? One big reason is we trade too much. Every time we buy or sell a stock we are in effect saying we know something about the future. The reality is however we know very little about the future and doing a lot of trading usually just guarantees we are likely to make more mistakes. *The chart at the bottom* shows that the turnover ratio or the amount of trading the average mutual fund does has soared the past fifty years. When I started in the business the average turnover rate was about 20% a year. This means you held a stock typically five years or so. We still manage money this way here with a turnover ratio of about 20%.

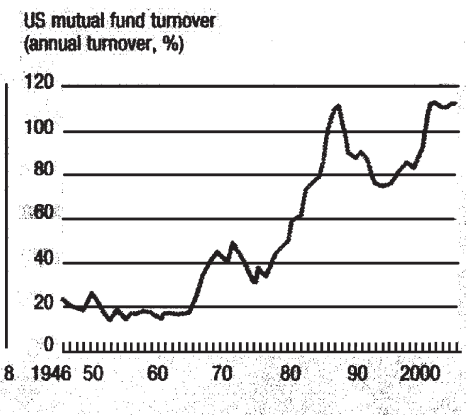
In the mutual fund arena however turnover has jumped to over 100% which means on average every stock is held less than a year. This is absurd if you are a long term investor. Those that do a moderate amount of trading do better than those that do a lot (*see chart below*). In fairness limiting your trading is not easy. Most of us are uncomfortable with the idea that life can be random. We want to see patterns in things because this gives us a sense of control. When we see patterns in the market we trade but in reality many of these patterns are illusory.

The acclaimed author Jonathan Franzen (*The Corrections*) is a birder. He noted in a recent interview in *Time* magazine that "much of bird watching is about disappointment. Part of the appeal is that really, more often than not, you don't see what you are looking for." Investing is somewhat like this. Sometimes you don't get the return you were hoping for (disappointment) and sometimes it takes a lot longer to get there than you expected (boredom). Wall Street doesn't do well with either disappointment or boredom. We overtrade to make things better and to beat the boredom but usually this just makes things worse. My advice: don't just do something, sit there.

Take the middle ground



Churn baby churn



SOURCE: *Financial Times*

Eric Hanson

Still Very Much on Parade . . .

The American Electronics Association annual "Classic" brings together over 150 high tech companies with sales under $1 billion. It is a good forum to gauge the health of U.S. high tech, see some specific companies and get a sense for the trends in the sector.

High tech is very much alive and well in the U.S. Companies at the AEA almost across the board have very strong balance sheets with plenty of cash and little debt. Research and development spending is often between 20% and 30% of revenues an amazing number relative to less than 5% for the average U.S. company. It is difficult to make broad generalizations about an entire sector but here is my take (and some specific ideas to boot).

• Convergence is the mantra.

Everybody is taking about this. Plantronics (NYSE, PLT) was founded by an airline pilot to make better audio headsets. Now the talk is about the "convergence" between communication and entertainment, high quality headphones for i-Pods, cell phones and computers for instance. Symmetricom (Nasdaq, SYMM) makes very high quality timing devices. We are talking about clocks that lose a second every couple of thousand of years! Phone companies need these to insure phone calls between say AT&T and Verizon aren't dropped. Now we are seeing the convergence of wireless, wireline and cable and Symmetricom will sell to all of these.

• Mobile is the rage.

The trend today is everything is going wireless. We have a long way to go to catch up to the Koreans, Japanese or even the Europeans here but we are moving quickly. Kopin (Nasdaq, KOPN) makes specialized chips that go into cell phones. They also make a miniature cyber display the size of your thumbnail that blows up images on personal devices to look just like a movie screen. Videos downloaded to cell phones or i-Pods are starting to create demand here.

AeA
Advancing the Business of Technology®

• Software, Software, Software.

This is not a new trend but a continuing one. Hardware has outpaced software. We have more power on our desktop and in our systems than good software to use it. Echelon (Nasdaq, ELON) has come up with a smart two-way control system for metering electric utilities, water companies and street lighting. Echelon software allows utilities to adjust power to a home on a real time basis and for consumers to flow back information on rate plans etc. Retalix (Nasdaq, RTLX) an Israeli company makes software for food retailers and distributors. Companies can control their system from warehouse and supply to the individual store and check out. Retail chains historically have very low profit margins down in the 1% to 2% range. Retalix systems allow the industry to squeeze out just that little more in profit and also to compete with WalMart.

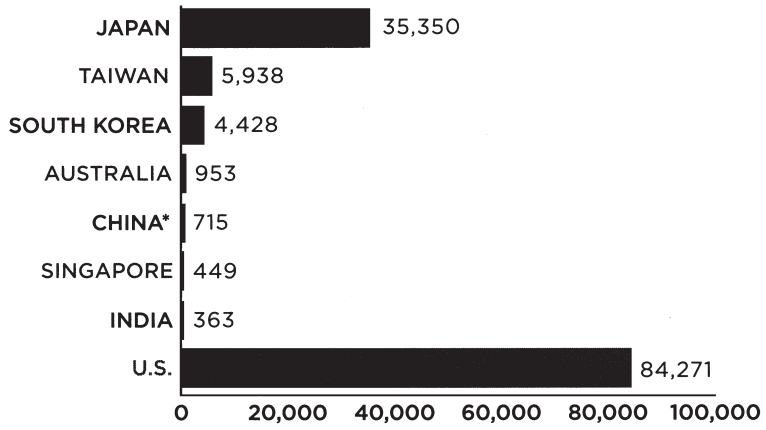
• When they yell gold rush....

...don't buy gold or even the gold mining companies, buy the companies which produce the gold mining pans. In technology this means when the demand for storage devices soars as it has now, buy companies like MKS (Nasdaq, MKSI) which makes the equipment to make more powerful chips and storage products. BTU (Nasdaq, BTUI) is another company in the semiconductor equipment arena. Their specialty is thermal process machines. A bonus is BTU also makes equipment to make solar cells, a very fast growing new area.

The AEA is about high technology but also about the continuing story of globalization. Ten years ago the trend was to move manufacturing out of the U.S. to Asia and other lower cost areas. Now globalization is affecting the entire workforce. Many companies at the AEA for instance are now saying they have multiple engineering and research facilities, one in Asia where many of the plants are located, one in the United States and one in Europe or newer areas like Eastern Europe. The AEA conference is all about change and so far smaller U.S. companies are now navigating the course just fine thank you.

TECH INNOVATION

Number of Patents Granted in 2004



Source: United States Patent and Trademark Office, an Agency of United States Department of Commerce *China numbers include P.R.C. and Hong Kong S.A.R.

Julie Won

The State of U.S. Manufacturing

Whenever an American factory closes, we tend to lament that U.S. manufacturing is slowly but inevitably declining. Only 12-17% of the U.S. economy is based on manufacturing – far below the 26% share that manufacturing had in 1950, or the 41% of output that manufacturing contributes to China's economy. But in terms of value of output, we still are the largest manufacturer in the world. Yes, that's true.

The U.S. produces a quarter of the world's manufactured goods – far more than anyone else (*see chart, right*). In fact, our share of manufacturing value-added has barely changed the last 20 years. It is true we have fewer factories now, and a much smaller percentage of our labor force is employed in manufacturing – 11% of nonfarm workers now versus 38% at the end of World War II. But we are making more with less.

The key has been productivity growth. It is unit labor costs, or labor costs per widget, that matter more than overall wage levels. *The Economist* notes that even though American manufacturing workers are better paid than their counterparts in Europe, unit labor costs in the U.S. are lower than any other European country except Finland and Ireland. Translation: We make more and higher quality goods with fewer people.

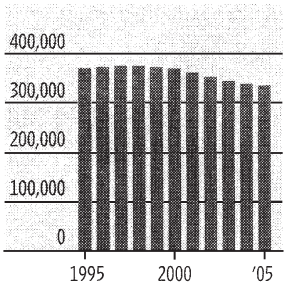
We do not make as many low-end toys or clothes as we used to, but we focus on goods that *The Wall Street Journal* calls "complex, difficult to package, and time-sensitive." In a recent series, the *Journal* featured selected U.S. manufacturers thriving on customization, and "complex processes performed by a deeply trained work force" that are difficult to replicate overseas (*see sampling of American manufacturers below*).

One of the featured companies is Bobcat, a unit of Ingersoll-Rand, which makes machines for small construction and landscape contractors that do everything from digging holes to cleaning barns. The company can get any part it sells to a customer within four days, something that would be impossible if it manufactured outside the U.S. Also, one of its core strengths is its work force, drawn from its rural setting in Gwinner, North Dakota. Deep farming and mechanical backgrounds mean employees understand their customers and are adept at solving product and process challenges.

Pessimists may note that in the World Economic Forum's annual rankings of competitiveness, the U.S. fell from first to sixth place this year (Switzerland moved up to first place). The main reasons for this, however, were the twin deficits, not the state of U.S. manufacturing. Pessimists take note: Out of the 30 nations in the OECD, only Luxembourg exceeds the U.S. in per capita GDP. As Fritz Meyer of *Barron's* remarks, even the Swiss produce just 85% of what Americans do.

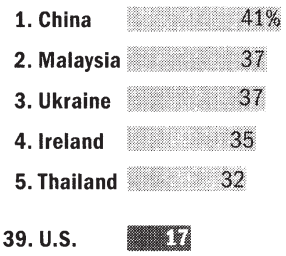
Less Is More

While the number of manufacturing facilities in the U.S. has declined...
Manufacturing plants operating in the U.S.

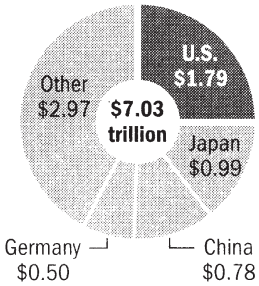


*Measured in constant 1997 U.S. dollars

And manufacturing represents a small share of economic output...
World ranking by manufacturing as a share of GDP, 2005*



The U.S. still leads the world in value of goods produced
2005 manufacturing output, in trillions of U.S. dollars*



Sources: Manufacturers Alliance/MAPI; Global Insight

SOURCE: *The Wall Street Journal*

As American as . . . A sampling of products manufactured in the U.S.

COMPANY/PRODUCT	LOCATION
Intel/semiconductors	Santa Clara, Calif.
Harley Davidson/motorcycles	Kansas City, Mo.
Goodyear Tire & Rubber/tires	Lawton, Okla.
Huggies[1]/diapers	Paris, Texas
Viking Range/ranges	Greenwood, Miss.
Cessna Aircraft; Bombardier/airplanes	Wichita, Kan.
Winnebago Industries/RVs	Forest City, Iowa
Bobcat[2]/Bobcats	Gwinner, N.D.
Arctic Cat/snowmobiles	Thief River Falls, Minn.
Kohler/faucets	Kohler, Wis.
Deo Volente Orthopaedics; DePuy; Zimmer Holdings/Orthopedics	Warsaw, Ind.

COMPANY/PRODUCT	LOCATION
Hershey Foods/Milk Duds	Robinson, Ill.
Lodge Manufacturing/cast-iron skillets	South Pittsburg, Tenn.
Oreck/Vacuum cleaners	Long Beach, Miss.
Batesville Casket[3]/caskets	Batesville, Ind.
La-Z-Boy/recliners	Dayton, Tenn.
Hoveround/motorized wheelchairs	Sarasota, Fla.
BMW Manufacturing/cars	Greer, S.C.
Schantz Organ/pipe organs	Orrville, Ohio
Zippo Manufacturing/cigarette lighers	Bradford, Pa.
Woodstream/mousetraps	Lititz, Pa.
New Balance Athletic Shoe/athletic shoes	Boston, Mass.

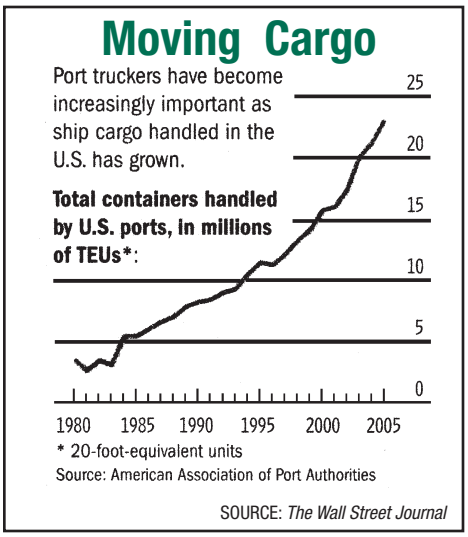
[1]Division of Kimberly-Clark [2]Division of Ingersoll-Rand
[3]Division of Hillenbrand Industries

SOURCE: *The Wall Street Journal*

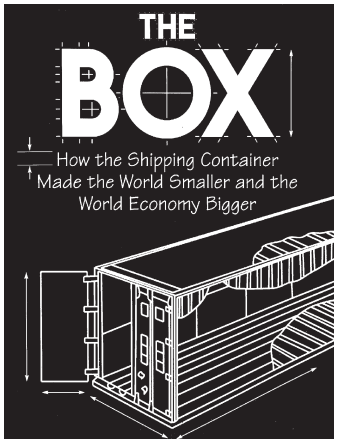
THE BOX: How the Shipping Container Made the World Smaller and the World Economy Bigger . . .

Globalization is *the* hot topic today. But what has gotten lost in the debate is an understanding of how we got to where we are today. Marc Levinson's just published book, *The Box*, chronicles how one seemingly small breakthrough, the shipping container, helped transform the world economy.

Up until the 1950's, most goods were shipped individually or in small packets on breakbulk ships. This process was time consuming and inefficient. In 1954, for example, it took over 44 days and $235,000 to send a loaded ship across the Atlantic. And of the total cost, between 40% and 50% was typically spent just loading and unloading freight.



The need to improve efficiency in this environment was clear but implementing even the simplest changes proved daunting. Labor unions had to agree to sweeping changes that were aimed at reducing jobs. Huge sums of public and private sector money had to be invested in new port facilities. And railroad and trucking firms had to adopt compatible means of moving goods. Levinson, a former finance and economics editor at *The Economist*, does an admirable job of chronicling the 30 year tug of war between proponents of the status quo and those of change.



by Mark Levinson
Princeton University Press
376 pages; $24.95

Even students of financial history might initially consider the evolution of containers somewhat dull. But Levinson makes this a fascinating read by focusing on the role one man, Malcom McLean, played in bringing about change. Like many successful entrepreneurs, McLean steadfastly believed in his idea and was willing to risk money and reputation to see it through.

So why read a book about a steel box? I think Levinson's work is worth reading because it reminds investors that innovation by itself rarely produces economic benefits. As was true of the electric light and the internet, the serious money was made not by the original innovators but by those who figured out how to put the innovation to productive use. Multiple shipping firms went out of business trying to adjust to the realities brought on by containerization. But the real benefits from improved efficiency did not show up until decades later in the form of reduced shipping costs and lower consumer prices.

Like all good histories *The Box* also sheds some light on where we are headed by examining our past. The evolution of container shipping is far from over. *As the chart below shows*, the drive to reduce transportation costs is as strong as ever. Container ships now under construction cost as much as $100 million, exceed 1,300 feet in length and can carry 11,000 containers. To accommodate these monsters, voters in Panama just approved a multibillion dollar project to expand the Canal. While these ships are easing the strain on global shipping, they are also making shipping a higher risk business. As Levinson points out, even small dips in volume, whether caused by an economic slowdown or high oil prices, can wreak havoc on highly leveraged firms.

Levinson's thesis, that containers played a central role in the subsequent explosion in world trade, is a grand one. Other factors such as deregulation of the U.S. trucking industry also strongly contributed to the trend. But the economic impact of containerization should not be underestimated. The future of thousands of ports and millions of jobs were directly impacted by its adoption. And thanks to containers, moving goods around the globe today is a faster, cheaper and more reliable job. That is no small feat.