

Thoughts from

# Hanson Investment Management Inc.

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## Everything Is Misleading ... But Not Exactly a Lie ...

**T**HIS COMES FROM SCOTT ADAMS aka Dilbert and his new book *Dilbert and The Way of The Weasel*. The weasel zone is the huge gray area between good ethical behavior and activities that can send you to jail. This twilight zone is where many companies have been with their financial reporting.

If change is going to happen it has to start at the top – with Directors and Management. How likely is this? The chart at the bottom from a McKinsey survey of nearly two hundred U.S. directors representing five hundred large companies gives reason for optimism. Directors are taking the issues seriously and considering changes in important areas such as appointing a lead director and preventing auditors from providing non-audit services. But is this getting translated into action? The Investor Responsibility Research Center in

Washington has collected data on 1240 U.S. companies. The study found that 72% of the total fees paid to accountants by large companies were for non-auditing services and 28% were for auditing work. We are aware of the dangers here. Will accountants be pushovers on the audit side in order to hold onto the lucrative consulting work? The solution is simple: employ one firm for auditing and another for consulting. But last year only nine companies of the 1240 used different firms for auditing and consulting. This year only six have made the move. We are talking the talk but not yet walking the walk. Better corporate governance is necessary to get Main Street back in tune with Wall Street. But change needs to pick up. Calvert the socially responsible investing organization has taken to voting against the accountant if consulting fees are more than 50% of total audit/consulting fees. Good first step.

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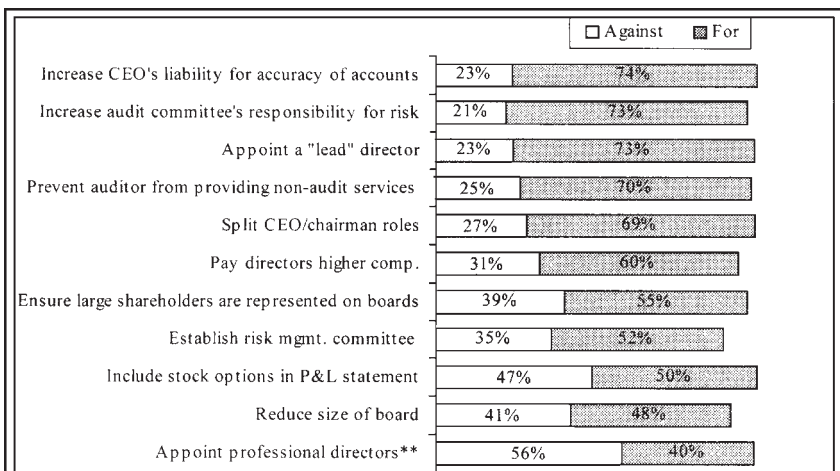
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**Hanson Investment Management is an investment counsel firm managing portfolios for individuals and institutional clients. The firm also consults with individuals on financial planning and works with self-directed retirement plans on investment options.**

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### Boards Understand the Need for Reform



Source: McKinsey Director and Investor Opinion Surveys on Corporate Governance, 2002.

Note: Where % do not equal 100, the remainder of the respondents marked "not sure."

\*\*Appoint outside directors who focus 100% of their time on a handful of board positions.

Source: Morgan Stanley

# The U.S. Scene . . .

## Working harder and working smarter . . .

**A** LOT OF BUBBLES HAVE burst recently. First it was the dot.com bubble and then the stock market bubble. But there is one bubble or at least one economic indicator which has remained rock solid through all this uncertainty. It is productivity.

Productivity is the increase in output per worker hour. Or how many more widgets a worker can produce in a 60-minute period. It is a crucial indicator for a number of reasons. First higher productivity allows for the increase in real wages. When output per hour rises workers can ask for higher pay and employers can give it without having to raise prices. A win-win situation. The chart at the bottom shows how wages have been pushed up as productivity has improved. This has allowed consumer spending to stay strong and the economy to stay upright.

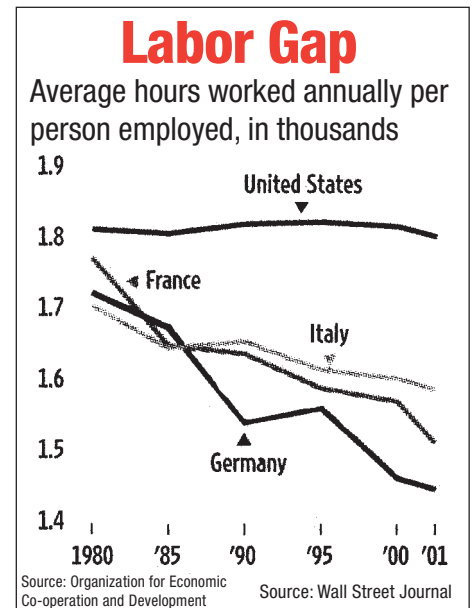
Productivity is also important because it is the backbone of long-term growth. The "natural" rate of growth of the U.S. economy is said to be 3%. How do we get to this number? First the workforce is growing at about 1% per year. This includes natural population growth and immigration. In addition productivity averages 2% per year or so. Adding the two together, more workers and more output per hour, you get the long-term rate of growth of 3%.

This is not set in stone however. From the early 1970's to the early 1990's productivity averaged just 1.4% per year. This cut our growth rate considerably. Between 1995 and 2000

productivity increased 2.6% and this performance has continued even as the economy has weakened. We will get a faster GDP growth rate because of the better productivity numbers.

Now contrast this with Europe. American labor is the veritable workhorse of the world compared to the Continent. We average over 1800 hours of work per year. European countries are moving in the opposite direction. France in fact has gone so far as to legislate a thirty-five hour workweek. The hope is that a shorter workweek is good social policy and higher productivity will offset the fewer hours worked. Well it hasn't worked out this way. European productivity has lagged the U.S. and GDP growth on the Continent is expected to be only 1% a year in the near term compared to 3% here. The greater rigidities in the European system and more interference in the workplace have affected job growth and investment.

Over the past three decades the U.S. has created fifty million new jobs compared to ten million in all of Europe. From 1991 to 1998 revenues of foreign manufacturers in the U.S. doubled to \$883 billion. Over this same period the output of foreign manufacturers in Europe shrank. Obviously investors are

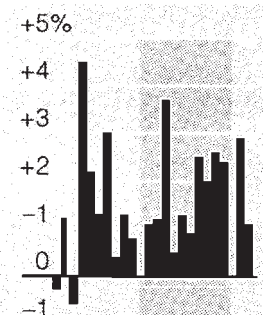


voting with checkbooks and their feet sending money to where labor can be most productive.

Higher productivity won't turn the economy around on a dime. But higher productivity and greater flexibility in the workplace mean that America will rebound faster when the world outlook improves. Working hard and working smart is tough (and stressful) but it is the only route to higher income and economic growth.

### PRODUCTIVITY

Annual change in output per hour, nonfarm workers

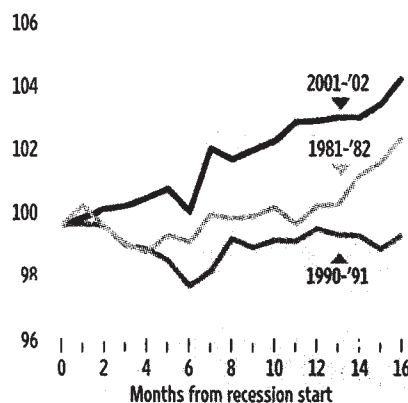


Source: Bureau of Labor Statistics  
Source: New York Times

### Propped Up by Spending

#### Consumers keep spending more...

Consumer spending, inflation-adjusted, in each of the last three recessions (indexed to 100 in the first month)



Sources: Commerce Department; University of Michigan; Labor Department      \*Last 12 months

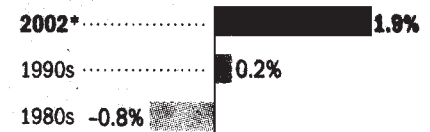
#### As optimism remains high...

Net percentage of consumers expecting improvement in their financial situation in next year, period averages



#### Thanks to strong incomes

Average year-on-year percentage change in hourly earnings, after inflation



Source: Wall Street Journal

# Global Migration . . . Is the Going Still Good? . . .

**W**E HAVE WRITTEN MUCH about globalization here but not much about one important aspect – migration. The poster child of this phenomenon is the Philippines. This country of 77 million has an astounding 10% or nearly 8 million of its citizens living and working outside the country. They are nurses and teachers in the United States (*see chart below*), domestic workers in Hong Kong and laborers in the Middle East. And they are an economic force. What Filipinos send back from abroad equals 8% of the nation's gross national product. In Mexico remittances are the third largest source of foreign exchange after oil exports and tourism.

## Countries send forth nurses

Number of foreign nurses who sat for the mandatory U.S. licensing exam in 2000 by country. About 47% passed.

Philippines	13,005
India	2,007
Canada	1,350
Nigeria	943
Korea	920
U.K.	381
Commonwealth of States <sup>1</sup>	345
Haiti	208
Ukraine	199
China	168
Poland	168
Pakistan	168
Trinidad/Tobago	168
Mexico	149
Other	4,601

1 – former USSR  
Source: National Council of State Boards of Nursing  
By Julie Snider, USA TODAY

But there is a downside to global migration. Millions of families are badly splintered. Sixty three percent of Filipinos working overseas are women who leave their families, their children, their husbands to be the breadwinners. It has great social cost including divorce, drug usage among the young and sometimes abuse of women trapped in foreign countries.

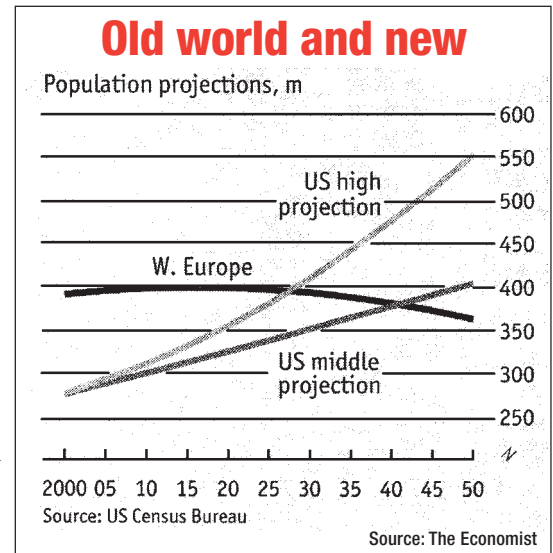
How does migration affect the U.S? I think it is a positive. The one million legal and illegal arrivals here each year are an economic stimulus more than a drain.

Over the long term we need a growing population to have robust growth. In 1950 the population of Europe was twice that of the U.S. By 2025 or 2040 the U.S. population may surpass Europe (*see chart*). Part of this I realize has to do with the low European birth rate now. But Europe has more of an aversion to immigration than we do and this is one reason the growth rate on the Continent has consistently lagged behind ours.

Labor migration is also adding to our knowledge base. A survey of new legal immigrants to America finds that 21% of them have at least seventeen years of education, implying some post graduate study, compared to only 8% of native born Americans. Twelve percent of Mexico's total labor force is now in the U.S. but 30% of its PhDs are. I realize this is a negative for Mexico but it benefits us.

Critics say I am overlooking the problems. The 25% of total immigrants who come from Mexico are not all the best and the brightest. There are big costs here in terms of welfare, schooling and other services. Also the fact that over 10% of our total population is now foreign-born makes it more difficult to create "Americans" out of the hodgepodge of various nationalities.

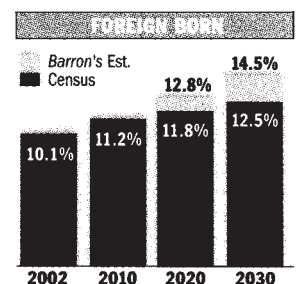
Global migration is



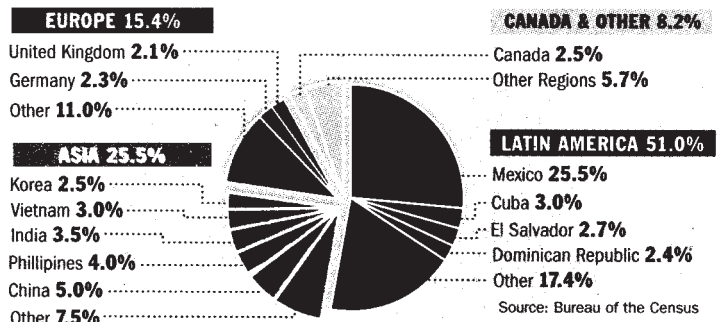
not slowing down. If anything it is speeding up. When the *Economist* recently looked at the effects of immigration it concluded that anyone who assumes the United States is now at the zenith of its economic or political power is making a big mistake. Demographics may indeed be destiny.

## THE NEW FACE OF LABOR

**Back to the Future** According to the Census Bureau, the share of foreign-born in the U.S. population will climb to 12.5% by 2030. But since the Bureau assumes no change in immigration policy, this forecast probably errs on the low side. *Barron's* expects the share to rise to about 14.5% by 2030, in line with the peaks reached in previous waves of immigration.



**Yearning to Breathe Free** In 2000, more than half the immigrant population hailed from Latin America and more than a quarter from Asia.



Source: Barrons

# Investment Strategy . . .

## Considering International Investing (Again) . . .

**H**ERE'S A QUICK QUIZ. What world stock market has produced the best investment results this year? While most markets are in negative territory, there are a few exceptions and Russia stands at the top of the winner's list. The country's dominant oil and gas sector is benefiting from the global rise in energy prices and its stock market is up almost 37% this year in local currency terms.

Don't get me wrong. I am not making a case for buying ruble denominated equities but I do think it is time to revisit the idea of international investing. Over the last decade, Morgan Stanley's EAFE Index, a widely used international benchmark, rose 45% while the S&P 500 jumped 108% and the NASDAQ Composite soared 160%. Foreign share's weak results have done little to attract investor interest. Currently, less than 4% of all mutual fund dollars are invested outside the U.S. yet foreign shares represent over 45% of the value of stock markets worldwide.

While this lack of international exposure paid off in the 1990s, longer-term results are more mixed. *Take a look at the chart to the right.* International stocks have outperformed U.S. stocks for significant periods in the past. But this pattern of out-performance is cyclical and predicting which asset class will "win" next remains extremely difficult.

So what should an investor do? If you cannot accurately predict the timing of these swings in performance, then it makes good sense to spread your bets by investing both at home and abroad. Because these assets tend not to move in sync, combining them reduces overall fluctuations in portfolio value.

Some skeptics have suggested that in today's increasingly global economy, international stock returns are too highly correlated with U.S. returns to provide diversification benefits. While it does appear that global markets are now

moving more in sync, I think international stocks still make sense for two reasons. First, a long-term look at global stock returns suggests that these correlation patterns move up and down over time. Because global markets are moving together now does not mean they will in the future. Second, diversification benefits still exist as long as the two assets don't move completely together. Consider this year's experience. Since January, the EAFE Index is off 7% while the S&P 500 has plunged 23%. True, both markets declined but allocating a portion of your funds abroad would still have tempered the U.S. market's losses.

While I cannot pinpoint the exact time when international stocks will once again shine, there are a number of reasons why I think they look attractive now. The world economy is far more integrated today than at any time in the past and many strong, global competitors are now located outside our borders. A recent study by Fidelity Investments points out that in seven out of ten market sectors, the best performing stock over the 1992-2002 period was located outside the U.S. Considering interna-

tional shares simply increases your investment opportunities.

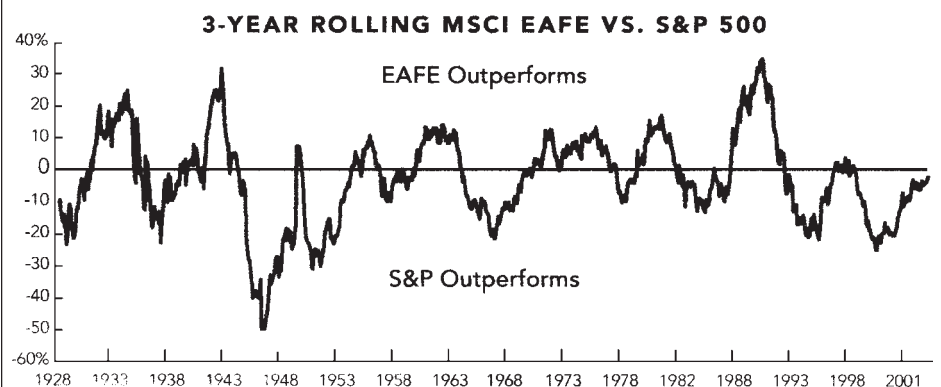
In addition, foreign shares are more favorably priced today when compared to their U.S. counterparts. Price-to-earnings and price-to-cash flow ratios of European and non-Japan Asian shares now stand more than 30% below those of U.S. shares. Finally, currency trends may help boost international investment returns. A weaker dollar helps U.S. investors as foreign earnings are translated into larger profits back home. Poor financial market returns, low interest rates and weak economic growth have contributed to the dollar's recent weakness. While predicting currency shifts is difficult at best, these trends tend to be multi-year events and strong forces exist to keep the current one in place.

After the latest market downturn, most investors don't want to hear another word about stocks, international or otherwise. But opening up your investment horizons to consider foreign shares can have a positive impact on portfolio risk and return.

—Anne Williams Doremus, CFA

### Foreign markets have outperformed the U.S. in the past, and outperformance is cyclical.

Exhibit 3: MSCI EAFE vs. S&P 500 in 3-year Rolling Periods.



Source: FMR Global Financial Data, 12/01

The Morgan Stanley Capital International Europe, Australasia, Far East (MSCI EAFE) Index is an unmanaged market capitalization-weighted index that is designed to represent the performance of developed stock markets outside the United States and Canada. The EAFE index is a registered service mark of Morgan Stanley and has been licensed for use by FMR Corp.

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Source: Fidelity Investments