July 1, 2003

Following the herd - To buy or not to buy, that is the question!

What is it about the stock market that gives us an overwhelming impulse to zig when we should zag. As markets hit a frenzied pace and good news abounds, we cannot pay enough for the privilege of owning securities (circa 1999-2000). Conversely, when opportunities begin to arise, we either rush to join the crowd to the egress or we simply sit immobilized by fear. This is a very human characteristic, flawed but predictable and if truth be known, we have all at one time or another felt at least some twinge of these emotions. Naturally, some are much more susceptible to these passions than others. Most investment advisors have one or two clients whom they are able to use as almost perfect contrary indicators; people who display almost deadly infallibility when it comes to their inaccuracy entering and exiting the market.

Late in February, one of these investors, who with great enthusiasm had entered the market in March of 2000, called to inform us that he could make more money other places and may be back later when stock market conditions are more certain. In all the years I have been in the investment business, I have yet to encounter a single instance when market conditions were certain. The Dow was 7882 when we received that call. As of this writing, it is about 9000. In truth, I am very sympathetic to the feeling of this fearful individual. Bear markets have a way of beating down the most resilient among us and this bear has lasted three full years.

Since March of this year, we have seen the stock markets stage an almost continuous advance, surprising even the most optimistic. While all indices have been strong, the Dow has gained the least. In fact, during this same period, the NASDAQ Composite advanced almost two and a half times as much as the blue chip indicator. . . shades of 1999? Does this mean we are returning to those glory days of the late '90s? While not wishing to rain on a parade, I must state emphatically that I do not believe we are going to relive those euphoric days when you could virtually close your eyes and buy a popular name irregardless of sales or earnings. Many of the stocks, which so recently have risen sharply, were the fashionable companies of a few years ago. Sun Microsystems, which has no earnings, ended the year 2002 at $3.11. On June 20th it closed at $5.17, a gain of 66%. This is pretty impressive until you consider that it traded over $64 back in 2000 (Investor's Business Daily). I call it a knee-jerk reaction after a huge decline, and of late, there are many NASDAQ stocks, which have followed this pattern. Our managed accounts are up, but have not matched these NASDAQ advances.

While the current uptrend does not necessarily mean that this market will become a replay the extraordinary move of the late '90's, it could continue to be a rally of several months duration. Keep in mind that explosive upside markets are the exception, not the norm. The great money managers of the last thirty years, to whom I have alluded before, did not need volatile upward moves to consistently produce excellent returns. I therefore believe the answer to success with our investments will once again lie in individual stock selection and portfolio management. This takes planning, experience, and a lot of hard work, but the results can certainly be well worth the effort and over time can produce far more than we anticipate.

We believe now is the time you should give consideration to a managed stock portfolio as opposed to other types of investments for the following reasons:

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1. Dividend-paying stocks are likely to be the beneficiaries of people searching to invest their money productively. With CD rates at about 1.5% and five-year treasuries languishing below 2.5% (Wall Street Journal), the alternatives for investment are decidedly limited. One of our favorite investment managers Bill Gross, who runs the bond portfolios for Pimco, stated, "The salad days for bonds are over." Put another way; don't expect growth from a bond portfolio - a forceful statement from one who is a bond portfolio manager. If you will, imagine a seesaw - interest rates on one end and the price of bonds on the other. As interest rates rise, bonds fall and when interest rates fall, bonds rise. At 1% or 2% interest rates are approaching the ground, which simply means bond prices are approaching the finite level they can attain. Would you purchase a stock at 18 if you were told that it could never go higher than 20, but absolutely had the capability to drop?

2. It is not our purpose here to discuss the morality or the economic astuteness of the recent tax bill. Suffice to say the new law is clearly beneficial both to those who earn capital gains, and especially to those who own or purchase stocks paying dividends.

3. We track the money supply figures released by the Federal Reserve. This year we are running at almost a nine percent rate, with much of the increase coming since February. This appears to be a clear departure from Greenspan's past policy of defending and supporting the Dollar. If the Fed continues or increases this rate of money creation, it would almost certainly be a stimulus to our economy. That should be good for certain segments, but it comes with a price. The expense of this economic policy could result in a weaker dollar, higher commodity prices; i.e. renewed inflation.

In the thirty-plus years I have been in this business, I have seen people enhance their standard of living and often grow wealthy simply because of owning equities - real estate, stocks, etc. I have yet to see a single individual earn a fortune from buying certificates of deposit. After three difficult years, it's important for us all to keep focused.

Sincerely,

Mike

J. Michael Hard
President