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# RESEARCH REPORT

*December, 2009*

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**Market Overview & Strategy Comments:** *The Class of 1999: Where Are They Now?*

As we come to the end of the decade, we can all remember back to the excitement associated with the Class of 1999 – that internet class of companies that was going to change the world. We take a look back at how things played out.

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<u>Key Statistics</u>	<u>Current</u>	<u>Change Since Previous Month</u>	<u>2009 Change</u>
Dow Jones Industrial Average *	10344.84	+6.5%	+17.9%
S&P 500 Index *	1095.63	+5.7%	+21.3%
S&P 500 Ave. P/E Ratio **	18.8x	+0.9x	+4.9x
NASDAQ *	2144.60	+4.9%	+36.0%
1 Year Treasury Bill Yield	0.27%	-10 bps	-10 bps
10 Year Treasury Bond Yield	3.21%	-20 bps	+96 bps
30 Year Treasury Bond Yield	4.20%	-3 bps	+151 bps
Municipal Notes - 1 Year Yield	0.50%	-10 bps	-65 bps
Municipal Bonds - 10 Year Yield	3.40%	-20 bps	-70 bps
Reuters/Jefferies CRB Futures	\$277.40	+2.6%	+20.9%
Gasoline NY RBOB (\$ per gal.)	\$2.01	+3.3%	+99.2%
Natural Gas (\$ per MMBtu)	\$4.85	-3.9%	-13.8%
Gold (\$ per troy oz.)	\$1181.10	+13.6%	+33.7%

\* price only \*\* based on 2009 earnings estimates.

The Reuters/Jefferies CRB Futures Price Index is an arithmetic average of commodity futures prices with monthly rebalancing.

Gasoline NY RBOB price excludes local, state and federal taxes (the "wholesale price").

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Securities are identified for illustrative purposes only. This should not be construed as a recommendation to purchase or sell any securities.

## **Market Overview & Strategy Comments:** *The Class of 1999: Where Are They Now?*

As we come to the end of the decade, we can all remember back to the excitement associated with the Class of 1999 – that internet class of companies that was going to change the world. That year’s graduating class included *Yahoo*, *America Online*, *Time Warner*, *eToys*, *Global Crossing*, *Nortel* and *Sun Microsystems*, the new corporate giants that were revolutionizing business around the world. Many of them had market values in the hundreds of billions of dollars; *America Online/Time Warner* was worth almost \$400 billion when their merger was announced in 2000. Cable titan Ted Turner even declared that the merger would “create the most exciting and socially conscious company the world has ever seen.”

In many ways that merger in early 2000 was a signal that things had gotten out of hand. *America Online* is now worth a few billion dollars and *Time Warner* \$35 billion, roughly 90% less than in 2000. Since then, *eToys*, *Global Crossing* and *Nortel* went bankrupt, *Yahoo*, *Agilent* and *LSI Logic* sell for about 10% of their 2000 peak and *Sun Microsystems* is being sold for a few pennies on the 2000 dollar to *Oracle*. That would be one somber ten year class reunion!

Before the bubble burst, investor excitement about the internet led to a massive exodus from stocks in oil, consumer staples and other traditional industries. Even Buffett’s *Berkshire Hathaway* fell out of favor as investors thought he had lost his touch. Hindsight is 20/20, but an investment of \$1,000 in the year 2000 in the “future” *AOL/Time Warner* is worth about \$100 today, while an investment in Buffett’s “boring” *Berkshire Hathaway* is worth \$2,000, or 20x more! So it would seem that Buffet knew what he was doing after all – keeping his portfolio diverse and not chasing trends.

Despite the failure of the Class of 1999 to live up to the hype surrounding it, the business and economic landscape of today is very much driven by the internet. *The internet changed the economy but just not quite in the ways many expected!* For instance:

- Content providers, such as *Time Warner*, *Disney* and *Sony*, were expected to grow rapidly as they put their wares on the internet. Instead, the content in demand on the internet has not really come from these providers, leaving them to fight for our attention and dollars.
- The broadband and wireless revolutions occurred, but profits have been scarce as pricing has come down and a dramatic drop in traditional phone usage has left most providers treading water. For the most part, only pure wireless companies have seen sustained growth.
- Traditional retailers were expected to fail in the face of on-line competition. Instead, while *Amazon* and *eBay* have prospered, so have *Wal-Mart* and *Target* and a few other retailers who have built up a strong internet presence. Specialized retailers have suffered more.
- The business cycle was supposed to be dead, as companies would use real-time information from the internet to better manage output. Unfortunately, while businesses have actually done pretty well, national and international events conspired to leave us with two deep recessions, no growth in incomes, a weak dollar, and soaring budget deficits.

Some things did happen as predicted, though. One of the things we often talked about ten years ago was how the internet revolution should help traditional businesses and this has certainly been the case. Companies such as *Colgate*, *Johnson & Johnson*, *IBM* and *Schlumberger* have used the internet and falling technology prices to lower costs, better connect to their consumers, move more quickly into new

markets, manage inventories and introduce new products. *In some ways these companies have benefited the most from technology!* Another forecast that was correct was that old media – newspapers and radio – would have a rocky future. We have since seen the *Chicago Tribune* go bankrupt, countless smaller papers shut their doors and even the *New York Times* on the ropes.

For investors, many lessons were learned following the Class of 1999's graduation:

- Valuation matters: Ten years ago the NASDAQ sold at over 100x earnings; today prices are still down over 50%! Even though some companies have done well, stock prices were so out of whack that investors are still in the red unless they waited until tech stocks hit bottom around 2003.
- In 1999, many reasonably valued stocks in the energy, consumer and international sectors were out of favor. While their growth was not as spectacular as the Class of 1999's, it was solid and steady. Investors who bought those stocks ten years ago have profited despite the overall drop in the averages. *Apache, Target, Coke* and *Berkshire* have provided positive returns including dividends. Clearly, the price you pay for an investment is just as important as what the investment is, especially at valuation extremes.
- Dividends do eventually matter and are an important component of total return. Even pure tech stocks such as *Intel* and *Microsoft* now pay dividends to attract investors.
- The early winners are rarely the long term winners. *Google* was not even on the list in 1999 but has beaten all the established competition since then. The early excitement about the internet has proven itself, but the way we use it has turned out to be different than forecast. Social interaction sites such as Facebook, Twitter, and YouTube have proven far more popular than passive modes such as just using your computer as a television or to read the newspaper.

In the end, for investors there has been and still will be money to be made when our economy undergoes revolutionary change. But at the same time, other global trends that don't get the same headlines can often be more profitable. We saw this with oil and emerging market stocks, some of the best performers this past decade, and two areas in which our participation has positively impacted performance.

Going forward, we are going to start the next decade with a lot less investor optimism than we began the last one. That's not necessarily a bad thing. As we've said before, things never seem to turn out as good, or as bad, as expected. The excessive optimism of ten years ago contributed to poor returns as reality fell short. Today, with expectations low, if things turn out okay or better, investors should profit as prices are discounting a very cautious future.

Furthermore, the Class of 2009 looks a lot more diverse and interesting than the technology focused Class of 1999. The Class runs the gamut from selling toothpaste to beer to oil; companies such as *Colgate, Femsal*, and *Petrobras*. Looking ahead we are upbeat about the Class of 2009 and where it may lead investors over the next few years, even as we look back on the tough times the leaders of 1999 have faced.

*Securities identified are for illustrative purposes only. This should not be construed as a recommendation to purchase or sell any securities. The securities mentioned may or may not be held in all client portfolios. For a list of current recommendations, please see the back page of this report and/or contact your portfolio manager.*

## CORE HOLDINGS LIST FOR 2009

Source: FactSet, First Call, Value Line, Bloomberg & CAM Estimates.

December 1, 2009	<u>Company Name</u>	<u>Ticker</u>	<u>Recent</u>	<u>2009</u>	<u>2010</u>	<u>2009</u>	<u>2010</u>	<u>Est EPS</u>	<u>P/E to</u>	<u>Market</u>	<u>ROE</u>	<u>Div</u>
	<b>Standard &amp; Poors 500</b>		<u>Close</u>	<u>EPS</u>	<u>EPS</u>	<u>P/E</u>	<u>P/E</u>	<u>Growth</u>	<u>Growth</u>	<u>Cap(\$mm)</u>		<u>Yield</u>
		SPX	1,095.63	\$58.43	\$71.24	18.8x	15.4x	8%	1.9x	9,655,201	13%	2.0%
<b>Financials:</b>	Berkshire Hathaway Cl "B"	BRK/B	3,353.00	\$160.33	\$186.74	20.9x	18.0x	5%	-	49,775	4%	0.0%
	MasterCard	MA	240.86	\$11.43	\$13.50	21.1x	17.8x	17%	1.0x	26,440	10%	0.2%
<b>Consumer Staples:</b>	Avon Products	AVP	34.25	\$1.71	\$2.22	20.0x	15.5x	12%	1.3x	14,627	126%	2.5%
	Coca Cola	KO	57.20	\$3.06	\$3.39	18.7x	16.9x	5%	3.2x	132,543	28%	2.9%
	Colgate Palmolive	CL	84.19	\$4.33	\$4.89	19.5x	17.2x	10%	1.7x	41,859	93%	2.1%
	Diageo Plc ADR	DEO	67.61	\$4.48	\$4.91	15.1x	13.8x	8%	1.7x	42,301	40%	3.4%
	Fomento Economico Mexico	FMX	45.51	\$1.97	\$2.57	23.1x	17.7x	23%	0.8x	9,836	8%	0.8%
	H.J. Heinz	HNZ	42.45	\$2.83	\$2.95	15.0x	14.4x	10%	1.4x	13,399	59%	4.0%
	Walgreen Co.	WAG	38.89	\$2.13	\$2.49	18.2x	15.6x	13%	1.2x	38,415	15%	1.4%
<b>Health Care:</b>	Becton Dickinson	BDX	74.80	\$5.00	\$5.27	15.0x	14.2x	11%	1.2x	17,737	24%	2.0%
	Johnson & Johnson	JNJ	62.84	\$4.58	\$4.91	13.7x	12.8x	7%	1.8x	173,382	30%	3.1%
	Novartis AG	NVS	55.60	\$4.07	\$4.54	13.7x	12.2x	7%	1.7x	146,652	16%	2.6%
<b>Consumer Discretionary:</b>	Staples, Inc	SPLS	23.32	\$1.13	\$1.34	20.6x	17.4x	14%	1.2x	16,845	14%	1.4%
	Target Corp.	TGT	46.56	\$3.14	\$3.52	14.8x	13.2x	13%	1.0x	35,022	15%	1.5%
	Toyota Motor Co. ADR	TM	78.54	-\$0.76	\$2.55	NMF	30.8x	5%	6.2x	135,403	14%	1.4%
<b>Technology:</b>	Cisco Systems	CSCO	23.40	\$1.38	\$1.49	17.0x	15.7x	13%	1.2x	134,610	24%	0.0%
	EMC Corp.	EMC	16.83	\$0.87	\$1.11	19.3x	15.2x	14%	1.1x	34,330	11%	0.0%
	Fiserv, Inc.	FISV	46.24	\$3.54	\$3.93	13.1x	11.8x	12%	1.0x	7,116	14%	0.0%
	Google	GOOG	583.00	\$22.78	\$26.28	25.6x	22.2x	22%	1.0x	141,668	17%	0.0%
	International Business Machines	IBM	126.35	\$9.88	\$10.88	12.8x	11.6x	11%	1.1x	165,974	59%	1.7%
<b>Industrials:</b>	3M Co.	MMM	77.44	\$4.49	\$4.86	17.2x	15.9x	12%	1.4x	54,824	32%	2.6%
	ABB Ltd. ADR	ABB	18.36	\$1.24	\$1.06	14.9x	17.4x	4%	4.4x	42,646	28%	0.0%
	Danaher Corp.	DHR	70.92	\$3.41	\$3.88	20.8x	18.3x	11%	1.7x	22,782	14%	0.2%
	United Technologies	UTX	67.24	\$4.14	\$4.54	16.2x	14.8x	12%	1.3x	63,040	25%	2.3%
<b>Energy:</b>	Apache Corp.	APA	95.28	\$5.40	\$9.42	17.6x	10.1x	10%	1.0x	32,031	4%	0.6%
	Petroleo Brasileiro S.A. ADR	PBRA	45.06	\$3.18	\$3.75	14.2x	12.0x	8%	1.6x	83,377	30%	0.8%
	Sasol LTD ADR	SSL	39.58	\$3.28	\$4.02	12.1x	9.8x	5%	2.0x	25,258	35%	2.7%
	Schlumberger, Ltd.	SLB	63.89	\$2.69	\$2.80	23.8x	22.9x	8%	2.9x	76,717	34%	1.3%
<b>Telecom Services:</b>	America Movil ADR	AMX	48.38	\$3.34	\$3.74	14.5x	13.0x	15%	0.9x	48,838	40%	2.5%
	China Mobile Hong Kong	CHL	46.87	\$4.08	\$4.15	11.5x	11.3x	10%	1.1x	188,045	28%	3.4%
<b>Transportation:</b>	Kansas City Southern	KSU	28.63	\$0.59	\$1.19	48.6x	24.1x	20%	1.2x	2,749	10%	0.0%
<b>Exchange Traded Funds:</b>	iShares MSCI EAFE Index	EFA	55.39	-	-	-	-	-	-	35,095	-	2.7%
	iShares MSCI Emerging Mkts	EEM	40.52	-	-	-	-	-	-	37,453	-	1.2%

0% weighting in utilities and materials.

The above is a list of common stocks currently held in clients' portfolios. Not all stocks are held in all portfolios for various reasons. Upon request we will furnish a list of all equity recommendations made within the past twelve months. This list includes the name of the security, date and nature of the recommendation, price at which the recommendation was acted upon, and the current market price of the security.

It should not be assumed that recommendations made in the future will be profitable or will equal the performance of the securities in this list.

Please contact Mickey Herst for a copy of the list.

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