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THE VIEWPOINT

Winter 2005

With the elections finally over and oil prices coming down from the mid \$50 range, the stock market has had a good fourth quarter. The rally was strong enough to turn most indexes positive for the second year in a row. It was a year when the more risk you took the better your reward. Put into Marshall & Sullivan terms the stocks in our Special Equity accounts out performed the average company in our Core Equity accounts.

2004 was not like 2003 where all equity asset classes went up in unison. In 2003 the average Large Value Company (companies with undervalued assets and low P/E ratios) was up 30% while the average Large Growth Company (companies consistently growing their earnings faster than the average company) was up 29%.

In contrast, 2004 was a tough year for the average stock even though most indexes were up. This is because value stocks like energy (+28%), utilities (+19%) and industrials (+17) carried the market. Growth companies like healthcare (+1) and technology (+2) barely advanced.

When 2004 started, most market pundits were predicting a single digit return for the markets and for interest rates to rise. This suggested a market where interest rate sensitive stocks like utilities would not do well and growth stocks would be the better performing companies. As the year started, things went just as was expected with the market and interest rates slowly rising. But the crude oil dilemma changed all of that. Instead of rising, 10 year bond yields ended the year almost unchanged and 30 year bond yields went down.

Will 2005 be just like 2004? Should portfolios be more heavily invested in the industries that did well in 2004, or is investing like karma? What goes around comes around. In other words, the hot investment area today becomes the laggard of tomorrow.

For example, the price of gold went from \$250 a troy ounce to over \$800 in less than 1 year between 1979 and 1980. Today gold is \$443 a troy ounce. And who can forget the internet age, where all preconceived notions

about the market and economy had supposedly changed. Where are all of those companies today?

This is not to say good money can't be made following trends. If you get in early and don't get greedy you can do well. But if you get in late or the trend never develops a lot of money can be lost. So trend investing is really for that small portion of your portfolio that is high risk.

Investing by equity asset class (Large Cap Value, Large Cap Growth, Small-Cap, Mid-Cap & International) is also like karma. A trend sets in where one asset class outperforms for a while and then just when you least expect it that asset class falls from favor.

For example, in the mid to late 80's it became all the rage to invest in International equities. In the 90's International equities were the worst performing equity asset class. International stock returns finished last versus other asset classes in 6 out of 10 years.

For the last five years the losing asset class has been Large Cap Growth. During 4 of the last 5 years it has been the worst performing asset class, International investing got that honor in 2001.

After another year of growth stocks under performing other asset classes we are hearing the question, is growth stock investing dead? When I joined Marshall & Sullivan in 1994 I was hearing the same question. We were just leaving a recession much like today and large company growth stocks had just spent the last few years under performing other asset classes. What followed was 5 years where growth was either the number 1 or 2 performing asset class.

So is growth stock investing dead? No, the average growth company is just getting cheaper making it more attractive to own. Karma will shift to growth stocks again.

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