Stanley E. Rulapaugh, CFA **April 1, 2006**

"Please, sir, I want some more."

Dickens' Oliver Twist asking the master for more gruel.

Unlike Oliver's gruel, the investment news this quarter has been a rich stew of delightful insights into the workings of business and the markets. In mid-February, darling Google announced "disappointing" earnings which, at one point, saw the stock down more than $75 a share in after-market trading. *The Wall Street Journal* summed it up nicely. "The big problem for the stock: Google's results didn't come close to matching the outsize expectations for earnings and revenue bandied about in the days leading up to Tuesday's report." "Didn't meet expectations" is the operative phrase in today's markets. There is a wonderful sentence in Jane Austin's <u>Sense and Sensibility</u> that describes Wall Street today. Jane Austin wrote, ". . . that what [they] conjectured one moment, they believed the next – that with them, to wish was to hope and to hope was to expect." Traders and investors alike "want some more."

How else could we explain the behavior of stock prices to what should be seen as good news. Again from *The Wall Street Journal*, a February 22 headline. "Home Depot's Net Jumps 23%; Sales Outlook Remains Bullish." The reaction? The stock finished the day up a penny. Williams-Sonoma's profits and sales increased for the last quarter to a level not expected by Wall Street. The reaction? Down $.21 in the trading day.

The outstanding earnings being reported by the energy companies are greeted with skepticism if not derision. The high earnings are not sustainable, so the mantra goes, and therefore should not be rewarded with higher share prices. The expectation is that oil will soon drop back to the $40 to $50 range. Maybe, maybe not. ("To wish was to hope and to hope was to expect.") Oil is over $65 a barrel and gasoline, because of the ethanol fiasco, is headed toward $3.00 a gallon this summer. Still no respect for the oil companies or their shares.

The brokerage stocks, on the other hand, have achieved new market highs based on their "trading" profits, as ephemeral a profit as there ever was. This quarter's profit could be next quarter's loss. A rogue trader's bet could sink the company so why is Wall Street willing to pay more for what amounts to luck? And what about next quarter when earnings must be up even more? Make bigger bets. "Please, sir, I want some more."

Speaking of gruel, Microsoft announced that its wonderful new "Vista" software program is again delayed until next year. Recall that the company started this replacement for Windows five years ago and is now two years late in delivering. Microsoft went down $.59 a share on the announcement, hardly a punishment. For all of the hype and the delays, this Vista software had better be able to run your computer as well as squeeze your morning orange juice when Microsoft finally gets it to the stores. Microsoft stock lovers need to appreciate that this company has 60,000 employees, enough to fill Sun Devil Stadium. Getting anything done with that large a group is like trying to sprint in snowshoes. The only way Bill Gates can add value to Microsoft shares now is to break up this empire, to split the company into ten separate little companies that will compete for customers. At our office we just bought a new computer loaded with Windows XP, Service Pack 2. There are reasons Vista is late and I'm not about to bet my business on what could be a buggy new operating system.

As I predicted last letter, General Motors continues in the news, this time with its huge employee buyout and yet another layoff. I continue to be struck by how troubled GM is. How is it possible to lose more than $10.6 billion in one year? That is an $18.69 loss per share for a stock that sells for $21.00 per share! Stated another way, GM lost $2,246 for every vehicle it sold in 2005. The company is taking steps to return to profitability by cutting costs but first GM must recover the $2,246 loss per vehicle before they can even think about a profit.

There are some stocks I bought where I expected more and got much less. Two in our portfolios stand out. Every time I see Intel or ConAgra in accounts I start to hum that 50-year-old Patti Page hit, "How much is that doggie in the window? (Arf! Arf!). I do hope that doggie's for sale." When I bought ConAgra a few years ago, I liked the story. The company had excellent brands, was selling unprofitable product lines, closing plants, changing management and it paid a high dividend while we waited for results. A classic "value" stock. The turnaround hasn't happened yet and a new management team is being installed. Recently announced plans hold promise but the dividend has been cut and earnings growth is years away. This "doggie" is for sale when I find a good substitute.

The other "doggie" in the Window[s] is Intel which, to date, I have refused to believe was as bad a stock as it has turned out to be. A chart of Intel's stock price shows stagnation, not growth. Intel first crossed $20 a share in January 1997 which is where it sits today. And you didn't get much of a dividend while you waited either. In fact, much as I dislike utilities, long-term holders of Intel would have been better off investing in Pinnacle West Capital Corporation, parent of Arizona Public Service. Unlike Intel owners, Pin West owners have a small capital gain in addition to the big dividend they received all those years. Intel's most recent big decision has been to change the logo which probably cost shareholders millions. When there's a problem, companies like to change the slogan, the logo, or both. It sure beats doing something meaningful.

When I go through the list of thousands of stocks that can be purchased for accounts, I'm looking for issues that we can hold for years rather than months. That is not true of mutual fund managers. *The Value Line Mutual Fund Survey* provides data on mutual fund stock turnover by type of fund. Aggressive growth funds have a turnover rate in excess of 100% which means the fund you buy in January is not the fund you own the following January. Growth funds are a little less frantic with turnover rates of 75% so at least you own the original portfolio for more than a year. All of this activity is designed to beat the market averages. Never forget, however, that beating the market is far different from making money for clients. When was the last time you heard a money manager on TV say their primary objective was to make money for their clients? Instead, we hear all the investment weasel-words like "outperform," "equal weight," "beat the market" and "tracking error."

Let's say there are only two famous money managers who invest in the stock market. The market itself goes down 50%. One manager is down 49% and the other is down 51% at the end of the year. The manager who "beats the market" by being down only 49% gets to go on TV as a guru. Lost in the performance fog is the fact that, in both cases, the client lost half of their money. The winner of the performance game sees a huge inflow of new cash to invest and the loser gets kind wishes on their future endeavors. The next time you see an ad on TV or in the mail detailing "market beating performance," think about my example.

The other problem today is the number of rookies in the market, those who think that Jim Cramer's hyperactive *Mad Money* program on CNBC is what investing is all about. For those who have missed this treat, Cramer yells, throws chairs, bites the heads of little stuffed animals and uses sound effects to keep his audience screaming. And all of that is before he takes listener calls. The studio audience, reacting to Cramer's one-liners, behaves like an uneducated mob. Make no mistake, Cramer can move markets which can ruin the performance of the most carefully constructed portfolio. I found the best description of this in the syndicated column "All About Poker," written by Steve Rosenbloom. Mr. Rosenbloom quoted poker professional Clonie Gowen who was commenting on losing money to rookie poker players.

> The land mines are the people who get in there and truly don't know what they're doing and they will blow you up . . . You will lose all your chips to them because no matter what you're doing, they don't understand what you're doing, and so they don't have that same thought process as you, so they are coming in with inferior hands that can totally cripple you.

Lily Tomlin was right. No matter how cynical you get, it is impossible to keep up.

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