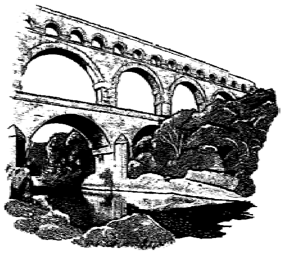

Stanley E. Rulapaugh, CFA **January 1, 2003**

Whither is fled the visionary gleam?
Where is it now, the glory and the dream?

From "Intimations of Immortality" by Wm. Wordsworth

As I write this, we are ending three years of lousy markets with all of us hoping for a better 2003. While some economists are still hedging their forecasts for 2002, most are expecting a 2003 to be a year of positive growth. Some think the economy will start out slow and speed up. Others think it will start fast and slow down. One lazy forecaster said it will be flat all year. I just hope it doesn't start slow and taper off. Then again, I like the comment from someone, perhaps renowned investor Peter Lynch, who said "Fifteen minutes forecasting the economy is fifteen minutes wasted."

We have had three consecutive down years in the market before, 1939, 1940, 1941 and early-1942. Consider the times back then. World War II started September 1, 1939 with the German invasion of Poland. Soon after that the Germans invaded Paris and the US initiated the peacetime draft. Lend-lease involved the US in the European war indirectly, and then the US started an oil embargo of Japan which lead to the attack on Pearl Harbor. The market turned up a few months after Pearl Harbor and it kept going up for the next four years.

It is important to remember that back then the stock market was not the spectator sport that it is now. Few people owned stocks and not much of anything else either. The information in the following paragraph was taken from William Manchester's marvelous book, <u>The Glory and the Dream: A Narrative History of America 1932 - 1972.</u>

> As the US went to war in 1941, more than eight million men were unemployed with more than a third of those working on menial jobs for the WPA. Half of the men called for the military draft were turned down because of malnutrition. The average annual income for half of the families in the nation was less than $1500 per year. Twenty-five percent of the population lived on farms where the annual income was $1000. Three out of four farms did not have electricity. Only one family in seven had a telephone and only one family in five had a car. Hot dogs were a nickel, a movie twenty-five cents, and dinner was forty-five cents. Schools in Toledo closed for two months for lack of funds.

From 1939 to 1942 the Dow Jones Industrial Average bumped up and down between 100 and 150. The low point on the Dow in 1942 was 93, just four points higher than the 89 point high on the Dow in 1932. No progress for <u>ten</u> long years. I would bet that the majority of Americans back then had never heard of the Dow Jones, let alone knew what it was or why it was important. Share volume, now more than a billion shares a day, averaged 378,000 a day in September 1942. (No, I didn't leave any zeroes out of that number. It is thousands.) On October 27, 1942, the daily volume was only 629,100 shares. General Mills traded 100 shares and J. C. Penney traded 200. All day. The market commentary column was titled "Purely Gossip." Now it is called "Heard On The Street." The old title is more accurate and should be reinstated.

I recall this history because it interests me, not because it has any relevance to the current three-year decline. Our war preparedness is certainly growing but going to war doesn't seem to have much of an impact on stocks. They went up in WW II, flat during Korea, up during Viet Nam and Desert Storm. To invest in stocks you have to be an optimist. No one ever got rich betting against the US economy. And while the current decline is certainly depressing, the economy is nowhere near as bad as in the 1930s (although some would like us to think so). Declines are a small part of long advances and should be expected. I guess it is the investing equivalent of sickness as the "in sickness and in health" part of marriage vows.

So where do we invest during the sickness while we wait for the good times to resume? *Business Week* devoted their cover story to "Quality Investing" like it was something brand new. All we must do to have a successful 2003, according to *Business Week,* is to buy stocks "with reasonable valuations, low prices, good growth, squeaky-clean balance sheets" and, oh, by the way, they must pay a dividend. This describes Enron in 1999 perfectly. Enron, now a shell of its former self, is again in the news because Enron ex-employee Sherron Watkins is one of *Time* magazine's "persons of the year." Her claim to fame was that she told Enron ex-chairman Ken Lay about the phoney accounting which gave Enron the appearance of quality noted above. Quality is fleeting.

Companies come and go. UAL, parent of United Airlines, has been around a long time and is one of the most recent to file for bankruptcy. Five years ago the stock sold for $100.00. Now it is $1.00 and probably overpriced at that. A story I particularly like of going, going, gone starts on June 16, 1969. American Motors had a stock offering at $12.75 a share. The brokers listed on the "tombstone" at the right - appropriately named - represented the underwriting syndicate that sold American Motors stock to the public. American Motors was a real success story even though it had been a minor player in the auto market. The first Ramblers had been built in 1902. The company tried to merge its way out of small-player status in 1954 when Nash-Kelvinator Corporation, maker of cars and refrigerators, merged with Hudson Motor Car Company. Anyone who remembers American Motors cars knows that the refrigerator designers got the upper hand in the automotive design studio with fatal results. The last car rolled off the assembly line in 1987. By 1990, twenty short years after the public offering, American Motors was gone as was every other company shown on this tombstone. They either merged or went out of business. Looking at my 1942 *Wall Street Journal*, a majority of the companies listed are gone, either merged or defunct.

This announcement is not an offer to sell or a solicitation of an offer to buy these securities.
The offering is made only by the Prospectus.

1,000,000 Shares

American Motors Corporation

Common Stock

(Par Value $1.66⅔ Per Share)

Price: $12.75 per share

Copies of the Prospectus may be obtained in any State only from such of the undersigned and others as may lawfully offer these securities in such State.

Kuhn Loeb & Co. — White, Weld & Co.

Blyth & Co., Inc. — Eastman Dillon, Union Securities & Co. — Glore Forgan & Co.

Halsey, Stuart & Co. Inc. — Harriman, Ripley & Co. — Hornblower & Weeks-Hemphill, Noyes

Loeb, Rhoades & Co. — Stone & Webster Securities Corporation

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June 16, 1969

Defunct may be the norm in American business and prosperity is abnormal, unusual, and fleeting. Most businesses today are scrambling for every dollar of revenue and cost savings they can find. We must wonder if the terrific, life-changing gains made by McDonald's, Home Depot, Disney, Intel and even Microsoft are temporary. If not, then what must they do to regain their former stature? Do these companies merit our attention now any more than General Motors? Buying quality issues often means buying seasoned companies with a history of success. American Motors was certainly old, seasoned, successful, but eventually gone. Microsoft is young, seasoned, successful and holding a $40 billion cash hoard because they can't find a place to invest it profitably. I find it impossible to believe that a company as visionary as Microsoft can't come up with an investment better than 1% Treasury bills. Microsoft's use of the $40 billion will tell us a lot about the course of markets the next few years. There is no glory in holding cash.

Much is made of today's lowered investor expectations. Continuing with the Microsoft example, the stock is around $50.00 a share, well down from its $120 high three years ago. Let's say Microsoft bought today returns 15% per year for the next five years. Most folks will accept 15%. Year one takes the stock from $50.00 to $57.50, not the kind of move that leads to early retirement, The multi-year 15% progression would be $57.50, $66.12, $76.00, $87.45, and $100.57 in 2007. At 15%, Microsoft won't get back to the $120.00 high until sometime in 2009! Will it happen sooner? I have no idea, but if it does, I would be a seller. Quality or not, even buy-and-hold accounts will have to trade more frequently to capture gains in excess of reasonable.

And quality is where you find it. Several years ago I had an opportunity to talk with Herb Kelleher who ran Southwest Airlines so successfully until his recent retirement. I learned from him that his vision was to manage the company as though something catastrophic could happen any day that would put the company in jeopardy. This was a dozen years prior to September 11, 2001. With conservative management and finances, he believed a company in a risky industry could prosper. Southwest has prospered in a terrible business by acting like every day was the last day. So has Dell Computer. We need to find more of these. That's quality.

Best wishes for a happy and prosperous New Year!

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