



ASSET MANAGEMENT COMPANY

FOURTH QUARTER 2004

2004 was a year marked by a “measured pace” of rate increases, a heated battle for the White House, continuing unrest in the Middle East *and* an up-year for stocks. To shift the burden of heavy U.S. consumption and indebtedness to foreign investors, the powers-that-be have adopted a policy of benign neglect for the U.S. dollar. As a result, the U.S. share of global wealth is being transferred abroad at fairly rapid rate. We’re working hard to keep our clients’ portion of that wealth intact and growing. In 2004, the Dow rose 3.2% and the S&P was up 10.9%.

In the travel business, like the investing business, agents will tell their clients not only where to go and where to stay, but where *not* to go and where *not* to stay. In the parlance of investing, this is the reward/risk tradeoff—enjoying the best the world has to offer without exposing oneself to unnecessary perils. This kind of recommendation system also meant, for example, that for years, far too many tourists went to Mickey Mantle’s bar on the Park rather than to some much more interesting places off the beaten path. Yogi Berra observed with his usual insight, “Nobody ever goes there (to Mickey’s) anymore; it’s too crowded.”

As we enter the fifth year of the new millennium, many of the old favorite places to invest have once again become crowded because Wall Street prognosticators have been repeating the mantra of buying technology and

large company growth stocks. In our view, there are more interesting opportunities to earn profits by *avoiding* these crowds.

Many of the most heavily promoted investments now have prices that will be difficult to sustain with realistic growth assumptions, hence there is outsized risk. We usually choose to pass on these investments because it is our core belief that in order to realize superior returns, an investor must carefully manage his/her risk. Luckily, this does not require foresight, only reasonableness.

Instead we choose to allocate our clients’ hard-earned capital to opportunities where the bar is set low for the investee to outperform consensus expectations on the upside. More importantly, the current price has to be at a sizable discount to the value of the stock (as measured by the value of likely future cash flow). At present, great opportunities exist where capacity and capital are scarce, but rarely spoken of by Wall Street pundits—among these are select commodity producers and certain foreign investments.

Global capacity to produce computers, software and fiber is free to expand exponentially, so we expect investment returns there to be low. Global energy and metal resources are finite, so as long as there is firm demand from Asia and reasonable prices, we want to own the stocks of their producers.



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Growth stocks are about new markets, new products and high expectations, so any disappointment in expectations can have disastrous consequences. By contrast, the stocks of commodity producers are about changes in demand from the same kind of consumers for roughly the same kinds of uses, year in, and year out. And when you have a billion people that are building enough wealth to afford indoor plumbing for the first time, it makes sense for any investor to have some exposure (assuming the price-value relationship remains compelling).

With respect to bonds, we are reticent to predict changes in Fed policy at this point. Inflation appears to be tame for the foreseeable future, but the increasing lack of respect for dollar-denominated assets by global investors may force the Fed to continue raising rates. We anticipate sticking mostly with high credit-quality, short duration bonds because we view the reinvestment risk as less than interest rate risk in longer maturity issues.

There will be periods when our clients' accounts will underperform the market, and also when returns, particularly in equities, will be negative. Seasoned investors and managers know that managing downside risk is more important than seeking lofty returns and also that returns will be "lumpy." We will continue to keep our eye on the risk management ball sometimes giving up "quick" returns. In investing, the tortoise beats the hare.

If you believe that a change in strategy is needed in your portfolio either through a change in your personal finances, or if you believe you are not well-positioned to benefit from emerging trends, please contact our office at (970) 925-8747 to set up a *no obligation* review.