



August 8, 2000

As we reflect on the markets at mid-year 2000, we note how much more uncertain (even contrite) investors seem in comparison to recent years. The US stock market is basically flat for the year and the technology heavy Nasdaq is negative for the first time in recent memory. The foreign markets are sour. Bucking these trends are bonds and real estate.

While there is still a respectable possibility of more interest rate increases in the future that could further harm the markets, bonds in the first half have actually outperformed stocks, perhaps for the first time since 1990. This all emphasizes the continuing need to stay diversified across broad asset classes since some classes will weather the storm better than others.

### **Betting Big**

It seems we in Seattle work at "ground zero" of wealth creation. We hear, see and feel that investors get rich by making a good bet on a stock. In this environment it's been hard even for the average guy to resist the temptation to dabble in individual stocks hoping to make a killing. It isn't the day trader alone who feels the pressure to pick a winner; sometimes the temptation is even too powerful for people who have long-held diversified portfolios and want to get in on more of the action.

Hoge Building  
Suite 800  
705 Second Avenue  
Seattle, Washington  
98104-1711  
Phone 206/382-4414  
Fax 206/382-4412

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How real is the action? If you look at the numbers behind the markets, more stocks are down than up in the last several years. So what about picking some great stocks and beating the markets?

We perceive that more and more people approach investing with the notion that to be well-off you need to *bet big* on the stock of one company. We are surrounded with stories of the enormous successes reaped by employees of software companies, or we hear stories of someone's brilliant stock pick. Envy feeds the "betting-big" culture, pure and simple. It affects investors of all kinds. It's natural for an investor, hearing about a stock or an asset class that has a dramatic price increase, to think ... "What if I had put all of my money in that?"

As comprehensive financial planners, we try to differentiate fact from fiction, identifying paradoxes if they exist. Here's one we think is important. *Betting big is a wealth creator if it relates to the business you are in, but it is too often a wealth inhibitor if you are an investor.*

In other words, if you've received your big bet position as an employee of a company through stock options or because you are an entrepreneur who is building a company, you may become very wealthy in a single stock position. You probably have no choice in the matter; your big bet goes with the territory. If you succeed, you may succeed big. You deserve it.

But if you are a passive investor, the odds are long that your big bet will pay off. This concept goes against the grain of our culture (at least during the 1990s) because we are fed a constant barrage of information about stocks to buy and because we all know ...or have heard of...someone who got rich by a big bet. We tend to believe we can pick the winners and get lucky. But these are very long odds indeed if you look closely at the statistics. Why be a gambler when you can still win...and sleep as well?

We think you'll find the enclosed column by Kenneth L. Fisher (*Forbes* July 3, 2000) entitled "How to Get Richer" to be on point. His thesis is that if those people on the 1987 list of *Forbes* billionaires had simply reinvested their wealth using basic concepts of portfolio theory, many of them would still be at the top of the list. Never mind that he goes on to tout stocks for a hopefully diversified portfolio; we won't let that detract from his excellent message.

Also on point is the following excerpt from a piece entitled "Single-Stock Risk" by Sanford C. Bernstein, a value manager highly regarded for its original research. The message is quite sobering for any investor who believes a stock concentration is the way to retain wealth. Other similar studies reach similar conclusions:

Source: Sanford C. Bernstein & Co.

## The Perils of Concentration

Concentrated stock risk comes in two flavors. One's a bit sour: the possibility of poor performance. That's when you may have been better off selling at least some of your stock and investing the proceeds elsewhere. The second flavor is really bitter: investment disaster - the possibility that your one company meets with problems serious enough to wipe out much of your net worth. Of course, an individual stock may outperform a diversified portfolio, but no stock - not even one with the sheen of invincibility - is immune from these risks. Below is a list of *Fortune* magazine's "Most Admired" companies of 1989 - the cream of corporate America-and their performance over the subsequent 10 years. Significantly, seven out of the 10 trailed the overall market. ***The lesson is one that few investors remember: Great companies often don't make great investments.***

Fortune's "Most Admired" Companies of 1989

	Annualized Relative Returns 1990-99*
Wal-Mart	11.1%
Merck	2.4
Herman Miller	0.6
S&P 500	--
Shell Oil	(1.2)**
Exxon	(1.3)
PepsiCo	(2.9)
3M	(5.0)
Philip Morris	(8.5)
Boeing	(8.6)
Rubbermaid	(14.4)

\*Relative to the S&P 500 index. \*\* Return for Shell's parent company, Royal Dutch/Shell

Source: CRSP, Fortune, Standard & Poor's and Bernstein

BUT FATE CAN BE EVEN CRUELER. The 10 companies in the next chart were all well-regarded, strong performers in the early Eighties. Zenith, for example, was an electronics powerhouse, Pan Am a dominant airline. You might have thought you were playing it safe by holding onto any one of these stocks, yet most of them were later rendered virtually worthless. ***Lesson #2: No matter how high a stock climbs at first, a 100% decline always leaves you with nothing.***

Strong Performers May Become Disasters

	Cumulative Returns	
	1982-84	1985-98
Intergraph	337.8%	(83.0)%
Ames Dept. Stores	298.8	(100.0)
Prime Motor Inns	226.7	(98.4)
Circle K	205.7	(100.0)
Shoney's	197.5	(82.5)
Data General	118.6	(45.1)*
Service Merchandise	103.7	(96.2)
Zenith Electronics	79.6	(99.0)
Pan Am	68.2	(100.0)
Wang Laboratories	57.6	(92.2)

\*Includes 10-12/99 return of EMC Corp. (acquirer of Data General) Source: CRSP

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Sobering thoughts in these volatile and demanding times! One of our greatest challenges working with clients is developing good habits for wealth preservation and enhancement. These habits involve not just diversification among stocks but, most critically, determining the appropriate mix between cash, bonds and stocks.

Our best wishes for a healthy and sun-filled summer.

A handwritten signature in blue ink, appearing to read "Fred", with a long, sweeping horizontal line above it.

FREDERIC T. KUTSCHER