

January 1999

Hey, Hey, LBJ, What Internet Stock Did You Buy Today?

At the beginning of each year, everyone in the investment business appears to feel compelled to issue predictions for the coming year. We are amazed by this lemming-like phenomenon for two reasons: (1) just about all the predictions prove to be wrong; and (2) even if they were right, it wouldn't have helped you invest anyway. As a result, our New Year's resolutions are the same every year: (1) don't pretend we know what's going to happen, because we don't; and (2) don't construct an investment policy that depends upon a single predicted scenario.

Are the pundits ever right? About anything? And if they were, would it make a difference?

If there was ever a year to prove our point, it was 1998. US company earnings were widely expected to grow more rapidly. They declined. Asian economies were expected to end their depression. They didn't. The Russian economy was not supposed to blow up. It did. After the White House scandal broke last January, the presidency was expected to end. It didn't. There was no way Democrats were supposed to pick up congressional seats in an off year election. They did. There was no way Clinton was going to be impeached after the election. He was. Imagine you were the only person in the world last January to correctly predict all this. Would you then have predicted that the US stock market averages would be hitting new highs?

Longer-term predictions are equally fallible. The primary reason set forth for the continued buoyancy in the US market is the supposed liquidity provided by the "baby boom" generation suddenly realizing they are closer to retirement than they had previously noticed. Of course, this was the same generation of the summer of love, communal living and a rejection of the traditional values of their parents. In the late 1960's, much ink was spilled predicting that in the new era dawning (the "Age of Aquarius", remember), greed and material desires were to be secondary if not extinct. Instead, baby boomers have become the most stock market-obsessed, money-grubbing generation since...well, at least since their parents in the late 1960's.

We don't mean that in a bad way -- everyone at Sigma is a member of the baby boom generation, and we'll plead guilty to market obsession. We just think everyone is fallible, including us baby boomers. And to be fair, a significant portion of the stock market obsession has only recently reached a fevered pitch with the soaring performance of Internet stocks. The recent Internet stock performance unhinged a reader of this newsletter, an old friend of Sigma's founder who had never before indicated any interest in the stock market. He e-

mailed us commenting on the huge gains in Yahoo, asking if the world had gone crazy.

In our reply, we shared his wonder at the stock's performance. We pointed out that even if we didn't own a General Motors car, the demise of GM would affect our lives, with thousands out of work, a dramatic impact on the US economy, etc. We use Yahoo every day, but if Yahoo disappeared, it would take ten seconds to program another default search engine in our Internet browser. Maybe 30 people would be out of jobs (and, apparently, half of those are investment PR types).

"Your analysis is brilliant, insightful, level-headed, succinct, scholarly, logical and perspicacious. Yahoo went up another 29 points today."

We also pointed out that there was a plethora of microcomputer manufacturers in the tech boom of the early eighties, but very few survivors. Similarly, at the beginning of this century, there were dozens of auto manufacturers. Just because you correctly identify a huge trend doesn't mean it's easy to cash in. Our friend's reply was simple and humbling -- "Your analysis is brilliant, insightful, level-headed, succinct, scholarly, logical, and perspicacious. Yahoo went up another 29 points today."

In *The Money Game* by 'Adam Smith', a stock market classic describing the wild and woolly stock market in the late 1960's, a character describes what was happening as "a kid's market." Everyone with a memory of past market declines was too scared to invest in the small technology stocks then driving the about-to-end bull market. If money is to be made by rapidly putting your hand on a stove burner, you are better off being advised by a two year old than someone in their forties. The book also joked about companies renaming themselves to identify with the hot electronics trend, something also going on today. We can hardly wait for the press conference to announce that it is now "E-Morton Salt.com."

Enclosed is our annual listing of the best performing asset among large stocks, small stocks, foreign stocks and bonds. If you were issuing your bold predictions in January 1995, you would probably advise steering clear of large US stocks, which had been the best performing asset in only one of the previous 29 years. Now that they have been dominant ever since, many pundits advise putting everything in them. We believe the table illustrates that once a "trend" of superior performance is discoverable, it is about to disappear. Our diversified approach is illustrated in the two columns on the right. You give up bragging about your predictions, but you get good relative performance with lower risk.

If you would like an investment program not dependent upon fortune telling, contact us.