Quarter Notes

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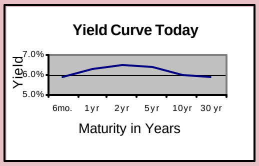
In this Issue

Bits and Pieces

The 30 year Treasury Bond closed the quarter with a yield of 5.83%.

The Yield Curve is now sightly inverted as shorter term interest rates are higher than long term rates.



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A Value Manager looks at irrational exhuberance.

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Measuring our Total Net Worth: Not just Dollars & Cents

First Quarter Volatility

The markets struggled through the first quarter. The Dow regained in March what it had lost in February, but that didn't erase the 5% loss suffered in January; it finished the quarter off 5%. After January and February losses the S&P 500 recovered enough in March to post a 2% gain for the quarter. The Russell 2000, the benchmark for small stocks, was the winner this quarter with a 7% gain.

While the Fed raised interest rates again, bonds actually had a small rally. The benchmark 30 year Treasury Bond finished the quarter at 5.83%. We have actually had a nearly flat yield curve. That means that yields on short term Treasury Bills are nearly identical to the yield 30 year bond. There is a small camelback hump about 2 years out.(*see graph)* This is an unusual occurance. A normally shaped yield curve shows interest rates gradually increasing with maturities. What this means is that the Fed is still fighting inflation, but the bond market sees none on the horizon.

Morningstar's Don Phillips on Stocks

Several of our clients have requested that we buy individual stocks of their own choosing for their wealth management portfolios. We attempt to accommodate these purchases assuming it doesn't overwhelm the investment policy goals. However, some clients have experienced the tremendous downside volatility of individual stock positions. When we ran across excerpts of a recent speech by Don Phillips, CEO of Morningstar, we thought it important enough to share with our readers.

Phillips has been an investor in both stocks and mutual funds since he was 15. But recently, he has started to get annoyed with friends telling him how much money they made in prominent "hot" stocks like Cisco or Lucent.

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With so much upheaval in the financial services industry, we find ourselves asking probing questions. Can we be replaced by the Internet? What special value are we to our clients? What is it that our clients value so much that they are willing to engage us?

When clients first come to visit us, it is usually to review one or more investment accounts. Many have no accurate picture of the extent of their financial net worth. However, financial net worth is only one component of total net worth. At a recent Financial Planning conference Greer Kendall, a Dallas based CFP, shared some of his thoughts about using money as the sole measure of one's wealth. After all, isn't money the measure society gives to wealth? Society has impressed upon us that the only wealth that is worth anything is financial wealth.

Money and the material things we posses, our financial capital, is only one of the measures of net worth. What value do we assign to honesty, integrity, duty, love, giving of our time and energies to causes in which we believe? Our social capital describes how we relate to the world around us. And our personal capital or wealth defines who are we as human beings. Our convictions, values and beliefs, artistic talent, and our relationships are the sum of the experiences of our lives?

Some of our "richest" clients have limited financial capital but huge balance sheets laden with social and personal capital. Since financial planning is goal and process driven, each client's circumstances are unique. We endeavor to not only define the client's financial goals, but to look further into what each client wants to accomplish with his life and his total net worth.

Financial capital is useful only in the function it serves either to its current owners or their heirs and beneficiaries.

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A Manager's view of the Risks of Irrational Exhuberence

From time to time we like to share particularly insightful comments of our portfolio managers with our readers. These comments about the technology and the Internet are by Robert H. Lyon, President and Chief Investment Officer of Institutional Capital, managers of the ICAP Funds. We thank him for his permission to excerpt these thoughts.

As we move into 2000, the sustainability of the global expansion is on firm ground. Around the world employment is increasing and access to capital has improved. All of this bodes well for the global economy. However, the story of the rebound of the global economy was nearly drowned out by the hype surrounding the speculative bubble in the technology sector. After an 85% increase in 1998, the NASDAQ 100 added another 102% for 1999. The S&P technology sector was up 77% and accounted for about 70% of the gain in the S&P itself. About a dozen tech stocks accounted for the majority of the gain in the index. Despite some widening in breadth, more than one-half of the stocks in the S&P had negative returns in 1999. The median return was 0%.

In essence the market has, perversely, lowered the cost of capital for the riskiest class of assets (unseasoned companies with no tangible assets or recurring earnings), while simultaneously raising the cost of capital for mature companies, many of which are enjoying improved demand and facing a consolidation among their competitors.

While there is no doubt that the Internet is obsoleting many traditional business models, the market is ignoring the possibility of Internet companies obsoleting each other, and traditionally dominant companies reinventing themselves.

Ultimately the leadership of the global economy will pass to the small number of Internet survivors, and the "old paradigm" companies that successfully reinvent themselves.. . . Despite the best efforts of creative investment bankers and security analysts to define new, non-cash valuation metrics to justify unsustainable capitalizations, veteran investors know that Wall Street is a perpetual daisy chain. The cycle outlasts all. Greed overtakes fear (one only has to go back to October 1998 to remember the fear that can affect investors).

The real question is how much of the future losses will be borne by the drop in paper profits of entrepreneurs, venture capitalists and the "mad money" of sophisticated investors, and how much of the losses will be borne by the world's new class of lemmings.

More importantly, how much of any decline will be borne by fiduciaries charged with the prudent investing of the retirement assets of the American public. It is this last class of involuntary investors who has the most to lose. They may not understand the unprecedented risks that are being taken in their behalf in the name of performance, and in the absence of solid research.

Robert H. Lyon
Institutional Capital
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Phillips continued from Page 1 Column 1

They tend to forget the money they lost on Iomega, TheStreet.com or the IPO du jour. Phillips asked one such friend to add up the return on her entire portfolio. When she did, she discovered, much to her surprise, that the portfolio had actually returned an annual rate of 8% over the past 3 years, even with her huge successes in Lucent and Cisco. Suddenly, mutual funds didn't seem so boring.

Phillips noted that Morningstar tracks 7,500 individual stocks. In the third quarter of 1999, 1865 of these stocks (roughly 25%) lost 20% or more. Out of the 10,000 mutual funds Morningstar tracks, six of them lost 20% or more during that period. Even more impressive is that, although 222 stocks in Morningstar's data base lost 50% during the same quarter, not one mutual fund in the 10,000 that they follow was down that much.

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As planners we must recognize the aspirations of each client. We must find out what and who do our clients care about and why; what causes, activities and people are most important to them.

We need to help our clients appreciate their total net worth and understand the role of financial capital is merely means to an end. What makes us special as advisors? We help our clients crystallize their dreams and then help them realize them.

Quips for the Quarter

"Investors today don't worry about P/E (price/ earnings ratios) they are buying stocks evaluating P/D (Price to DREAMS)"
John Bogle, Jr.

"The investment time horizon for the typical investor varies directly with the speed of his computer modem."

"Investor's confidence and self-esteem is based directly upon the short-term performance of their portfolios."

"A stock in motion will continue to move in the same direction -- until it ceases to do so."

"Investor's perception of risk varies inversely with recent investment performance."

Ralph Block from Laws of Investing Bay Isle Financial Corp.© 1999