Jolley Asset Management
Investment Outlook

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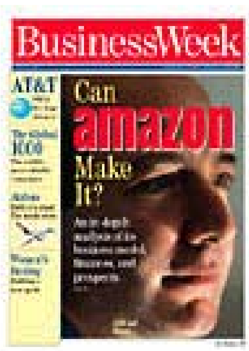
"Every trend goes on forever until it ends."
John Neff

As we discussed in our Spring 2000 Investment Outlook, we felt the odds were good that the speculative bubble in the tech-laden NASDAQ had finally been pricked. Look no further than the latest cover of *Business Week Magazine* (7/10/00) as evidence that the public's insatiable appetite for speculative Internet stocks has largely come to an end. Contrast that with the *Time Magazine's* 1999 cover (12/27/99), which named Jeff Bezos, the Amazon CEO as the 1999 Person of the Year. The irony of these two contrasting cover stories is that in a little over six-months time, the investing public and the media have shifted from a state of "euphoria" and giddiness to one of questioning the very financial survival of the company. As Warren Buffett of Berkshire Hathaway stated at the recent annual meeting, "In the last year the ability to monetize shareholder ignorance has never been greater." Needless to say, these past two

Jeff Bezos/Person of the Year



Can Amazon Make It?

years have been quite unusual and difficult for the rational investor who believes that in normal times, the value of a common stock should approximate the discounted cash flows that the enterprise will generate over some reasonable period of time. However, these times have been anything but normal for equity investors. The dissemination of news that used to take days, weeks, or even months to digest is now known by all interested parties in a matter of minutes. Better yet, we have had the financial media to interpret the numbers for us and place the appropriate "spin" on the situation. Should we really listen to the broadcast media who is primarily concerned with ratings? Should we really pay attention to a brokerage firm analyst whose opinion may be somewhat jaded with regards to the prospects of an investment-banking client? As Warren Buffett put it, "Never ask the barber if you need a haircut." These have been unusual times; with the "old economy" versus the "new economy", earnings versus business models, prudence versus speculation, day-trading versus long-term investing.

In light of the above, I thought that this April (4/29/00) might be a good time to make the pilgrimage to Omaha, Nebraska to attend the Berkshire Hathaway annual meeting. What better way to clear the mind than to spend a weekend with Warren Buffett, Charlie Munger and some 10,000 Berkshire Hathaway shareholders for what many call the "Capitalist Woodstock". Buffett, as you probably already know, is arguably the world's most successful investor, and in the opinion of this writer, is not one to bet against. The next few paragraphs will be used to share some of Mr. Buffett's and Mr. Munger's thoughts and wisdom on recent investment trends and the implications for investors going forward.

Thoughts from the Berkshire Hathaway Meeting On the Economy and Interest Rates

Buffett: "I don't make guesses (regarding the economy) and when I do, I don't pay attention to myself. Charlie (Munger) and I never talk about macroeconomics. It's fashionable for banks to have economists make forecasts. So they say that GDP will grow by 4.3% instead of 4.6%. So what?"

Buffett: "If we thought we knew what the dollar and interest rates were going to do, we'd know what to do. But we don't. In the end we're really more interested in predicting whether more people will buy Coke around the world than dollar or interest rate changes

Buffett: "The best times to buy stocks in recent years was when interest rates were sky high."

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On the State of the Markets and Valuations

Buffett: "We've seen companies valued at tens of billions of dollars that are worthless, and seen other companies trade at 20-25% of their true value. It eventually gets sorted out. But the speculative mania in one area is not creating equivalent discounts elsewhere. We are not finding business at half their real value today. Forty-five years ago, I had lots of ideas and no money. Today, I have a lot of money but no ideas."

Munger: "This is a very unusual period."

Buffett: I've seen companies valued at $10 billion, that couldn't borrow $100 million. This sort of thing has happened before, but this is the most extreme ever, including the 1920's. In the past year the ability to monetize shareholder ignorance has never been greater."

Munger: "It's the most extreme in modern capitalism. In the 1930's we had the worst depression in 600 years. Today is almost as extreme in the opposite way."

Buffett: "In time people will see this era as one of enormous wealth transfer, but the only wealth actually created is by the businesses. Investors as a whole may feel richer, but they're not. It's like a chain letter. The early participants can make a lot of money, but no wealth is created. In fact, due to frictional costs, wealth is destroyed."

Buffett: "Anytime there has been a real bubble it has been corrected. But with a huge number of participants with a whole lot of money, the game can go on for a long time."

Munger: "We use the phrase wretched excesses, because the consequences are wretched."

On the Internet and Competition

Buffett: "For society, the Internet is wonderful, but for capitalists, it will be a net negative. It will increase efficiency, but lots of things increase efficiency without increasing profits. It is way more likely to make American business less profitable than more profitable."

Munger: "This is perfectly obvious, but very little understood."

Buffett: "The Internet democratizes capitalism. The fluidity is incredible, in terms of moving resources around."

Buffett: "The Internet gives everyone real estate. Buffett noted a certain site in Omaha where two streetcar lines crossed had once been prime real estate. "People said, who would ever tear up the streetcar lines?" "Now with the Internet, the streetcar lines get torn up everyday."

On Investing in Technology Stocks

the same thing."

Munger: "There are worse things in life than being left behind by a pile of money."

Buffett: "We are enormously risk averse. We don't knowingly go into a business where we see a significant risk of change."

On Future Stock Market Returns

Buffett: "We don't think the general ownership of equities is likely to be very exciting over the next ten years."

Munger: "I recommend reading Warren's Fortune Magazine article two or three times. We're in for reduced expectations from investing in stocks." (This article was sent out to our clients in January, please let us know if you would like an additional copy.)

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While acknowledging the above do not represent original thoughts, I do believe that one can learn a lot from studying an accomplished investor such as Mr. Buffett. Furthermore, I believe his comments add validity to the notion and concept that these are not normal times; at least not for "rational" investors. While we believe that as Mr. Buffett stated that these "things eventually get sorted out", we have no desire for our firm or clients to become one of the casualties in the process. We do think it is time to become more selective in our equity process; a time to ignore the noise or hype surrounding the current market. We have been telling our clients for some time that expectations for equities should be more modest for the next decade. Does that mean we have become more bearish on equities? Absolutely not. It is our belief that any attempt to time the markets will be futile, and our best course of strategy is to continue to construct diversified equity portfolios with companies that we believe offer attractive risk/reward characteristics and strong financial attributes.

While we are concerned over the near term about a weakening economy and the implications for corporate profits, we are positioning portfolios in some of the more traditional defensive areas, where we believe earnings will be less impacted. The Federal Reserve appears to have successfully engineered a slow down, the question now is do we get a "soft-landing" or a "hard-landing". While the FED has continuously denied that it was targeting equity prices, we believe that Greenspan has been very concerned about the level of stock prices and the potential inflationary impact (wealth effect). In our opinion, with the recent decline in equities (especially NASDAQ), this concern is likely to decline in importance to the FED over the coming months. While we believe there could be one more FED hike coming, the odds have shifted to no greater than a 50/50 chance. Any further evidence that the FED will adopt an easier stance would have positive implications for both stocks and bonds.

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