The Mallard Message

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Frequently Asked Questions

1. **How large is Mallard?** There are twenty clients who receive ongoing investment management services. Three of these clients signed up in November and December. Together these clients have entrusted Mallard to manage $11 million of their money. I also typically provide a few one-time consultations each quarter.

2. **Does Mallard have employees?** I am the sole full-time employee at Mallard, and am responsible for all investment decisions. There are two part-time employees, Margaret Badger and Becky Tinsman, who provide office/administrative support. Outside Mallard, Margaret works as a music teacher, and Becky works for a physical therapist practice.

3. **Do you work out of your house?** No. I doubt that my clients would appreciate the dogs barking in the background. I have been in an office in downtown Newark for more than three years. There is free parking behind the building.

4. **Did your clients' trading costs come down recently?** Yes, TD Waterhouse, where the majority of my clients' investments are held, reduced the trading costs for stocks purchased through their online system. The cost used to be a flat $25. It is now $12 for market orders and $15 for limit orders. Mutual fund trades are either 'no-transaction-fee', or a flat $24. Since I am Fee-Only™, all trading costs/commissions go to the brokerage firm, and I receive no portion of them. This is designed to eliminate any conflict of interest in my recommendations.

5. **How does someone get to know Mallard without becoming a client?** My seminars in May provide a good opportunity for someone to get to know me, without any obligation. The seminars are described in a later section of this newsletter, and are purely educational in nature. I am also happy to add people to my mailing list. I send this newsletter, holiday cards, and announcements of seminars to the entire mailing list. If you have a friend who would like to be added to the list, please provide me with their name and address.

Spring Plans

I will be back in my son's classroom leading a unit on investing on Thursday mornings in April. The office will likely be closed the week of Memorial Day. Other than that week, I do not expect to be out of the office for more than two consecutive business days.

Whenever I am away from the office for more than one business day, I check my phone messages and return all

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urgent ones.

By the way, while it was too short, we enjoyed our four-day trip to London in February.

Year 2000—Much Ado About Nothing?

Did we miss something? The earth kept revolving in January. Was this a hoax devised by computer engineers, or computer companies? Was this a gigantic waste of time, money, and energy?

I suspect not. I think that the time, money, and energy devoted to this effort helped to make this a non-event. In this process, we increased our knowledge of our systems, eliminated old ones we could no longer support, and updated ones we could. We now better understand the interconnections between our activities and those of other firms.

Most importantly, if disaster had struck, whether due to a terrorist action, or due to one missed program, the people affected would not have panicked. Rather, they/we would have taken a breath, and considered various channels of assistance.

I feel fortunate that I justified getting a newer PC, and that I have a fairly accurate list of the phone numbers for the support divisions of the software and service firms I use. I am better prepared for my next non-Y2K failure.

A Class Act

I have been leading an investing class in my son's school since December. The school, the Elementary Workshop, is a Montessori school that has multi-age classrooms. My son's class has children from nine to twelve years of age.

The class includes a ten-week competition in which students across the state and country invest a mythical $100,000 portfolio. The website www.smg2000.com is used by the students across the country to enter their trades, and to review their results.

You may recall that last year, the first year that I did this, the students' portfolios outperformed most of my clients' holdings. Their big winners last year included Amazon.com (up 83%), E*Trade (+106%), Broadcast.com (+83%), and AOL (+68%). The top two out of our six teams last year earned more than 15% during the ten weeks.

This year they have been riding a wild market. Yet the kids have found some hot stocks, including Ebay (+44% in five weeks) and E*Trade (+33%). Halfway through the ten week period, our average team has gained about 5%, and has invested approximately 70% of their $100,000.

I find it interesting to see how the kids choose their stocks. Both years we have had companies with high kid-visibility, such as Gap Stores and Disney. This year several students are bringing in the names of stocks they hear about at home, typically from a parent. Other kids seek out the stocks with the greatest returns for the past 13 weeks, as reported in Value Line Investment Survey.

While I don't think that this class will provide them with lifelong stock picking skills, I am hopeful that it will increase the chances that they will start investing earlier in their lives. Perhaps they will also welcome new opportunities to broaden their investment knowledge.

Three Month Activity

In this section I review the significant investment actions I have taken over the fourteen weeks ending March 16th. I began working with several new clients during this time, and therefore there was a greater amount of activity than normal.

Mutual Funds—I have begun using or increased my use of the Federated Total Return Bond, Fidelity Diversified International, Janus Overseas, Oppenheimer Real Asset, Payden & Rygel Global Fixed Income, RS Diversified Growth, Scudder International, Strong Municipal Advantage Bond, and Undiscovered Managers Behavioral Growth funds. I continue to use many of the Vanguard index funds. As I have reduced the level of inflation hedges I recommend, I have sold shares of American Gas Index, Cohen & Steers Realty, Excelsior Energy, and Vanguard Specialized Energy. For one new client, I sold several funds with which I am not satisfied, including Neuberger & Berman Guardian and Yacktman.

Specialized Funds—I purchased several closed-end funds, including Adams Express, Europe, European Warrant, Morgan Stanley High Yield, Royce Value, and Scudder New Asia. I sold the Irish Investment closed-end fund to realize a loss.

I have begun using several ETFs, Exchange Traded Funds, including ones that match the S&P 500, the S&P Midcap 400, and several HOLDRs, including the Business to Business Internet, the Internet Infrastructure, and the Pharmaceutical HOLDR.

Bonds—I purchased $225,000 of individual bonds, primarily municipal, while $80,000 in bonds was called, matured, or sold to realize a capital loss.

Stock Purchases—I purchased several US stocks, and one foreign stock, Daimler Chrysler. US stocks included Dell, H&R Block, Kohls, MBNA, New Plan REIT, Papa Johns, Providian, Safeguard Scientifics, Staples, and Tyco. There was a limited amount of year-end selling during this period. Most of the purchases were related to building a collection of stocks, diversified across industries and company size.

Stock Sales—I sold eight US stocks during this period. Some sales were motivated by realizing losses, and others were motivated by risk-reduction (taking some winnings off the table).

No Longer Avoiding Growth

Since the start of the year, I have been willing to allow more growth stocks into clients' portfolios than I had previously. My past approach was based on the conviction that the hot growth sectors were at much greater risk of sharp drops in price, and the value sectors offered a superior combination of potential returns and risk. While this is a change in course it is not a reversal.

I have been, and will always remain, a contrarian investor. I much prefer buying a stock that has gone down than one that has risen. I prefer increasing foreign stock holdings after two down quarters rather than after they have risen for six months.

At almost every point in the past six years, since I began offering investment advice beyond family members, the growth companies have seemed overpriced, and ripe for a fall. The longer these sectors continue to rise, I concluded that the risk of a fall, and of a severe fall, seemed to rise. A recent economic study has caused me to question these prior conclusions.

Kenneth Fisher has written the Portfolio Strategy column in Forbes for more than 15 years. He studied the impact of overvaluation on future returns. When analyzing the stock market at the end of the year, and the following year's stock market return, he expected that when the market began seemingly overpriced, it would suffer below-average returns, and when it began under-priced, it would achieve greater-than-average returns. He found just the opposite. His conclusion was that 'high price-to-earnings ratios are not really risky'.

I suspect that his conclusion is a bit overstated, yet I feel that there is more truth than fluff in it. He observes that investors like to chase yesterday's top stocks, and do not give up on a top sector, or a stock market, until they have suffered lower returns than they had hoped **for an extended period of time**. This period of time seems to be more than nine months but less than two years.

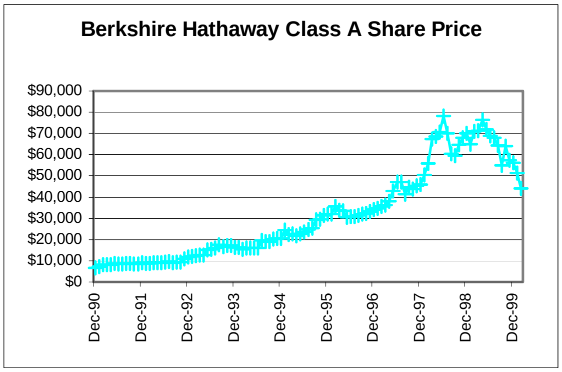
When I incorporate Fisher's research into my investment views, I conclude that the US markets are not likely to fall sharply, and stay down, until they **first** have a number of low return (or small loss) quarters. For then you would have the combination of an overpriced market, **plus** disgruntled investors. Until then, I suspect that market drops will be limited in depth and duration due to the 'buy the dips' mentality that has served us so well over the past several years.

Therefore, over the past three months, and going forward, I am recommending that portfolios be more evenly balanced between growth and value. If I have adequately explained the risk, I am comfortable placing more than half of a portfolio's stocks in investments that are more growth than value oriented.

Buffett-errible

If this is the first Mallard Message you have read, you may not know of my admiration for Warren Buffett, the chairman of Berkshire Hathaway. Warren has been a value investor for decades. As is my tradition, in the Spring issue I provide a review of the Chairman's Letter from Berkshire's recently released annual report. He speaks so clearly about investment topics that the company's annual meeting is so well attended, and it is called 'Woodstock for capitalists'. Lest you think that 'Buffett-errible' is ridiculous, I would point out two book titles: <u>Buffettology</u>, and <u>Invest Like Warren Buffett, Live Like Jimmy Buffett</u>. OK, "Buffett-errible" is ridiculous, but is not alone.

Berkshire Hathaway has holdings of both public companies and private companies. Some of the larger public companies in which it invests are American Express, Coca-Cola, Freddie Mac, Gillette, Washington Post, and Wells Fargo. Its private company holdings are less well-known, with the exception of GEICO.



Value investors were out of luck in 1999, and Berkshire Hathaway investors were not spared. Class A shares fell 19.9% in 1999.

Buffett takes the bulk of the blame for the year's poor showing, and explains that 'several of our largest investees badly lagged the market in 1999 because they've had disappointing operating results.' As you may know, in 1999 the market rewarded high growth companies, ignored those with low growth, and decimated those with negative growth.

Buffett tries to invest in companies that 'have important competitive advantages that will endure over time… This explains, by the way, why **we don't own stocks of tech companies**, even though we share the general view that our society will be transformed by their products and services. Our problem – which we can't solve by studying up – is that we have no insights into which participants in the tech field possess a truly *durable* competitive advantage.'

While he does not predict when the market will enter a bear market, Buffett offers: 'If investor expectations become more realistic – and they almost certainly will – the market adjustment is apt to be severe, particularly in sectors in which speculation has been concentrated.'

So where do I stand on Warren Buffett? I continue to admire him. He never claimed to understand technology, and made clear that he only invests in things that he understands. I don't think that he should need to apologize for this. Investors in Berkshire should understand that it holds companies that are not sexy, and that during times when sexy sectors lead, Berkshire will lag. 1999 was such a time, and while the 20% drop is painful, the stock had risen 175% in the past five years (for a +22% compound annual growth rate).

1999 provided a **lesson for investors**. Know who is managing your money, and their approach. Try to distinguish between results that are due to their approach and results that are due to their execution of the approach. Buffett claims that he executed poorly in 1999. I suspect that the bulk of the poor results were due to the value approach, which led to disappointments in 1999 for most value managers.

In February, I purchased shares of Berkshire Hathaway (class B) for a client. These are the first shares of BRK that I have had the pleasure to purchase. I plan to close my eyes on this stock for a few years, and let Warren work his magic.

Upcoming Seminar—Can You Attend?

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I will be offering a series of four free seminars on investing. They will be held on the first four Tuesdays in May, from noon to 1pm, at the Unitarian Universalist Fellowship of Newark, on 420 Willa Road, in Newark. Attendees are encouraged to bring their lunch. **Advance registration is required**, due to space limitations. Please phone or email my office to register. The first class will review **investing fundamentals**. The second class will cover **stocks**, the third will cover **bonds**, and the fourth will cover **mutual funds**. These seminars are open to the public, so feel free to mention this to family or friends.

Past Conferences

In early February I attended two conferences. The Groundhog Day conference showcased many companies, including several Pennsylvania-based companies. Safeguard Scientifics, one of my clients' top holdings, and its offspring companies received particular attention.

The second conference I attended that week was a Linux conference in New York City. Linux is a computer operating system (NOT made by Microsoft), and is also a movement amongst software developers. Stocks with Linux ties enjoyed strong returns in 1999. I wanted to learn more about Linux, so that I can better assess the investment characteristics of companies involved in this sector.