

THE FULL CIRCLE

Regular readers pretty much know where we are coming from most of the time, so it would appear to be overkill to reiterate what we have written about all year long in regard to the inevitable resolution of the conflict between common sense and “New Economy” thinking. But sometimes you just can’t help yourself. As an inveterate “news clipper,” it was particularly amusing for me to go back over the past year and rehash what passed for conventional wisdom in the press and within the analyst community. It simply seems unbelievable how quickly utter nonsense became the norm and again how quickly it has faded into...reality.

Thus, we will dedicate the first installment of our first Strategy Letter of 2001 to a somewhat chronological view of 2000, providing bytes of post-mortem anecdotal evidence so that you, too can claim to have seen it coming and join the large crowds that held 100% in cash in October 1987, bought Microsoft and Wal-Mart on their IPOs and held them, and really do live in Dade County and voted for Al Gore.

January 2000. The Beginning of the End

Robert Markman of Markman Capital Management, who seems to have an unbeatable PR firm because we see him quoted all over the place, had this gem of a quote in Investment News, a fairly decent investment industry weekly. “*There is no value to be added by having value in a portfolio.*” He then went on to contend that a client’s entire portfolio should be invested in the fastest growing companies. It should also be noted that he shifted out of value in favor of the tech go-go stocks in late 1999.

As a postscript and a perfect example of how the press sometimes resembles a unique intellectual organism devoid of any memory, Investment News comes back to Markman in its December 18, 2000 issue, where he states that he does not see any sign of a recession as “consumers are too strong and too active” and favors “broadband/storage.” All of this makes the obvious case that we clearly will be in recession by late 2001 and why storage king EMC is getting killed.

February: Twist the Earnings Until They Give

Conseco, the walking disaster of an insurance company now in the hands of former GE Capital executive and the Alex Rodriguez of executive compensation, Gary Wendt, reported Q4 earnings where nearly 50% of the number was an UNREALIZED GAIN. We have written previously about how certain companies woke up in 2000 to discover that their true vocation was investing rather than running their core businesses. Therefore, why not bundle investment gains with operating earnings, since it was obvious that these gains were the result of easily repeatable genius? It’s one thing to try and keep a straight face when you include cash-in-hand realized gains, but it’s otherworldly to make the same case for paper gains. It will be VERY interesting to see what will happen in 2001. If the gains are okay to report in operating income, will the same people then state that the inevitable dot.com write-offs are one-time charges?

March: The William Shatner Era

There is nothing in the human genetic code that prevents “celebrities” from investing intelligently. But practically speaking, there does appear to be some disconnect, as the concept of “celebrity” involves some coordinated and personal attempt at machining high profile positive PR. Successful investing, on the other hand and in our humble value-oriented opinion, is geared toward a quiet analysis of things that aren’t so obvious on surface.

Which brings us to William Shatner and PriceLine. One could argue that PriceLine’s plunge from \$185 to \$2 a share says it all, but somehow we don’t think subtlety will suffice in this case. So that we do not offend any closet “Trekkies” who may be clients, let us then state that the buyer should be very aware (and scared) when his company has financially enticed an aging and out-of-shape former celebrity to represent them via aggressive media campaigns in which the viewer’s first reaction is to visibly cringe.

Also in March, a portfolio manager in the Wall Street Journal dartboard vs. the investment pros contest recommends the purchase of Commerce One at \$125. “Although the company is not close to making money, it is one of the opportunities to invest in businesses that are changing the ways things are done. You can’t rationalize too much or you won’t participate.” Current price: \$21.

April 2000: Fire the Messenger

Pioneering Portfolio Management by David Swensen is our personal favorite for best investment book of the year and it should be must reading for anyone who works in the investment business or sits on an investment committee for a foundation or retirement plan. Among other issues discussed in a plain and non-sense fashion is the idea that once you have set up an intelligent investment plan and hired intelligent managers to execute that plan, the worst thing you can do is take money from the laggards and/or fire them and give money to

those who have recently outperformed. This fairly intuitive advice is obviously one of the most ignored pieces of common sense in the investment world and the year 2000 was a poster child for it. It would be safe to assume that nearly every dollar that went into a Janus fund in 2000 came from a value manager, and the inflows peaked this month, as did the relative performance of growth versus value. Among the near legendary value managers who were fired or “retired” in the top of this trend were Bill Sams at First Pacific Advisors, Gary Brinson at UBS Brinson, George Vanderhagen at Fidelity, Julian Robertson at Tiger Management, and Tony Dye also at UBS.

On a similar note, long time value manager Neuberger and Berman launched a new technology fund in order to stem the tide of client and mutual fund defections from the value approach. Also in March, the Industry Standard, which is the Barrons/Forbes/Business Week of the New Economy, peaks at close to 300 pages, an extraordinary showing for an ad-based weekly.

May 2000: You Know You are Getting Older When....

The author becomes personally tired of stories of business school students leaving Harvard for a start-up dot.com and recalls an older indicator from somewhere in the distant past where someone postulated and proved that there was an inverse correlation between the performance of the stock market and the percentage of Ivy League MBAs going to Wall Street. (The author does not have an MBA, for the record.)

Newspaper headline on Berkshire Hathaway with the A shares trading under \$50,000: “Tech Phobia May Topple Buffet.” (RCB establishes initial position.)

Bill Clinton hosts the White House Conference on the New Economy, confirming that whatever is happening in technology, it certainly isn’t new anymore. (Reason Magazine.)

June 2000: Spinning Gravestones

Attendance at the annual seminar on value investing at Columbia University, the intellectual home of value investing (Ben Graham taught Warren Buffett there) was down 75% year over year.

Sales of the book Dow 36,000 (trashed by RCB in a former Strategy Letter) are surpassed by Gary Shilling's book, Irrational Exuberance.

A breath of sanity occurs as the UK's Financial Service Authority, the UK equivalent of the SEC, threatens to ban the use of performance statistics in the advertising and marketing of retail financial products. The FSA did an intensive study into whether past performance is in any way indicative of future performance and concluded that "such evidence is not forthcoming." The study confirms numerous other US based studies and confirms the inevitable pull of reversion to the mean.

July 2000: Sprecken Zie Shareholder Value?

Deutsche Telecom signals the beginning of the end for the wireless mania by grossly overpaying for US wireless concern, VoiceStream. Even the CEO of France Telecom termed the price "ridiculous", which despite centuries of animosity still says a lot given some of the deals they've done. And what's with these Germans? With this deal coming on the heels of the unwinding debacle at Daimler Chrysler, it appears that the German corporate world has firmly taken the title of worst cross-border acquirer from the Japanese.

August 2000: Value managers Still Waffling Despite Improving Relative Performance

Deep value manager Sanford Bernstein initiates coverage of PriceLine at \$27 with a "market perform" even though their "aggressive" model inputs conclude with a \$14 per share value. "We do, however, recognize the fact that

Internet companies have seldom conformed to traditional valuation metrics and thus do not view this as a source of concern." See William Shatner for further details.

September 2000: The Ultimate Sign of the Top

This writer excitedly accepts an offer to write for GrantsInvestor.com and when given a choice of cash or stock options, picks...no, leaps, for the now worthless options.

In an interview in the Industry Standard, former McKinsey consultant and internet incubator guru John Hagel releases a study concluding that if you give the top 36 internet companies 20% after-tax profit margins and extrapolate current growth, you still only come up with \$45 billion in market cap of intrinsic value. Current market value: \$594 billion.

October 2000 In All Fairness to William Shatner

While Michael Jordan looks a heck of a lot better in tight pants and a turtleneck than William Shatner, the announcement that he would be joining the board of Divine InterVentures, a recently launched public internet incubator raises eyebrows. Not that Divine needed the celebrity kiss of death. The whole idea of a publicly traded venture capital fund, or less kindly, a blind investment pool, is a terrible one. No one in the post-war era of American equity securities with the exception of Warren Buffett (history buffs prove me wrong) has been able to run a de-facto publicly traded investment pool and have it sell at a premium to net asset value. The idea that someone who has done one great deal, wears a goatee and has cool office space can somehow patent a Midas touch investing in private companies has been and will continue to be an absurd concept. As hopefully the last of its kind, Divine in particular was a tortured deal that Robertson Stephens among others should and did know better than to hoist upon the public markets and was another painful

reminder that in IPOs, investment banks owe their allegiance to the selling client, not to the buying client. Offering price: \$9. Current price: \$1 23/32.

November: Tensions Fraying in the Analyst Community

PSINet, an Internet Service Provider, states that it is putting itself up for sale after announcing large operating losses for the current and foreseeable future. Says a terse David

Levy, an analyst at Chase H&Q in the Financial Times, in what could be an epitaph for the many companies in the sector: "The future of this company is very bleak. It has been systematically mismanaged both financially and operationally."

December 2000: The Full Circle

The Industry Standard comes in at a trim 96 pages and a table worth a 1000 words:

The 20 Largest Internet Related Companies - Yesterday and Today

Date: 12-26-2000

Company	Year-end Price 12/99	Year-end Market Cap (\$bil) 1999'	Current Price	Current Market Cap (\$bil)	% Change in Price 52 Weeks
America Online	\$75.88	\$181.8	\$38.28	\$89.3	-52.9%
Yahoo! Inc	\$216.34	\$84.1	\$29.56	\$16.5	-85.3%
Amazon.Com Inc	\$76.13	\$30.2	\$15.56	\$5.5	-82.7%
Internet Capital Group	\$170.00	\$27.0	\$3.63	\$1.0	-98.0%
CMGI Inc	\$138.44	\$22.1	\$6.88	\$2.1	-94.9%
Akamai Technologies	\$327.63	\$22.1	\$23.56	\$2.5	-91.6%
eBay Inc	\$62.59	\$21.0	\$35.00	\$9.4	-50.8%
Juniper Networks	\$56.67	\$18.1	\$123.13	\$39.1	128.5%
Excite@Home	\$42.88	\$14.9	\$5.88	\$2.4	-86.7%
Exodus Communications Inc	\$44.41	\$14.1	\$22.13	\$9.3	-47.9%
Terra Networks	\$54.75	\$13.7	\$11.00	\$3.0	-79.6%
Verisign Inc	\$190.94	\$12.6	\$80.44	\$15.9	-53.8%
RealNetworks	\$60.16	\$11.4	\$7.84	\$1.2	-88.3%
Doubleclick Inc	\$126.53	\$10.9	\$10.03	\$1.2	-90.5%
Intuit Inc	\$59.94	\$10.7	\$35.25	\$7.3	-39.8%
Ariba Inc	\$88.69	\$10.5	\$54.59	\$13.5	-32.6%
Commerce One	\$98.25	\$9.6	\$23.31	\$4.5	-76.6%
Openwave Systems	\$115.94	\$9.2	\$45.88	\$3.8	-61.2%
Portal Software	\$51.44	\$9.0	\$5.75	\$0.9	-89.6%
Priceline.com	\$47.38	\$8.7	\$1.28	\$0.2	-97.7%
TOTAL		\$541.7		\$228.7	-63.6%

Source: 'Barron's & Zacks Research

Note: The Inevitable and Upcoming Year Ahead Review follows next week.

In an effort to provide these Investment Strategy Letters to our audience in a more timely and efficient fashion, we are working to convert their delivery to an e-mail format. Please send your e-mail address to Cristina Gomez at cgomez@rcbinvest.com.