

JULY 1997

## Tiger Woods Will Shoot a 41 In 2007

*Since Tiger's average golf scores have fallen from 80 ten years ago to 67 now, he will eventually have rounds in the 50's and even 40's in the next decade. Ridiculous as it sounds, this is the type of logic applied by many investors in today's stock and bond markets. We think Tiger Woods and current market conditions may be the best ever, but are convinced that there are mathematical limits to both.*

Just as Tiger Woods marvels the golf world with long, straight drives and a superior short game, the current economic climate is perfect for the stock market. Global growth opportunities, high corporate profitability and low interest rates are the basis for unprecedented optimism. The investment confidence is so strong that some feel that no price is too high for a stock as long as it is in a large, recognizable company. Taking the analogy further, advertisers are pouring money into Tiger's coffer as fast as investors are buying stocks. Today's common investment mantras include "Where else are you going to put your money?"; "Just think how many Cokes the Chinese will drink" and "Inflation is dead".

As we have discussed in previous newsletters, we are skeptical as to whether inflation will remain in check. On the labor front, for example, a shortage of workers exists throughout the country, forcing many companies to pay higher wages. In addition, the military has substantially sweetened its compensation terms in order to

attract new candidates. We also wonder whether employees have tempered demands for higher wages partly because of the remarkable investment gains they have witnessed in their 401-K and retirement accounts.

Some non-wage inflation issues also trouble us. The strong U.S. dollar has contributed to our low inflation rate since we have been able to buy inexpensive imports. This situation could reverse and cause inflationary pressure. Compounding the problem of a weak dollar would be foreign selling of vast holdings of U.S. Treasury debt which may result in higher domestic interest rates. Finally, and most esoteric of all, is the fact that stocks are going up partly because it is assumed that inflation is gone. However, what if inflation actually resides in stocks this time? Historically, inflation has been focused in gold, real estate and other assets so why not hide in stocks for awhile?

The ideas for our summer 1997 newsletter arose from discussions with Judith Vicks Sweet, CFA,

our Chief Investment Officer, upon her return from an investment conference sponsored by the Association for Investment Management and Research (AIMR) in New Orleans. Aside from us, the nation's leading investment advisers were in attendance and shared their latest investment techniques and strategies.

Judy was amazed to learn how many billions (trillions?) of dollars are currently managed by exotic computer programs which use quantitative methods to forecast future returns. Earnings momentum models, market timing and sector rotation strategies were in abundance, and many money managers bragged about their proprietary multi-factor models. Judy wondered whether these "high-tech" investors ever ask their computers simple questions such as "Are oil companies a good buy because supply is shrinking and demand is growing?" or "If a company's earnings are projected to grow faster than its revenues, won't their earnings be larger than their revenues some day?" Perhaps common sense questions simply do not compute on some of Wall Street's computers.

We wonder if these computer models would calculate Tiger Wood's scores over the last decade and boldly predict his shooting an average score of 41 when he plays in the year 2007. Tiger, and the market environment, may be the best ever, but they can't be that good.

So what do we do in this market? We use common sense; we take some profits and diversify among superior high-quality bonds and stocks. Our equity investments are concentrated in reasonably valued Blue Chip stocks and in appropriate exposure to high growth, small capitalization and international equities. Importantly, among the Blue Chips, we have a significant allocation in oil and aluminum companies which offer a hedge against a resurgence in inflation.

Make no mistake, we remain committed to stocks (60% for balanced accounts), but continue to find better excuses to sell than to add new names to our Buy List.

**Andrew C. Burns**

*President/Chief Investment Officer*

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