

FEBRUARY 2003

Tina's New Printer

Tina is our newest employee. Since joining our Operations Team a few months ago, she has shared a networked printer with her co-worker. That is, until last week when our purse strings were dusted off and we made our first discretionary technology purchase in recent memory. While it would be silly to draw conclusions from one printer purchase, the research we have done on computer technology spending leads us to some positive conclusions.

Recall that when faced with Y2K at the conclusion of Calendar Year 1999, organizations worldwide increased technology spending well above normal levels as they replaced any electronic object inclined to fail when the millennium odometer clicked 2000. Thanks partly to that pre-emptive capital spending, Y2K was a non-event. Business disruptions were minimal because organizations were already running their shiny new mainframes, servers, PCs and the latest software packages. When the global investment markets soured during the last few years, non-essential technology spending was easily postponed.

A good proxy for the cyclical nature of technology spending is Intel, whose revenues grew 11% in 1999 and 14.6% in 2000. This growth, however, was followed by a natural economic slowdown, punctuated by the fateful 9-11 events. Technology spending dropped precipitously. Intel's revenues were off 21% in 2001 and have been relatively flat since then. From peak to trough, Intel's profits fell the same percentage as did the NASDAQ...80%.

We believe that corporate spending will pick up, and not a minute too soon. Our economy has grown through the recent malaise because of strong consumer spending which has been fueled by historically low interest rates. We expect consumer spending to moderate and to be partially offset by increased government spending. The most important issue now is whether corporations will increase their spending for capital items. If good corporate spending returns, we will avoid a double-dip recession and global growth will continue.

A recent poll published in Fortune Magazine indicated that 87% of CEOs expect their company's capital spending to be the same or higher this year. This datum is encouraging and supported by recent good news from notable computer manufacturers. Moreover, corporate technology spending was up 2.6% in the third quarter of 2002 as compared to a 5% drop in the same 2001 quarter. Responding to this expected growth, our Buy List of 33 companies now includes five of the technology companies we think will benefit most. Intel is among them.

Despite negative headlines and poor stock markets, the fact is our economy grew 2.4 % last year and is projected to grow over 3.0% this year. Most of the companies on our Buy List posted higher earnings in 2002 and 70% of those who pay dividends increased their payout. Just recently, two of our holdings, Microsoft and Perrigo, decided to pay dividends for the first time. Essentially every company we own had solid cash flow last year. As we have told our clients, the companies we own are doing very well...it is their stock prices that are depressed.

We remain focused on the big picture, particularly as it relates to global prospects. Over the last twenty-five years, the "West" has picked up around 2.5 billion new potential customers out of a world population of 6.0 billion. China, India and Russia have embraced capitalist-based models as ways to improve their standards of living. These countries seek cleaner water and better medicine for longer life spans for their citizens. Fulfilling these needs will engender global growth for decades to come. We believe the selected well-managed global companies will take advantage of this encouraging phenomenon.

Serious troubles exist in the Middle East and elsewhere. It is refreshing, however, that the United States, Russia and China are coordinating, to a degree, their conversations regarding both the Middle East and North Korea. This is an immeasurable improvement over the old Cold War situation wherein every conflict had to be sorted out vis-à-vis the ongoing conflict between the West and East. Despite how uncomfortable the situation seems right now, we have a hunch that things will work out better than expected because the vast majority of the world is united against rogue states and in favor of more freedom. As an example, there are

very recent and comforting indications from Saudi Arabia that they seek democratic reform and the closing of U.S. military bases in their country once Iraq is liberated.

We scour Wall Street for well-managed companies with predictable and growing businesses. We have been quite active in the last few years and have added some terrific companies whose valuation has finally come in line with earnings potential (witness Intel).

In conclusion, Wall Street can be a funny and, at times, frustrating place. Investors seem much more comfortable when they buy high than when they buy low. If Wall Street was a department store, it would scare off customers when goods went on sale. There exists approximately \$2-3 trillion of investors' cash sitting on the sidelines, waiting to buy stocks once they move higher. Go figure, or in Tina's case, go print.

Your comments and questions are always welcomed.

Important Disclosure: "It should not be assumed that recommendations made in the future will be profitable or will equal the performance of the securities discussed in this newsletter."

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