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Greenspan Versus the Postal Service

Alan Greenspan's policy of startlingly low interest rates may well cause postal revenues to drop. Any good capitalist knows about the "time value of money" but few realize just how far the concept can go when interest rates are this low. To clarify, consider the fact that one is currently better off prepaying by one year any monthly household bill less than \$52.86 because the money saved on 12 stamps is greater than the earnings on one's own cash. (Assume 0.7% money market return and no value to either your time or the envelope.)

We have little interest in the postal service, but allow us to explore why interest rates are so low and the related variables influencing investors at this time. We believe Alan Greenspan is keeping rates so low because he must encourage the global economy to grow. He especially wants to see U. S. consumers bolstered by low mortgage rates and he welcomes the fact that low interest rates refuel our banking system's capital base. Low interest rates are part of his easy money policy for growth, but also reflect the deflationary impacts of globalization (cheap labor) and technology-driven productivity, which have both held inflation in check.

Ideally, life goes merrily along with low interest rates, stable currencies and low inflation. However, a risk we face going forward is the likelihood that federal and state budget deficits will be financed via borrowing. By our reckoning, the U. S. must borrow another trillion dollars in the next few years to keep the global economy percolating. While interest rates are low now due to tepid

growth and a flight to safety by bondholders, it is very possible that rates may have to rise appreciably in order to attract investors. This has certainly started to happen over the last few weeks.

To protect against possible higher rates, we have allowed the average maturity of our clients' bond portfolios to drift to the low point of a 3-5 year targeted range. We have also selectively liquidated some long-dated bonds. As rates rise, we will extend these maturities accordingly. "Patience is a virtue" in this fixed income market and we are not trying to "reach" for yield at this time.

Rising interest rates are not typically good for the stock market. However, we expect to see that rule violated. For one, higher interest rates may be accompanied by improved global growth. This growth should translate to higher than expected profits by large companies with the right global reach (not every Blue Chip will play its global cards properly). For example, the emergence of new con-

sumers by the billions over the next 20 years will provide continued growth opportunities for companies such as Coca-Cola, Colgate-Palmolive and many of the other Blue Chip stocks we own. Please note as well that interest rates can rise from here, yet still remain well below historic norms.

As discussed in our last newsletter, another rule likely to be broken is the historic one which connects a good stock market with strong employment in the United States. Unfortunately, tomorrow's global prosperity may mean that millions of Americans lose high paying jobs or see their pay collapse by 10%-20%. Ford (not on our Buy List) has announced 10% pay cuts across the board and some predict that millions of computer technology and software jobs will leave the United States in the next ten years for low cost (and high expertise) places like Russia, China and India.

Selected stocks may do very well in the face of possible higher interest rates and a poor domestic employment outlook. Notice the emphasis on the word "selected" in the prior sentence. It is important to note that the crosscurrents from global growth that we foresee will benefit some companies but certainly hurt others. Our advice is to sell the Blue Chips that are screaming for more protectionism and buy those that are learning how to speak Chinese.

We expect a "stock picker's market" where not every large company does well simply because it is large. This is reflected already in the fact that we have been able to outperform index funds (which must own all large stocks) over the last three years. Fortunately for our clients, our size allows us to

deftly own just 30-35 of those companies that meet our proprietary screens for quality, growth and management integrity. We also employ a global equity manager for wider diversified global exposure.

As for dividends, we see opportunity but have words of caution as well. The reduction in the tax on dividends is welcomed. Previously, and too often, companies viewed enhancement of their Wall Street "image" a more valuable strategy than the production of cash. Our stock selection process has always rewarded a company's ability to produce cash relative to its market value as a key fundamental (that's how we avoided so many of the popular stock meltdowns). A warning to investors, though, is to let the market settle down a little and allow historically low dividend paying companies to increase their dividends. Avoid jumping on a high yield too soon, only to own low growth, or a tainted company, as a result.

In conclusion, save some time and stamps and prepay the milkman if you want to maximize returns. Who knows, maybe the Postmaster General will "one up" Greenspan and drop stamp prices! Secondly, celebrate the fact that we no longer count China and Russia as enemies and be prepared for global competition over jobs. The global pie will grow, creating tremendous investment opportunities if one is careful.

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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