Trusted Advisor

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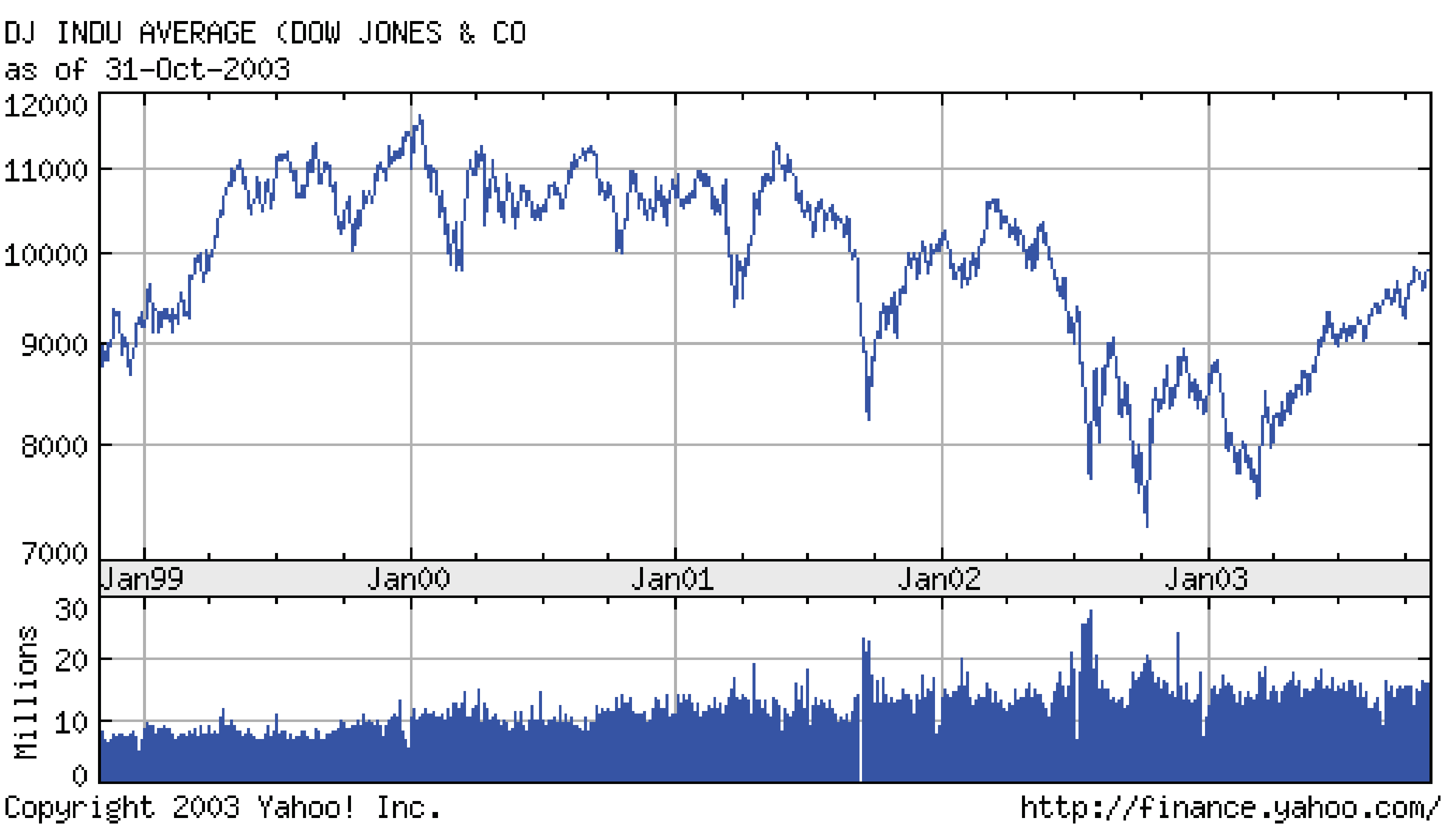
Dow 10,000?

The last time this monumental level was breached 2 years ago, stock investors were on the verge of suffering a subsequent 30%+ plunge in the index over the following ten months. No wonder I'm leery of making new equity commitments, despite signs of an improving U.S. economy. Looking at the past five years, the 10,000 Dow level can be considered in technician's terms, "over head resistance". It has been penetrated a couple of times, but then the market has twice fallen through this important mark, and collapsed violently thereafter (see chart below). It has become "over head resistance" (note the body of trading between 10,000 and 11,000 on the accompanying chart)

Is this merely technical babble from those who think they can predict the future by looking a black lines on graph paper? Hardly. Resistance levels have cogent behavioral bases, as I'm about to explain, in somewhat tongue and cheek fashion: Over head resistance is something like the infamous "Glass Ceiling" at corporations, difficult to define, and even more difficult to penetrate. Like the Glass Ceiling, over head resistance in the stock market has a lot to do with gender.

Overhead resistance develops when a large body of investors has positioned themselves in stocks, and subsequently has watched the value of their holdings decline. Most of these investors are *married men*. Men do not like to be proven wrong. So if their stock picks decline, they find myriad ways to justify the fact that "the market" is wrong and they, in their infinite wisdom are in fact correct. Most importantly, these investors insist this stock (or index) will soon "come back".



Certified Financial Planner™

Gary Miller is in his 30th year of providing financial guidance to individuals and pension plans. He is a Registered Investment Advisor and a Certified Financial Planner ™ Practitioner. Gary holds a Certificate in Personal Financial Planning from the University of California, Irvine and has served as a Board member of the Financial Planning Association, Orange County Chapter.

Think about all the guys who bought stocks in the last rally, near Dow 10,000 two years ago, and for that matter those who bought in early 1999 near the first breach of 10,000. Have these guys sold? Not many. Are they about to be proved right? You betcha, or so they think - and this is where *married women* enter the picture. While most of these brilliant Male investors, who have been sitting on loser stocks for 24 to as long as 56 months are checking the internet every ten minutes with baited breath, hoping to see their judgment and patience vindicated, their wives are thinking how ratty the sofa looks, with the holidays approaching or how nice it would be to ski in Aspen this winter or how the kitchen really needs a major remodeling.

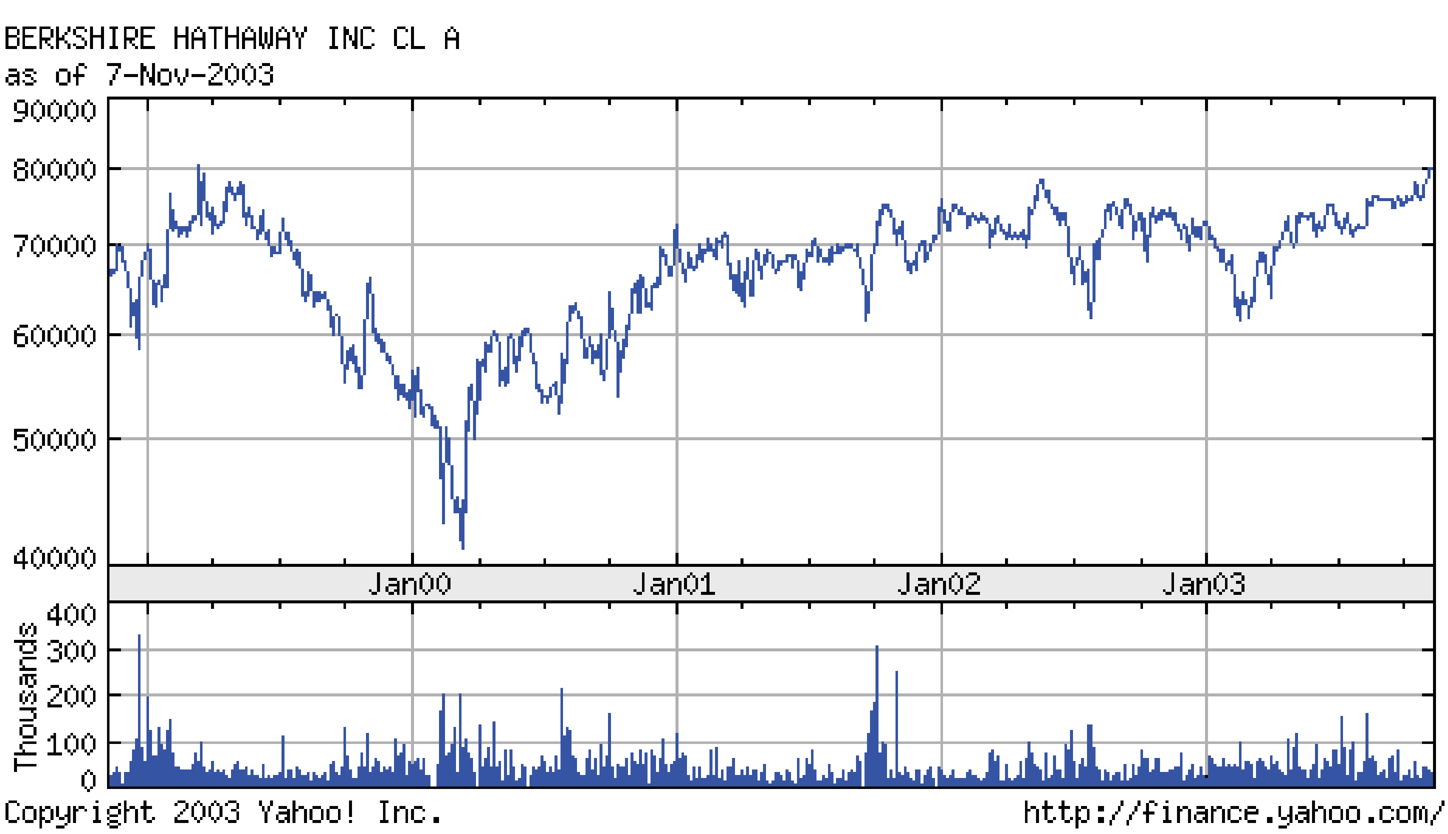
These patient wives are fully aware that the market has finally come back, because their husbands have been heralding victory every night at the dinner table. These ladies do not want to see all that money melt away again and realize that the time is right to begin working on their husbands to sell those *lousy stocks* in order to pry loose funds for overdue household expenditures! A certain percentage of these wives will be successful (98%), and those who are not will make their husbands *suffer for the rest of their lives!*

So now you understand "over head resistance". Until most of the stocks that male investors bought years ago at around 10,000 Dow are sold, there will be a large amount of supply meeting whatever demand for stocks may arise from a new crop of younger and less experienced husbands now entering the market!

At best, the market should stall in the 10,000 to 11,000 range for months before eventually advancing. At worst, 10,000 to 11,000 is the top for this market cycle. That's why I have been taking selective profits on some of our holdings, and why I have re-pledged myself to buying only companies that are cheap using discounted free cash flow as the metric.

"Berkshire Earnings Soar"

This was the headline in Saturday, November 8th's *Wall Street Journal* On Line. Most clients hold a significant portion of Berkshire Hathaway, either the class A shares trading near $80,000 or the fractional share Berkshire B trading at about $2,650. As I've often explained, Berkshire is a collection of many, many businesses that have been chosen because they enjoy a unique and/or protected market niche and high quality management. But above all, Berkshire is an insurance company – those people we love to hate until calamity strikes and we are glad we are covered. I noticed Berkshire suddenly climb from it's trading range in the mid $70,000's during the California fires. My theory is that Berkshire, a major property and casualty underwriter, was not exposed to most of the lost homes, but will benefit as homeowner's insurance premiums climb in coming months to help the industry recover from this big hit. Perhaps the reason for the rise was leaked rumors of the great earnings the company was about to report. As this is written, the firm just announced record earnings, 38% higher than last year at this time.



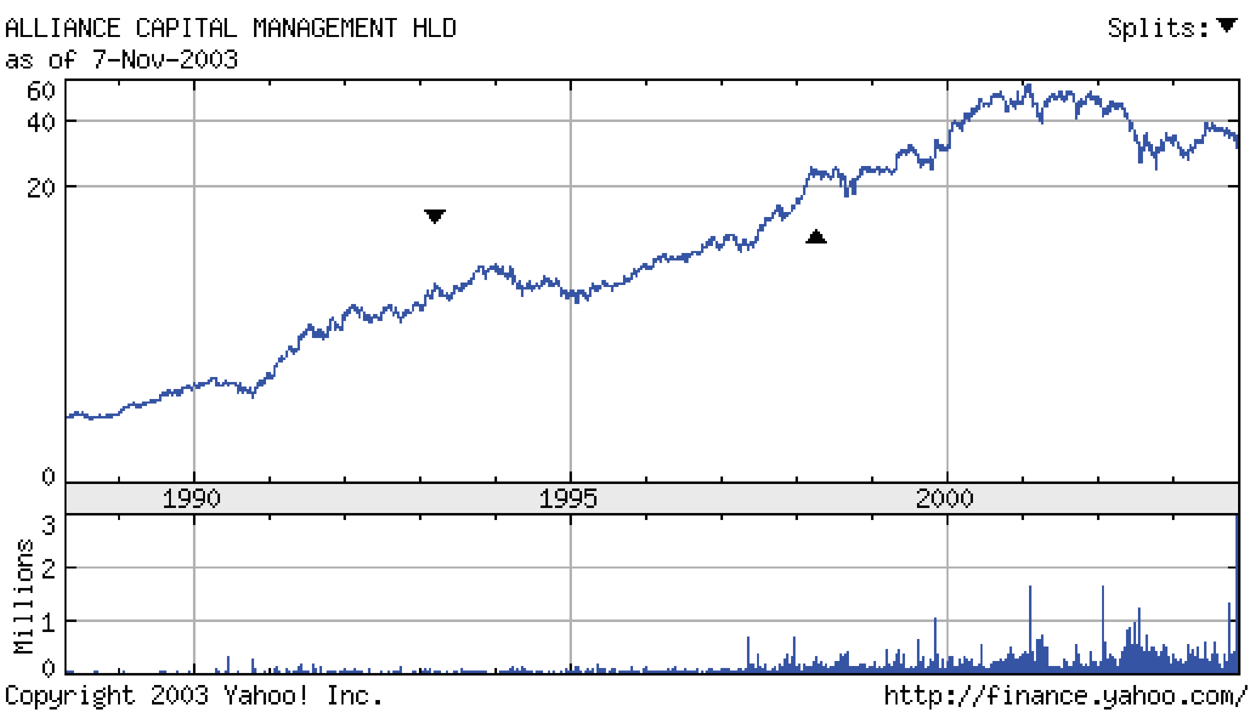
Fixed Income Challenge

A recent article in *Barron's* provides statistical backing for what has become evident to me: bonds have entered a phase of historically high volatility, diminishing one of their greatest attributes: the ability to dampen volatility when incorporated in a diversified portfolio. As the utility of long term bonds comes into question, and yields on short term instruments remain near the lowest levels in memory, the challenge to find substitutes grows. I've anticipated rising interest rates for some time, so have steadily reduced portfolio duration by exiting long term bonds and shifting to "bond substitutes". These include REIT's (Real Estate Investment Trust) and MLP's (Master Limited Partnership) that are not taxed at the corporate level, pay high dividends and which are, in my opinion, likely to increase cash payouts over time. This strategy has generally proven successful in the past twelve months, with most of the REIT's scoring double digit total returns and until recently our two MLP's doing equally well. But the sad tale of Alliance Capital, L.P. highlights that this alternative income strategy has risks as well.

I've used this MLP as a client investment vehicle at various times since it's new issue in 1987. As assets under management ballooned to over $500BB in the last bull market, the company became one of the world's premier asset managers. Alliance's dividends blossomed accordingly, as did it's share price, which reached the high $50's in 2000. Alliance benefited from a stable of successful growth funds, including it's flagship *Alliance Technology* fund, and rode the high tech bull market throughout the '90's. While many retail investors know of the Alliance mutual funds, 70% of it's assets under management are provided by institutions, including some very large pension funds.

In September, under pressure from New York State regulators, Alliance revealed that it, like other fund companies, had given specialized treatment to large institutional clients. Two of Alliance's funds permitted trading in shares after the major markets closed.

It appears that the company's future earnings will suffer as it makes restitution to mutual fund shareholders, and pays the lawyers, but the worst may be coming: In the week ended November 7 2003, a competing miscreant fund company, Putnam, had been told it would see the exit of some $4BB (yes, Billion) of institutional money. State pension funds from Iowa, Pennsylvania, Vermont and Rhode Island left Putnam, while the State of California is considering similar action. Another $4.4BB of mutual fund dollars took to the exits in one week as well.[1] When I learned on November 6 that Alliance has received a "Wells Notice," meaning the Securities Exchange Commission is planning to charge the company with violating regulations for similar activities as Putnam's, it was time, in my opinion, to exit this holding. This is one of those cases where a company with a lot going for it has blown years of good will. Not a place for my clients' money!



(Footnotes)

1 "Investors Pull $4.4 Billion From Putnam", Wall Street Journal November 7 2003