

# THE TANDEM REPORT



## MARKET COMMENTARY: *... Waiting for a Clearer Picture*

*"When you come to a fork in the road, take it."  
- Yogi Berra*

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### MARKET SCORECARD:

S&P 500:

<i>year-to-date</i>	<b>-7.26%</b>
<i>1 year ended 6/30/01</i>	<b>-15.82%</b>
<i>3 years ended 6/30/01</i>	<b>2.59%</b>
<i>5 years ended 6/30/01</i>	<b>12.79%</b>
<i>7 years ended 6/30/01</i>	<b>15.57%</b>

Is the domestic economy in the midst of a deepening recession, or on the cusp of economic recovery? Are equities still inflated, or underappreciated? With no compelling argument for future direction emerging, we are at the proverbial fork in the road. From the present vantage point, it is difficult to discern a clear vision of either path. Which way to turn?

Our inclination, as always, is to favor the optimistic route. We have observed previously that we cannot recall encountering many successful pessimists. One must be open to finding opportunity when it presents itself, and a mindset given over to pessimism makes this a more difficult challenge.

The wise optimist, however, is grounded in pragmatism. Thus, as we stand at this fork deliberating over the economy's direction and the stock market's fortune, we know the path to follow, but we are in no particular hurry to begin our journey. Allow us to explain.

The Federal Reserve has cut interest rates six times this year by a total of 2.75 percentage points. Monetary policy has been aggressive. There is historically, however, a lag time of six to twelve months before interest rate moves begin to impact economic conditions. The improved rate environment will most likely lead to an increase in economic activity in the third quarter. Yet, there are few signs

*(Continued on page 5)*

## RANDOM TOPICS

A new feature, this section may recur periodically. We thought it an appropriate place to share some thoughts.

In this issue, we put the spotlight on AES Corp. While AES relies very little on the U.S. energy markets, the

company does sell energy in California. At the risk of offending some, we feel compelled to opine on the topic of deregulation. We fundamentally believe in capitalism, and encourage government to refrain from interfer-

*(Continued on page 5)*

# TOP TEN HOLDINGS IN THE TANDEM GROWTH COMPOSITE

AS OF JUNE 30, 2001

The list to the right reflects our ten largest holdings, ranked by total market value, in the accounts that make up our Tandem Growth Composite. The order has changed since our last report. Only Pfizer and Applied Materials retained their positions. Amgen and Mellon declined in price and fell from the list, while Exxon Mobil shares gained better than 9% during the quarter, allowing the company to make its first appearance on our list at #7. Tyco makes its initial appearance on the list as our 9th largest holding.

One year ago, we published our Top 10 holdings for the first time. While the order has changed, six of the ten names remain the same. Given the market's volatility over the past twelve months, this statistic, we believe, is a testament to our patience with the stocks we own.

1. General Electric
2. Pfizer, Inc.
3. Merck & Co.
4. Microsoft Corp.
5. AES Corp.
6. Applied Materials
7. Exxon Mobil Corp.
8. Johnson & Johnson
9. Tyco International
10. Home Depot

More detailed information about the Tandem Growth Composite, its performance, and the accounts that comprise it are available upon request.

## TANDEM NEWS

This publication marks the one year anniversary of *The Tandem Report*. We greatly appreciate the positive response we have received from our clients. It is our intention to make this a useful piece to you, and we welcome your input. Thank you for helping us get *The Tandem Report* off to a successful start.

Last quarter we reported a change of address. This time, our Charlottesville office has a new area code. We are told that 804 will continue to work for a while, but the new area code is 434. Please make a note.

A new service we would like to experiment with is e-mail updates of timely events such as purchases

and sales, or confirmation of deposits and withdrawals. If you would like to participate in this experiment, please contact John Carew at [jcarew@tandemadvisors.com](mailto:jcarew@tandemadvisors.com) or Allen Ouzts at [caotandem@email.msn.com](mailto:caotandem@email.msn.com). We will see how it goes, and keep you informed.

If you know of someone that might enjoy receiving a complimentary copy of *The Tandem Report*, please inform Jennifer Tyson at (800) 527-0101, or e-mail the name and address to [jtyson@tandemadvisors.com](mailto:jtyson@tandemadvisors.com). We always appreciate your spreading the word.



# SPOTLIGHT ON AES CORP.

(JULY 19,

2001)

AES CORP. (NYSE:AES)

RECENT PRICE: 36.68

52 Week Price Range: 36 – 72.813

Dividend Yield: 0.0 %

Earnings Yield: 6.6%

P/E Ratio on 2002 EPS: 15.2

Earnings Per Share: 1998  
.84

1999  
.96

2000  
1.46

2001  
1.84(E)

2002  
2.41(E)



Source of chart and estimates: CNBC.com

### Long Term Growth Rates:

Next 5 years - Median: 30.0%

Number of brokers estimating: 11

Last 5 years Actual: 30.7%

### Description:

AES is the world's largest global power company, comprised of competitive generation, distribution, and retail supply businesses in Argentina, Australia, Bangladesh, Brazil, Canada, China, Dominican Republic, El Salvador, Georgia, Hungary, India, Kazakhstan, the Netherlands, Mexico, Pakistan, Panama, the United Kingdom, the United States and Venezuela. As an international independent power producer, the Company owns or has an interest in 173 power plants in 27 countries.

AES Corp. has been a Top 10 holding at Tandem for some time, and has provided exceptional returns over the past several years. Oddly enough, the stock has given back considerable ground since October, just when energy and deregulation are in the news. We thought this would be an appropriate time to share our thoughts on the fifth largest holding in our growth composite.

Founded in 1981 as Applied Energy Services, AES has aggressively expanded domestically and

overseas to become the world's largest power company. Unlike the average utility, this company's common stock is not for the faint of heart. The price has proven to be quite volatile, and many analysts give AES low marks for safety and financial strength. Much of the Company's growth has been financed through the issuance of debt. In fact, debt is 70% of total capital. That compares with a domestic utility company average of just over 50%.



## AES CORP. (CONTINUED)

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Adding additional risk is the Company's exposure to foreign markets. Only 38% of revenue comes from North America. Currency devaluations and political instability in many developing parts of the world have adversely affected the Company's earnings in the past, and likely will again. Further clouding the immediate future for AES and other power generating companies is the debacle in California.

In the past, AES has overcome these short-term obstacles, and established an impressive record of sustained earnings growth over time. Earnings per share for this company have grown every year since going public in 1991. The lowest increase from one year to the next was 6.0%, while the average annual earnings increase has been 27.9%. We believe management will likely continue to successfully navigate the Company through the short-term troubles, and view the future to be bright for the shares of AES.

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## SPOTLIGHT UPDATES

We started the spotlight series to better inform you about some of the stocks we own. AES Corp. is our fifth spotlight. We would like to take this opportunity to update you on the previous four, and how we currently view them.

**Dover** - Since our report in July, 2000, the stock price has fallen from 45 to 37.65 as of 6/30/01. That represents a decline of 16.3%, compared to a decline of 15.8% for the S&P 500 over a similar time period. For the last four quarters, Dover has issued earnings warnings. While this is understandable given the current economic environment, our confidence in future earnings dependability is waning. It is conceivable that the Company's earnings have become more cyclical than we had anticipated.

**Microsoft** - Since our report in October, 2000, Microsoft shares have gained 20.7% to 73 as of 6/30/01. The S&P 500 declined 10.5% over a similar time period. With a new Justice Department, and Judge Jackson's break-up ruling dismissed, we are confident that good things lie ahead for this stock as investors focus on the Company's business instead of pending litigation.

**General Electric** - Since our report in January, GE's price has risen 8.3% to 48.75 as of 6/30/01. The S&P 500 declined 7.3% over a similar time period. While we are disappointed that the merger with Honeywell fell through, we remain confident that GE will continue to be a stellar performer. CEO Jack Welch will step down in September, so there may be some weakness in the stock until his successor, Jeffrey Immelt, becomes established.

**Tyco International** - Since the April report, Tyco has appreciated 9.0% to 54.51 as of 6/30/01, while the S&P 500 appreciated 5.5% over a similar time period. We still have high expectations for this company and its shares.

These comparisons are meant to be updates, not accurate portrayals of returns. The returns calculated are not exact, because the price of each stock when initially reported was not on a specified date. We are using S&P 500 returns from quarter's end to 6/30/01, which may or may not accurately reflect a fair time period for means of comparison. That said, at least three of our four stocks are moving in the right direction.



## MARKET COMMENTARY

*(Continued from page 1)*

at present leading investors to believe that such improvement is imminent. As we have asserted in these pages on several occasions, a market rally typically precedes economic recovery. Attempting to time a rally's onset is beyond our capability.

Therefore, the prudent course of action is to take no action at all. To be sure, there are securities we find attractively priced. Many of them, in fact. But we already own them. By and large, we have left the portfolios we manage unchanged since last spring. We see no value added to a portfolio by moving in and out of the market. We prefer to exercise discipline and patience, rather than incur transaction costs and taxes.

If the market rallies from here, our portfolios will

benefit. If the market falls further, we will be in position to capitalize with the reserves we hold. We would prefer to wait for confirmation that a recovery is upon us before adding to our holdings. Yet, it is important to remember that we have this luxury available to us because we did not react to the downturn by selling securities.

Numerous studies reveal the futility of market timing. We are not nearly clever enough to repeatedly time correctly when to buy and when to sell based on the anticipation of market moves. We are confident that the companies we own will continue to expand their profits. Price will eventually follow. The legendary investor Sir John Templeton once asserted that the best time to invest is whenever one has the money. We would add to that one caveat. The wise investor, with a well-constructed portfolio, can afford to be patient. Or, in baseball parlance, a good hitter waits for his pitch.

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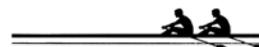
## RANDOM TOPICS CONTINUED

ing with the machinations of the free market system. It is our conviction that domestic deregulation of the utility industry is good and necessary. It is our opinion that California did not deregulate. Rather, the state created an environment in which supply has been constrained and demand has been artificially stimulated by holding prices below fair market levels. When markets are free and open, the consumer benefits. When markets are manipulated, even with the best and most noble of intentions, the consumer suffers.

On to another topic...Tandem supports charitable giving, and would like to share with you some ways to fund, or perhaps increase, the gifts you would like to make without breaking the bank. For larger gifts, we advise donating securities with a low cost basis. You receive the current market value as the basis for your gift, and the charity pays no gains tax, which you would have incurred. This is an excellent way to make a

commitment using stock you otherwise would not or could not sell due to taxation. For smaller gifts, you may consider donating items of little value to you that can be readily sold, such as an old car or frequent flier miles. These ideas allow you to have an impact on your favorite charity without having an impact on your wallet.

Lastly, we would like to share an observation. Most of our clients do not view themselves as wealthy. We have witnessed many times people failing to plan for the future because they didn't think they had enough to bother with. At twelve percent growth, money doubles every six years. After a long and healthy life, you certainly will have enough to matter. For your heirs' sakes, please have your wills checked, and make certain your loved ones, and not the IRS, benefit from your hard work.



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*...working in tandem with you to  
attain your investment goals*

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Tandem Investment Advisors, Inc. was founded in 1990 to provide professional portfolio management with uncompromising service to investors. For more than a decade, we have worked in Tandem with our clients to attain their investment goals. If we can provide further assistance, please contact one of us at the following:

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