

# THE TANDEM REPORT



## MARKET COMMENTARY

*“The only thing we have to fear is fear itself.”*

*Franklin Delano Roosevelt  
March 4, 1933 inaugural address*

Sometimes, the most difficult challenge we face as investors is to keep events in perspective. Distinguishing economic perception from reality is never easy, but a healthy dose of skepticism can only help. A good rule of thumb is that no matter how hopeful or how desperate the situation may seem, it isn't. When the experts tell us it is different this time, it *definitely* isn't.

It has long been observed that the stock market's performance in the short run is driven by greed and fear. Greed is a human condition, but fear is an emotion. We display greedy tendencies, but we *feel* fear, and it can cloud our judgment. When we are frightened by the market's condition,

we do not always respond rationally to the facts, because we fail to perceive them as they really are.

It is fact that Arthur Anderson, Enron, WorldCom, Global Crossing, Adelphia, and perhaps a few more, are guilty at some level of severe, perhaps criminal, misconduct. It is also fact that there are more than ten thousand other publicly traded companies that have played by the rules all along. Why, then, does the market treat venerable companies like Merck or Johnson & Johnson as if they were equally guilty of similar misdeeds? Because investors are scared, and are reacting with emotion rather than rea-

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## MARKET ANALYSIS

It wasn't supposed to be like this. The eleven rate cuts by the Federal Reserve were supposed to boost the market. What happened?

The fact of the matter is that the Fed rate cuts did help. The economy has emerged from recession and is exhib-

iting healthy signs of growth. Industrial output has risen five consecutive months, and projections are for a sixth consecutive increase in June. Capacity utilization at our nation's factories rose in May to its highest level since September 2001. The in-

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### MARKET SCORECARD:

S&P 500:

*year-to-date* **-13.73%**

*Annualized returns:*

*1 year ended 6/30/02* **-19.16%**

*3 years ended 6/30/02* **-10.32%**

*5 years ended 6/30/02* **2.26%**

*7 years ended 6/30/02* **8.90%**

*10 years ended 6/30/02* **9.26%**

# TOP TEN HOLDINGS IN THE TANDEM EQUITY COMPOSITE

AS OF JUNE 30, 2002

The list to the right reflects our ten largest holdings, ranked by total market value in the accounts that make up our Tandem Equity Composite. Since the last *Tandem Report*, we took some profits in Johnson & Johnson and T. Rowe Price. As a result, J&J has moved down the list, and T. Rowe Price has been replaced by General Dynamics. The defense industry stocks have enjoyed a run-up in price since 9/11, and the group's popularity propelled General Dynamics all the way to number 5 on our list.

When compared to the list of one year prior, eight of the ten holdings remain the same, although the rankings are different. General Dynamics and AMGEN have replaced AES and Tyco. Six of the ten holdings from two years ago remain in our Top 10, reflecting the value of patience.

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

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

## MARKET ANALYSIS CONTINUED

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dex of leading economic indicators, a forward-looking statistic, has been up five of the last six months. Gross Domestic Product (GDP) rose 6.1% in the first quarter. That is serious growth. And while that rate is certainly unsustainable, GDP growth in the second quarter would appear to have remained healthy. Perhaps the most encouraging sign of economic vitality is employment. Jobless claims for the last week of June fell to their lowest level in fifteen months. With the employment rate at 5.7%, and the attention given this statistic (need we remind you this is an election year?), we must point out that 94.3% of the American work force is employed!

So with the economy humming along, why isn't

the market following suit? There has clearly been a disconnect between the economic cycle and the market cycle, and this is a bit unusual. Historically, the market has been a leading indicator, or predictor, of economic growth. Is the market warning us of a double-dip recession? Perhaps.

In our opinion, it is more likely that the market is going through an unusual period of uncertainty and re-evaluation. Investors are regrettably suspicious of earnings numbers in light of the financial shenanigans that have been revealed. Further, an August 14 deadline has been imposed for corporate officers to sign accountability statements for the financial numbers their companies

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## SOME HISTORICAL PERSPECTIVE

Every year, Standard & Poor's publishes its S&P 500 directory. The most recent edition is complete through 2001. The book is a wonderful reference tool for the history and analysis of the index that perhaps best represents "the market".

In 2001, the S&P 500 closed the year at 1148.08. In 1935, the first year the book references, the index closed at 13.43. Not bad. But few of us have another sixty years of investing. Perhaps a more relevant period might be ten years. The index finished 1991 at 417.09, a modest return of 175%. Still too long you say? How about five years. The S&P ended 1996 at 740.74, a return of 55%, even in the midst of a bear market.

Since 1935, the S&P 500 has had twenty years when the index declined in value. Twenty out of sixty-six is certainly a relevant number. Of those twenty declining years, only four have been in

succession. Assuming 2002 is the twenty-first decline, it will mark only the second time since 1935 that the S&P has declined three consecutive years. The other time was 1939-1941. It has never declined four consecutive years.

We highlight these statistics because they help to illustrate a relevant point. Markets have declined before (quite often, in fact), and they will certainly decline again. But the market, at least to date, has *always* risen to new highs subsequently. Unless one truly believes this time is different, the third consecutive year of declines would not seem to be the most prudent time to divest oneself of stocks.

The point we wish to make is that this is nothing new. Have patience, have faith, and stay the course. The stocks of good companies will survive bad markets, and live to fight another day.

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## MARKET ANALYSIS CONTINUED

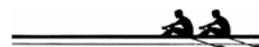
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report. This unfortunate deadline causes worry that new misdeeds may be uncovered as part of a cleansing effort before the signing date. As a result, there is reluctance to pay the same amount for earnings that we once did.

If, however, credibility can be restored, there is no reason to believe that earnings will continue to be valued differently. This is not to say that the market will then return to previous levels. Rather, companies, in this litigious environment, will be far more cautious about how they report, erring on the side of understatement. At the end of the day, all of this is good news for investors. The more confidence we have in the credibility of the corpo-

rate financial statements we read, the better. Ultimately, the market and economy will reconnect.

The economic news is unmistakably good. Corporate profits, however they are now defined, are growing as the result of a sound economy. Corporate criminals will be prosecuted, and we will be able to once again acknowledge that being a CEO can actually be a noble profession. These are uncertain times, and emotions are getting the better of us. We prescribe patience, and a bit of faith. And it wouldn't hurt to turn off the television, either.



## OBSERVATIONS

The summer has brought some fairly relentless selling to the market, which begs the question “where has the money gone that came out of the market ?” That is a tough one to answer with certainty, but if mutual fund inflows and redemptions are any indications, bonds have claimed at least some of that money. We have asserted previously that we need to be concerned when competition for investment dollars emerges, and that has indeed materialized in the form of bonds, gold and real estate.

That said, with interest rates this low, it is difficult to believe that bonds are a permanent home for *all* of the money that has flowed to fixed income. When the market stabilizes and preservation of principal becomes less of an issue, look for some of that money to return to stocks. Aside from the

obvious benefit that would bring to the market, it would also likely cause an increase in interest rates. Therefore, bond investors would be wise to shorten the maturities of their portfolios, and home owners should strongly consider refinancing, even if they have done so already.

Another topic in the news of late has been the concern over the credibility of Wall Street analysts. We could not be more pleased that this has come to light. Tandem was founded on the premise that the only true way to serve investors’ interests is to eliminate the inherent conflicts of interest other firms face. As long as a brokerage firm represents both the corporate seller of investment securities and the individual buyer of these same securities, the only interests being served are those of the bro-

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## MARKET COMMENTARY CONTINUED

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son.

Bear markets can exact a severe toll. As observed here previously, the most destructive aspect of a bear market is its ability to inflict fear and panic on the investing public. Anyone with money invested in the stock market ought to be concerned. After all, most investors have never experienced a market like this. Fear is certainly understandable. But how one reacts to that fear is critical, and panic is not the correct response.

As with all preceding bear markets, this, too, shall pass. In fact, perhaps it already has. We never know at the time. It is essential for each of us to remind ourselves that *this is not new*. Bull and bear markets are recurring. The periods of rising stock prices in a normal market cycle tend to last longer than the inevitable declines, and thus we often forget the emotions we experience when stocks stop

going up. Attempting to predict or time the turn-arounds is folly. Studies show that that greatest returns are realized by those investors already in the market when the tide turns.

Thus the conclusion to be drawn from the current set of circumstances is that we must keep events in perspective by giving them some historical context. Yes, this market is painful to watch, and yes the decline takes a toll on our outlook and our prosperity. But, assuming this time is not different, we have been here before. Bear markets end. We have no way of knowing when, but we can rest assured that they do, and this one undoubtedly will (or has) as well. The prudent investor is one that plans ahead for good and bad times alike. It is impossible to avoid the carnage of a bear market, but it is imperative to remain true to one’s convictions, and to have faith in good companies and the U.S. economy. We have always prevailed before, and it is definitely not different this time.



## TANDEM NEWS

Obviously, these are trying times. But we have been encouraged by the inflow of new business in spite of the market's lack of cooperation. Accordingly, we believe this is precisely the time we should invest in Tandem. What does that mean?

First, we ask that you please help us welcome Andres Gonzalez to Tandem. Andres graduated from the Darden Graduate School of Business at the University of Virginia in May, and prior to that spent seven years working in the investment industry. He brings a wealth of knowledge, and will be instrumental in both the development of new business as well as improving upon the ser-

vices we currently offer our existing clients.

Another important investment we have made is in technology. As a result, we are expanding our research capabilities and improving upon our internet presence. Further, we are undergoing a bit of a corporate makeover, so look for new reports and improved communications in the coming months.

These are extraordinary times. We view this as an opportunity to better serve those who entrust their investments to us. We are not changing who we are. Rather, we are simply making certain that we provide you with the best portfolio management and service available.

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## OBSERVATIONS CONTINUED

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kerage firm. It has been a painful but valuable lesson for the investing public. We must know how and why those handling our investments get paid. Analysts at brokerage firms may have other agendas. Tandem has never relied on anyone's analysis other than our own. While reform is promised to be on the way, we remain skeptical.

It occurs to us that bear markets of this magnitude are rare occurrences, and are historically followed by equally rare opportunities. The last period that offered this much potential market appreciation, in our estimation, was 1982. We caution against attempting to try to call a market bottom, or time its turnaround. Rather, stay in the market so you don't miss out.

Which brings us to another point. We have received more than the usual number of calls from investors seeking some reassurances. It is understandable that you are concerned. We certainly are. But please remember that this is not the appropriate time to reallocate your investments. We have attempted to diversify the portfolios we manage, and to own only the best companies.

When order is restored, and one can take stock (no pun intended) of the situation, we must re-evaluate our priorities and tolerances. If any are necessary, make the appropriate adjustments then. To do so in the midst of this market turmoil is not the time. History tells us things will get better.

We suggested in our Market Analysis column that it might be advisable to turn off the television. For those who actually heed this advice, our summer reading list may help fill the time previously devoted to Maria Bartiromo or your favorite CNBC anchor. For the beach, it is hard to beat James Lee Burke. Any of his Dave Robicheaux novels are terrific reads. If you are new to the series, start with Half of Paradise. Another great summer read is Birds of Prey by Wilbur Smith. For the business-minded, we recommend Execution—the Discipline of Getting Things Done by Larry Bossidy and Ram Charan, or A Thread Across the Ocean by John Steele Gordon, a wonderful account of the history of the transatlantic cable. Lastly, for golfers, you must read The Four Cornerstones of Winning Golf by Butch Harmon and John Andrisani. Its better than Mr. Pennick's Little Red Book. Enjoy!



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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 us.

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