

# THE TANDEM REPORT

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## MARKET COMMENTARY: ANOTHER THIRD QUARTER STUMBLE

What is with the third quarter? This year, the S&P 500 declined 1.24%. Last year, it was off 6.56%, and in 1998, the return was a chilling -10.30%. The third quarter swoons failed to deter the market in 1998 and 1999. The ultimate outcome is less certain for 2000.

The third quarter has traditionally been a difficult one for technology stocks. Sales often slow in the summer, and the lofty valuations assigned to tech stocks tend to make investors nervous when sales growth slows. But the fourth quarter is generally strong for these same companies, and the market has rebounded accordingly in previous years. Can the market really be this predictable and short-sighted?

The answer is yes, and history bears this out. But there are other factors at work this year. As we discussed in the last newsletter, the Federal Reserve has hiked interest rates aggressively this year, and economic growth is finally showing signs of slowing. Stocks always have a difficult time in a rising rate envi-

ronment. On the brighter side, it appears that the Fed has been successful, and that growth can now continue at a more sustainable rate. This limits the threat of inflation, and perhaps declining rates are now on the horizon. The year 2000 is looking more and more like 1994.

Over the years, Tandem has been able to outperform the market in difficult times, and this year is no different. In 1994, the market had a rough time because interest rates were rising and investors were ill-prepared. Today is little different. While some of the high fliers have been taken down, other areas have performed admirably. A well-constructed portfolio provides balance by design. We have not been immune to the collapse of the technology stocks, but we have benefited from the rebound in the pharmaceutical stocks. No one can predict the next hot sector, so why try. Owning good companies in a variety of industries dampens the effects of market gyrations, and it has always been our philosophy that it is

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## POLITICS AND THE STOCK MARKET: A LOOK AT THE PRESIDENTIAL ELECTION

The market does not favor Republicans over Democrats, or vice versa. Both political parties have ruined a good thing a time or two. Rather, the market wants certainty and predictability. It also wants to be left alone.

Some argue that the market's success in the 1990's is due in part to gridlock in

Washington. A Democrat president and a Republican Congress means nothing gets done, and, to the cynic, that is a good thing.

Others believe that Republicans are good for business, or that Democrats are more fiscally responsible (my, how times and

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# THE TOP 10 HOLDINGS IN OUR COMPOSITE

## AS OF 9/30/00

Tandem recognizes that no two clients are the same. Therefore, no two portfolios are managed exactly the same. But there are similarities, so we thought it might be of interest to you to be updated on the ten largest holdings in the Tandem Growth Composite. The composite consists of all growth accounts that we manage with full discretion.

There have been some changes since last quarter. AES Corp. rocketed from #6 to #1, as its share price rose from \$45.62 on 6/30 to \$68.50 on 9/30. 1-5 on the 6/30 list now make up 2-6, with Cisco dropping behind Pfizer. 7-10 have some interesting changes. The decline in the tech sector caused IBM and Applied Materials to drop out, with American Express and T. Rowe Price climbing to numbers 10 and 8 respectively. As you know, we have minimal portfolio turnover, so the repositioning is a reflection of what is going on in the market, not what we have done.

1. AES Corp.
2. AMGEN, Inc.
3. General Electric
4. Merck & Co.
5. Pfizer, Inc.
6. Cisco Systems, Inc.
7. Dover Corp.
8. T. Rowe Price
9. Johnson & Johnson
10. American Express

## MARKET COMMENTARY

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easier to make money when you don't give it all back.

The good news is that the technological revolution remains in tact, and the economy and stock market should continue to prosper. Still unclear is who the winners will ultimately be. What is more clear is who the winners will not be. Companies with novel ideas but no business plan or earnings have already lost. Companies that fail to make good on promises made have lost as well. Invest-

tors no longer appear willing to place bets on what-if scenarios. They want earnings, and are punishing even the most respected names when they fail to deliver. So, how are we to handicap the future?

Our answer is to look to companies that are incorporating technology to enhance their business, or manufacturing real products with real demand. In the end, earnings growth is the only compelling reason to own stocks, and predictability is a more certain road to success.

## TANDEM NEWS

To all of those who offered feedback on the newsletter format, thank you. We received some very positive comments, and hope to make each report better. If there are any topics we are not covering, let us know. We got one comment from a few of you that we would like to address.

There has been some concern expressed that we are getting bigger. While it is true that our firm has grown over the years, it remains our number one goal to provide the highest level of service available anywhere. We are here

to serve you. The amount of money we manage will never change that. To that end, we welcome Jennifer Tyson as our Administrative Assistant. She will allow us to focus more on the things that matter to you by spending less time consumed by the ever-growing paper trail. While we welcome Jennifer, we will miss Stuart McClintic. Stuart has decided to step down after 6 years here to spend more time with her family. We are indebted to her for all she has done for Tandem, and wish her the very best in her retirement. We continue to strive to serve you better, and look forward to more exciting announce-

# SPOTLIGHT ON MICROSOFT

## MICROSOFT (NASDAQ: MSFT)

Recent Price: 60.50

Dividend Yield: 0.00%

Earnings Yield: 3.1%

P/E Ratio on 2001 EPS: 31.8

Earnings Per Share:

<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001(E)</u>
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0.84	1.42	1.70	1.90(E)
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Microsoft is no longer a top holding at Tandem, as its price has declined dramatically this year. After reaching a price of nearly \$120/share in late 1999, the stock's value has been halved, dropping it from our Top 10 list. That said, it isn't all bad news at Microsoft these days. But first, a bit of history is in order. Microsoft was founded in 1975 with one product – a computer language to run the first personal computer. The company went public in 1986, and \$1,000 invested then would be worth \$409,464 today. Not bad. From its humble beginnings, Microsoft has become what one Federal judge deemed a monopoly. The company is the world's largest software provider and a growing internet presence. Businesses include operating software, television, games and wireless technology. If they are not a major player in all these areas today, they likely soon will be.

Microsoft has come under pressure on two fronts. First, they have had a very public battle with the Department of Justice and Judge Thomas Penfield Jackson. Second, many analysts have concerns about the company's future rate of growth, partially due to the uncertainty surrounding the outcome of the Federal anti-trust case. On both concerns, we remain quite positive. The Supreme Court sent this case back to the Federal Appeals Court, where Microsoft has enjoyed some success in the past. Further, a Justice Department under a future Administration may not be as zealous as the current DOJ. As far as future growth is concerned, we believe Microsoft is well positioned, regardless of the outcome of any litigation.

The Company still produces the number one operating system in the world, and is leveraging this dominance across the internet through the introduction of Microsoft.Net. Windows 2000, Office and Internet Explorer are all industry standards, while MSN has made significant in-roads as an internet access provider. Microsoft has the ability to make computing at any level easier for the user than ever before. And we think companies like this should be rewarded, not attacked by the Federal Government.

One of Microsoft's greatest strengths over the years has been an ability to invest in the right technology for the future, and then market that technology like no one else can. Once Microsoft is able to focus exclusively on its core businesses and not on its defense from government siege, we believe Microsoft will re-establish itself as one of the premiere companies and investments in the world.

## THE ELECTION AND ITS EFFECT ON THE MARKET

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perceptions have changed). But the stereotypes may not hold this time around. Time will tell.

Personal politics aside, the market appears to favor a Bush Administration at this time. While Al Gore certainly has the tremendous prosperity of the last eight years to run on, he has chosen to focus on issues that can make the market nervous. He has attacked the drug and oil industries, and proposed a more active role for government. George W. Bush, on the other hand, has advocated a less active government generally, and has proposed that a portion of Social Security be turned over to future recipients to manage. Clearly, the stock market would benefit from a new inflow of money, and businesses benefit from less regulation.

The closeness of the race has contributed to the uncertainties hamstringing the market. However, for the first

time in recent memory, voters actually have a choice worth making. This has been a good campaign, based largely upon differences of opinion about the most pressing issues of the day. In the end, the American public wins when clear choices are presented and debated above the chatter of personal attacks.

Ultimately, after the election is decided, the market will go back to focusing on the fundamentals of the economy, which likely will remain strong regardless of who the occupant of 1600 Pennsylvania Avenue may be. Political campaigns are often important, sometimes informative, and usually entertaining. In the short run, they can cause tumult. But in the long run, as long as the economy is left to its own devices, the President has little effect on the business of investing. And that is a good thing.

**TANDEM INVESTMENT ADVISORS, INC.**

In Charlottesville:

117 4th Street NE  
Suite A  
P.O. Box 2259  
Charlottesville, VA 22902

Phone: (804) 979-4300 or  
(800) 527-0101

(This section intentionally left blank)

In Charleston:

1470 Ben Sawyer Blvd.  
Suite 4  
Mt. Pleasant, SC 29464

Phone: (843) 216-3791 or  
(800) 303-8316

Tandem Investment Advisors, Inc. was founded in 1990 to provide professional portfolio management to investors. Today, we manage in excess of \$30 million in assets for over 100 relationships. If you would like more information, please contact one of us at the following:

**John B. Carew** – President and Portfolio Manager

Phone: (804) 979-4300

e-mail: [jcarew@tandemadvisors.com](mailto:jcarew@tandemadvisors.com)

**C. Allen Ouzts** – Research Director and Portfolio Manager

Phone: (843) 216-3791

e-mail: [caotandem@email.msn.com](mailto:caotandem@email.msn.com)

**Robert P. Northington, III** – Marketing Director

Phone: (804) 979-4300

e-mail: [rnorthington@tandemadvisors.com](mailto:rnorthington@tandemadvisors.com)