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Commentary
Spring 2001

The Markets

The first quarter of 2001 has been a challenge for everyone who owns stocks, especially after a difficult market in 2000 when the blue chip stocks were down 10% and technology stocks declined 40%. Most people expected a quick rebound from last year's experience and this has not yet occurred. During the first 3 months of this year, the Standard and Poor's 500 declined 12% while the technology laden index, the NASDAQ, declined 26%. The overseas markets faired slightly worse than the US large companies with a decline of 14%. Bonds continued to provide a safe haven for investors with the corporate bond index increasing 4.5% and the tax free-bond markets advancing 1.2%.

The Rikoon-Carret portfolios performed closely in line with the markets. Our US stocks declined 12.7% while our international stocks were down 16.7%. On a combined basis, our overall stocks were down 13.8% compared with the index decline of 13.2%. Our municipal bond portfolios beat their corresponding index with a return of 2.01% for 3 months while corporate bonds advanced 3.99%.

This letter will spend more time on stocks than past issues because of the huge amount of attention which the market has been garnering. While most people are aware that stocks decline, and sometimes do so for an extended period of time, many investors haven't experienced a downturn like this past 12 months because a bear market has not occurred since the early 1980's.

The stock market finished the first quarter of 2001 with little strength. Many big tech stocks have been sliding for a year and now they have dragged down companies in every industry. By many measures, the market is now oversold. Most industrial stocks have begun to stay level even when bad news is released. The market may well go down further but it does feel like many of the short-term investors are finally out of the game.

This means it may be time to go bargain hunting. During this sell off, which was most painful during February and March, many of our companies reported strong sales and earnings. The main thing that has driven them down is that they have had their P/E ratios compressed. P/E means price to earnings, or how many years of profits one must purchase in order to become an "owner" of the company. P/E ratios are now so low that our company's GARP (Growth At a Reasonable Price) philosophy indicates that this is a good time to buy.

The stock market's meltdown came partially from selling pressure due to mutual fund redemptions, as many people have been forced to sell in order to raise money to pay taxes. In addition, the market is somewhat at the mercy of the Federal Reserve Board which recently cut key interest rates in order to get in line with the economy. Wall Street is tired of the Fed falling behind the market and now wants it to lead the economy by cutting key interest rates again in order to help jump-start a recovery. We feel the Federal Reserve Board will cut key interest rates soon, but it takes from 9-15 months for cuts in interest rates to be felt in the real world, so don't expect an immediate jump in stock prices.

Bad news continues to rattle the stock market, especially anything associated with technology stocks. In fact, the NASDAQ plunge during this past year is one of the worst declines in history and is reminiscent of the pain investors suffered in 1973 and 1974. Some companies' stock prices have been hit so hard that they now have reasonable P/E ratios for the first time in 6 or 7 years. Nonetheless, Wall Street continues to punish great companies despite the fact that they actually have reasonable P/E ratios relative to lower quality stocks. Even businesses with strong earnings have been subjected to relentless selling pressure as Wall Street continues to beat up any stock with a high P/E ratio. A high P/E ratio indicates that a company's future growth is already reflected in the price of the stock.

We remain worried that technology stocks remain vulnerable since their PE ratios are almost double that of the S&P 500. The NASDAQ market will stage a strong rebound only with aggressive Federal Reserve Board action or a sudden turnaround in the U.S. economy. One key that will signal an economic recovery is a rebound in consumer confidence which will show up in strong retail sales or housing. Consumers control approximately 70% of the U.S. economy. Until their spending re-accelerates, the U.S. economy will remain stuck in neutral. By the time July rolls around, the tax cuts urged by President Bush should cut withholding taxes and put more money in the pockets of workers at all levels. Between housing refinancings, now at record levels, and the anticipated tax cuts, this extra money should help spur increased consumer spending so we are cautiously optimistic about prospects for the market 9-15 months from now.

The average person in the U.S. is still hopeful about his or her future. In fact, consumer confidence is much healthier than investor confidence at the present time. Even recent corporate layoffs have failed to affect consumer spending since the U.S. continues to bask in near-record low unemployment. In other words, people getting laid off are able to find new employment relatively quickly.

Over $6 trillion in "wealth" has been lost in the stock market correction during the past year. Yet, historically, sharp stock market corrections have failed to significantly put a dent in overall U.S. economic growth. The exception would be luxury items such as elaborate homes, yachts and expensive sports cars. The proposed $1.6 trillion tax cut over the next decade will not erase investors' losses so some part of the "wealth effect" that stocks generated over the past few years has been wiped out. We don't know how this diminished wealth effect will impact the U.S. economy.

The last time there was a similar downturn in the stock market was in October 1987. Then, it took 1 3/4 years to replenish the "money" that had been wiped out. Today, it may take two years or more to earn back the money that has been lost over the past 12 months. It is possible that this could happen much faster if the U.S. economy explodes, but this is unlikely unless the Federal Reserve Board over-stimulates the U.S. economy by cutting interest rates by 2%. We think it more likely that the stock market will stage a cautious recovery that will be stretched out over 24 months.

In our opinion, it is inappropriate to sell now since tax-related selling has diminished. All of the changes to our portfolios in the past few months have been designed to incorporate more 'GARP' stocks. We are confident that our approach is working, both in terms of allocation between stocks and bonds and in the kind of diversification we have in the stock area. Our stock selection process depends on a value-oriented search for companies that dominate their industry. Long-term Treasury bonds, based on the 10 year maturity, are now well below the 5% level. As interest rates continue to fall, people get frustrated with low yields, so some of that money will eventually find its way back into the stock market. Currently the S&P 500, with a P/E ratio of approximately 21, remains undervalued relative to long term Treasury bonds.

Investor Education

The Rolling Stones sang "Time is on my side," a few years ago! Let's look and see how we can make this ring true. Somewhere between ignoring one's monthly statements and being addicted to CNBC is a happy medium. The objective is to develop a frame of mind that will help see us keep our equanimity through whatever the market's current circumstances might be.

As investors, our true risk tolerance can only be determined when we face a bear market. Risk tolerance means how much pain we can endure in order to enjoy the long-term benefits of owning stocks. What exactly does "long term" mean? Jane Bryant Quinn said, "Long means long. If you genuinely—cross your heart (and hope to live)—hold stocks or mutual funds for the long term, ignore the daily news stories and stick to your (investing) program." To us, long term for stocks means at least three years.

The chart below, from Ibbotson Associates, illustrates the chances of making or losing money in blue chip U.S. stocks (S & P 500) over various holding periods. Near term, stocks carry more risk than most people realized before this current downturn.

If you Hold	Your chance of losing money	Your chance of making per year*		
		0-10%	10-20%	20+%
1 year	26%	18%	20%	37%
3 years	14%	28%	39%	19%
5 years	10%	31%	49%	10%
10 years	4%	42%	53%	1%
20 years	0%	37%	63%	0%

*S&P 500 stocks average, annualized monthly returns since 1926, all dividends reinvested, source: Ibbotson Associates

This table illustrates several points. First, notice how the chance of losing money decreases dramatically as stocks are held over the years. The longer you hold stocks, the less chance you have of losing money. Second, your chances of making money each year increase over the long haul. Third, the last column tells us that based on history, the 20% plus returns of the late 1990's in the stock market were abnormal.

One way to make time on your side is to lessen the emotional impact of the media's coverage of financial events on your thinking. What helps people refrain from turning on CNBC too often? Gardening, hiking, having tea with a friend, or emailing someone far away are possibilities. We find that people who watch a great deal of the 24-hr. financial networks tend to make less productive and more short-term based decisions. This happens because it is a natural response to want to do something when the sensory input bombarding one's senses has a constant "crisis' quality to it.

In our culture, where most things become obsolete quickly, it is no small feat not to think about time as being measured by the market's closing prices but by the slow and steady progress one is making towards financial security. This is especially true when there are bumps along the way. James Taylor sang "the secret to life is enjoying the passage of time." Building wealth through investing involves the passage of long periods of time, so one of the main foundations of investment success is informed patience.

If you are compelled by curiosity or anxiety to look at your stock prices every day, try looking only at how a few of the more aggressive stocks are doing. Try to ignore your solid, slow moving companies. These "clunkers," more likely than not, will end up being the source of much of your long-term wealth accumulation.

One's ability to perceive "investment time" in a healthy way can be developed through a variety of circumstances. Making mistakes and learning from them is one way. Listening to other people's experiences is another. Whatever you find useful in furthering your financial education, remember not to take the market's ups and downs too seriously as the market is a great teacher of humility. Take profit in the words of one of the most successful stock pickers of modern times, Warren Buffet. He said, in referring to people who do not clothe their portfolios with a solid overall philosophy, "it's only when the tide goes out that you learn who has been swimming naked!"

Rikoon-Carret Investment Advisors

One of the benefits of our recent move to Don Gaspar Avenue is that now we have a lovely patio. In honor of a long awaited spring, we will make our next afternoon tea outdoors. It is scheduled for Thursday, May 17th at 3:00pm. Refreshments will be served and you are welcome to bring a friend.

To accommodate many of our clients who live in the Albuquerque area, we recently opened a satellite office at 3200 Carlisle Northeast, Suite 201. This is on the west side of Carlisle between Candelaria and Comanche, not far from the Big "I" interchange. Initially, we are staffing the ABQ office on Wednesdays only and ask anyone interested in seeing the office or meeting with us there to call ahead, as we will operate on a "by appointment only" basis.

The continued interaction between Rikoon-Carret in Santa Fe and Carret and Company in New York has produced some noteworthy progress. We are in the midst of converting to new portfolio management software system which will produce improved reports which you will see over the next few months. Also, we have installed a direct telephone and data connection between Santa Fe and New York which allows us to use the company's considerable resources in New York for our clients' benefit.

Soon, clients and friends can receive a Rikoon-Carret technical analysis of the stock market via email. We encourage you to call or email us at rrikoon@aol.com so we can add you to our list of recipients of this narrative, which will be produced on an irregular basis.

Best wishes and be sure to go outside and enjoy this wonderful spring!