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## ***JOS. A. BANK'S & SONS, OAKLAND SOUL AND THE ECONOMY***

In my last quarterly report I touched on three themes. Let me take this opportunity to expand on them.

### *James Carville's Favorite Subject*

At the end of the second quarter it was not as easy as it is today to see that the country's economy was moving forward. Back then the general wisdom held that we were still mired in an economic miasma, that the second quarter stock market run-up was but a chimera. I felt otherwise. Now, at the end of the third quarter we can see real forward momentum much more clearly. All equity indexes are up, substantially above their October 2002 lows, with the Dow up 11.19% YTD thru the third quarter. Listen to the economy's drumbeat for the last quarter:

- July 26: Dow hits 5-week high on strong economic reports.
- July 29: Weekly index of leading economic indicators climbs to highest level since April 2000. Rate of growth fastest since 1987.
- July 31: Federal Reserve: "Broad improvement" in long-ailing manufacturing sector. "Signs of budding recovery include broad upturn in manufacturing sector."
- August 1: *USA Today*: "Economy surprises with fast growth." Pace of growth is fastest in nearly a year. Labor Department reports unemployment applications fall for third straight week.
- August 11: "Defense spending gives boost to economy." *USA Today*.
- August 25: *Business Week*: "The second half looks more solid every day."
- August 27: "The economy seems poised for a more sustained recovery." Congressional Budget Office.
- August 30: Commerce Department reports increased consumer spending in July. Disposable income has largest monthly increase since January 2002. Economy predicted to stage a "material rebound" in the second half.©

- September 4: 11 of 12 Federal Reserve districts report economic improvement.
- September 22: *Business Week*: "Consumers keep carrying the ball." *BW* notes that job losses over last two years have been limited to the manufacturing sector with factory payrolls shrinking by 1.2 million jobs since November 2001. Outside that sector employment has grown by 97,000. The popular press ignores this distinction. (If I could buy a company selling job increases in all non-manufacturing sectors I'd do it now, and before people start jumping on that band wagon, which they should do in about 6 months.) And finally,
- October 10: Dow Jones hits 16-month high.

I don't pretend to be an economist but the bullet points noted above have a consistent, rhythmic pattern. And I do recognize the steady, constant beat from Rocco Prestia's base guitar whenever I hear a live performance from *Tower of Power*. Let's hope that our Mr. Base Man, the Nation's Economy, continues to lay down these same, positive licks in the months ahead.

### Oakland Soul

In my last report I asked a rhetorical question: "Anybody want to go to a *Tower of Power* concert?" Little known, this urban-soul, funk, jazz, fusion, rhythm and blues 10-piece band is West Coast-based, and although it has been around for 35 years, it performs in Delaware about as often as Joe Biden loses a Delaware election.

Sure enough, the stars must have been aligned right because two days later my friend Jon Hickey told me that *T.O.P.* was coming to Wilmington's Grand Opera House on October 8<sup>th</sup>. (And on October 18<sup>th</sup>, they will play at the Rehoboth Autumn Jazz Festival.) I don't expect more than 1 out of 100 people on my Westover mailing list to know about *Tower of Power*. But the band's longevity, through musical styles as varied over time as disco and rap, is a symbol for my belief that long-term investing beats shorter term gambling any day.

*T.O.P.* has never been a Top 40 band. Over the years and as musical styles have come and gone, this fundamentally sound, superbly schooled group has been, as one of their songs puts it, the "Real Deal." Their music has evolved over that period yet at the same time stayed true to their roots. At the Grand, and led by vocalist Larry Braggs, the group had us literally standing in the aisles for two hours, moving and grooving to their 2003 syncopations. And you won't see Murray Sawyer beboppin' like that very often! About as often as Bill Roth loses a Delaware election.

Thirty years ago this group played with the likes of Sly and the Family Stone and Creedance Clearwater Revival; twenty years ago it was Smokey Robinson. In the mid-80s they were the horn section for Huey Lewis's mega hit, "Power of Love." As we rolled into the '90s, they recorded with Sting, Elton John and Carlos Santana. In mid-decade they complimented Michael Bolton and most recently, Phish. Regardless of the fellow artist, they've always blended and adjusted their style to accommodate that of the "headline" performer. Similarly, we at Westover seek to blend our individual stock picks with our client-performer's individual goals, each of which is as distinctive as are the voices of Smokey, Huey and Elton.

This ten man group has had a core of performers, 6 or 7, who have been there from the beginning. That's what we do with our stock picks. We have a core that will stay with us for many years, but we move and groove, adding and subtracting individual equities as necessary.

Why invest for the long haul when conventional wisdom would have you trade every 6-12 months? Here's why: historically, investors who have stayed in the market on a long term basis have been rewarded for their patience. In musical lingo, *Tower of Power* investors trump One Hit Wonders.

Look at this study by Ibbotson Associates. There have been 77 rolling one-year periods from 1926 through 2002. In 54 of them, or 70% of the total, large-company stocks had positive returns. The remaining 23 periods, representing 30% of the total, were negative. But here's how staying the course for five, ten and fifteen-year rolling periods have increased your odds for a good result:

**The Benefit of Time**

Time Period	1-Year	5-Years	10-Years	15-Years
Negative Return	30%	11%	3%	0%
Positive Return	70%	89%	97%	100%

Conclusion? The longer the holding period the more likely the return is to be good. That's why patience has been so important over these last 3 years. And that's why we are long-term investors.

Personally, I hope I see *Tower of Power* in Delaware again in 10 years. If so, I'll probably find myself standing in the aisles once more, clapping my hands and moving an old body a-rhythmically with the same excitement I did when I first heard them many years ago. And our clients' stocks will have had the same benefit of time, their returns almost certain to be positive ones.

### Joseph A. Banks & Sons Clothiers

Joseph A. Banks is a Mid Atlantic-based men's clothier with a store in Greenville, Delaware. Their clothing is excellent quality and is offered at very good prices. You'll find Wilmingtonians wearing Brooks Brothers' suits on Monday and a Bank's equivalent on Tuesday. My really "hip" friends, and I actually have three or four, one of whom is my Santa Monica, CA son-in-law Lance, might wear a Giorgio Armani drape on Wednesday. Personally, I've never seen the benefit in wearing an Armani and I stopped buying Brooks Brothers fifteen years ago, but that's just me.

We pick our client's stocks just as we buy our suits. Let's look at today's typical prices for men's suits:

- Armani Black Label suit: \$2,000
- Brooks Brothers traditional 3 button: \$1,200
- Joseph A. Banks Italian Merino Wool: \$495 (Their top of the line)
- Joseph A. Banks Merino on sale: \$199

When I buy stocks for my clients I leave the Armani prices to the Momentum Guys. I let my friends who buy Good Companies Regardless of Price pay the Brooks Brothers' tariff. I won't buy my suit and I won't buy my clients' stocks unless I can get them at Joseph A. Bank's prices. And occasionally, when the stars are aligned and *Tower of Power* is coming to good ole' Wilmington, Del., I can buy those stocks at Joseph A. Bank's sale prices. When that's the case, I jump in with both feet.

So there you have it. That's why my philosophy on timing the market is long term. That's also why my philosophy on buying stocks is "value price" oriented. Notice I didn't say just value oriented; but I said value price oriented. I won't pay Brooks Brothers charges for any stock I buy. And I sure won't pay Armani prices. Sorry, Lance.

(As an aside you might be interested to learn this about the Jos. A Bank's stock market price. A Westover-related person I know well bought a passel of this stock in 1998 before Westover existed for less than \$5 a share. Last week it was selling at more than \$47 per share. Good suits; good stock, wouldn't you say?)

### Westover Continues its Forward Momentum

Our independent and objective stock analysis approach is distinctive. It grows from my lawyer's training to provide the

same kind of independent, objective advice to clients. It's a disciplined and admittedly contrarian philosophy. We have no investment-banking business to generate, no trading commissions to protect. We are willing to say "no" to both specific "hot" stocks and to the market.

Our investment focus is on discounted free cash flow rather than reported (read "managed") earnings. Then we wait until our selected companies have Joseph A. Bank suit prices. We want companies to have a large margin of safety which we define as the ability to keep competitors at bay through various factors such as patents, high switching costs or being a low-cost producer. We take what corporate management says with a grain of salt. We are skeptical about companies that aggressively issue capital, grow through acquisitions or fail to put shareholders first. We believe the odds are high that over time companies who carry these built-in protections and who throw off significant free cash flow will create solid shareholder value. This philosophy has resulted in very satisfactory returns for our clients, and we intend to follow that approach for the years to come.

Historically, stocks have risen at an average annual rate of 11% while bonds have risen at 6%. Given a 50/50 asset allocation, an investor should enjoy an average growth rate of 8.5% but with considerably less volatility than is seen in just the equity markets alone.

There is no "typical" Westover client. Each of our client's portfolios is individually handcrafted and so there is no "norm." Some like Creedance; others Elton John. For some, a heavy emphasis on bonds is the order of the day; for others we emphasize stocks. Regardless, every portfolio contains a combination of stocks, bonds and cash which reduces volatility substantially while providing very acceptable returns. You might say our band can play with anybody and still bring value to the investment table.

We will continue to buy good stocks but only at the same prices as we find our suits at Bank's. And I hope our selections ring as true as the notes from Adolpho Acosta's trumpet when *T.O.P.* plays "Your Still a Young Man."

To Doc Kupka, Emilio Castillo and the rest of the *Tower of Power* band, I say when I see you next just keep laying those high notes on top of that rhythmic base line. If so, you know I will be one happy camper. And if we do the same in our milieu, some day you might find our WCA clients dancing in the aisles right along side this old man.