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***AMERICANS ARE FROM VENUS.***

***WESTERN EUROPEANS ARE FROM MARS.***

Over the last five years Randy and I have had the good fortune to travel to many places in Western Europe, Eastern Europe and the Baltic States. We have been to France, Italy, Switzerland, Sweden, Finland, Hungary, the Czech Republic, Austria, Latvia and Estonia. We have experienced the beauties of these countries, their history, cultures and customs first hand. We have also seen their social and governmental structures.

Ladies and gentlemen, I'm here to tell you that free markets work. Productivity works. Tax policy works. And it's all interrelated. We may find fault with elements of our American system which favors individual enterprise but it sure beats those alternatives which rely on centralized government on the other side of the Pond. In short, and For What It's Worth David Crosby, somethin's happenin' here, what it is is exactly clear, and it's this -- good old-fashioned American capitalism trumps those continental economic systems hands down.

In late June, Randy and I stood on Gullert Hill, overlooking the Danube River, basking in the warm summer sun in Budapest, Hungary. We, along with our dear friends Hal and Margo Measley and eight other Americans, listened to our Hungarian guide extol the wonders of his country. He was proud of the free education, the free medical care, the free and generous pensions, the subsidized transportation system, the subsidized opera concerts and other numerous benefits his citizens received, all compliments of the Hungarian government. At the end of his talk he asked if anyone had any questions. Showing no temerity, I raised my hand and inquired as to tax policy and employment issues in Hungary. He told us that the government was easily the largest employer; unemployment was rampant, the black market was alive and well, and that the effective tax rate upon

Hungarian citizens was more than 90%. To say the least, I was astonished. But I had the genesis for a Westover Report. This one.

### Tax Policy Does Matter

Ten, mostly Eastern European countries, joined their fifteen Western European counterparts in the European Union this past May 1<sup>st</sup>. In doing so they brought a new spirit of capitalism and lower tax rates to their stodgy, fellow European Union members. Upon joining the EU, Lithuania announced it would cut its corporate tax rate to 19%. The corporate tax rates in the newly-minted European Union countries of Latvia, Cypress, and Poland also stand at 19% each. And, believe it or not, Estonia's is at zero! All these new EU countries say that their low tax rates will help them to attract foreign investment. Each is considerably lower than the tax rates of existing EU members, France, Germany, Italy, Spain and the Benelux nations.

So who's upset? Can you say Germany and France? Those countries have corporate tax rates which are *two times higher* than those of Lithuania, etc. But instead of competing with their aforementioned new EU neighbors by lowering their own regressive rates, German Chancellor Gerhard Schroeder and French Finance Minister, Nicholas Sarkozy, suggested that the new E.U. members *increase* their tax rates in order that jobs and industry not leave Germany and France! Well, I have news for Mr. Schroeder: Fugetaboutit. Prediction: Eastern Europe, in general and Estonia in particular, will see their economies increase markedly on a relative basis in the next 5-10 years, while France and Germany will continue to stagnate.

### The Leisure Society and the Work Society

Productivity gains in the U.S. this year should come in at 3.3% according to Eurostat, the statistical agency of the E.U. That's nearly twice the rate of France and Germany.

Europe has an hourly output per worker some 20% below American worker's levels. The trouble is that uniquely European factors -- from stiff job-protection codes to hidden barriers against competition -- keep those Western European countries from breaking free. Roger Fulton, an analyst in the British office of Gartner Inc. put it succinctly "The U.S. is a 'just do it' society, whereas Europe is a 'let's think about it' society." Nike's Phil Knight couldn't have said it better.

Look at this chart of average hours worked per country and corresponding jobless rates per country. Tell me what you see

in these numbers.

<i>Country</i>	<i>Annual Hours Worked</i>	<i>Jobless Rate</i>
United States	1,904	5.4
Spain	1,722	11.4
France	1,605	9.0
Germany	1,557	9.0

Loss of production and increased unemployment is what happens when work weeks move from 40 hours to 35 hours and lower. Sorry, Monsieur Chirac.

The French average 5 weeks of vacation a year and the Germans 6; the U.S. average is 2.5 weeks. Sweden, as only the Swedes can, just undertook a two-year study of the *social* effects of a 30-hour work week. Why they didn't study *productivity* effects is beyond me. It just proves once again that Thorstein Veblen and his theories about the leisure class still exert a bigger pull on the European imagination than does Adam Smith.

"We have created a leisure society while Americans have created a work society" Klaus F. Zimmermann, the President of the German Institute for Economic Research said recently. He concluded "Our model does not work anymore." Amen, Mr. Zimmermann.

#### Little Rock or Rome?

Three of the least wealthy U.S. states have proven to be almost as productive as those three European heavyweights, France, Germany and Italy, in terms of their respective per capita gross domestic product. Compare the highs and lows:

<i>Country/State</i>	<i>GDP Per Capita</i>
Delaware	199
Luxembourg	194
Connecticut	190
France	105
Germany	100
Italy	100
Arkansas	99
West Virginia	92
Mississippi	92

That higher GDP per capita helps the average American spend about \$9,700 more than the average European on consumption each year. That gives Americans the ability to enjoy more cars, TVs,

computers, etc. than do the Europeans. Seems "La Dolce Vita" is spoken in Italy but is better enjoyed in the U.S.

The percentage of Americans living below the poverty line is now at 12%. If Sweden, that model European welfare state, were judged by the same low income standard, 40% of their households would qualify. The Swedish Research Institute of Trade recently concluded "The expansion of the public sector into overripe welfare states in large parts of Europe is and remains the best guess as to why our continent cannot measure up to our neighbor in the west."

### Barcelona or Istanbul?

The Associated Press recently reported that Western Europeans are mightily concerned that their jobs are heading to Eastern Europe and Asia. They should be. Electrolux recently moved jobs from its home country of Sweden to Hungary. In Finland Nokia, the world's largest mobile phone manufacturer credits its decade-old decision to outsource manufacturing jobs to Asia for the bulk of financial its success. Both Levi Strauss and Samsung Electronics, corporations of the United States and Korea respectively, have recently closed plants in Spain, saying production costs were 50% lower in Turkey.

What's going on? The inevitable and inexorable world-wide move toward capital markets where products and services of equal or better value are provided or produced in countries with lower costs.

### Stocks to Consider\*

In each Report since January 2003 we have been highlighting one or two stocks for you to consider.

The two companies offered for your consideration today are First American (FAF) and Valassis Communications (VCI). Both companies are on the value side of the value versus growth investment seesaw.

First American is a mid-cap title insurer selling at \$29.69 per share. It pays a 2.0% dividend and should double, according to WCA's crystal ball, in five years. It enjoys a 22% share of the

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\* It should not be assumed that the recommendations made herein will be profitable or will equal or exceed the performance of securities not discussed herein. Securities highlighted in this newsletter may or may not be held in an individual client account. The performance of these stocks, as well as those previously discussed, is not a guarantee or predictor of future stock performance results under any circumstances.

highly-concentrated U.S. title insurance market and has consistently expanded its share. The firm owns the largest U.S. property data base and captures data from 95% of all U.S. real estate transactions. It has the largest repository of title deed images with more than 1.8 billion documents. It has a subsidiary, First Advantage, which provides information-screening products and is one of three motor-vehicle record screeners and the third-largest employment screener in the U.S. It also has the largest U.S. sub-prime credit database with more than 35 million records. Its gross and operating margins, along with its return on assets and return on equity, have steadily increased for ten years. Its forward PE is 8.0 and its PEG is a very modest 0.7. In short, the numbers look good; the business looks solid.

Valassis Communications is a free cash flow cow. It is a small-cap media company offering a broad range of marketing solutions to manufacturers and retailers. It trades at \$28.82. VCI supplies the free-standing inserts we love to hate in our daily and Sunday newspapers. In June, the free-standing insert industry (FSI) achieved its eighth consecutive quarter of year-over-year volume growth. Coupons can be easily tracked since customers literally redeem them for goods and services. Its operating margins are at 20% and over. While Valassis does not pay a dividend it does have an earnings yield of 6.7% and a cash return of 6.43%. Its forward PE and PEG ratios are both below industry averages by a good 25%. I don't expect this company to do anything spectacular in the next year, but I do expect to see its price double in five.

### **You're Kidding, Right?**

This report initiates a new section called You're Kidding, Right? It will poke fun, hopefully in a gentle way, at some of the absurdities I have noticed in the investment world and otherwise. I intend to alternate this section with our Listen To The Music section. Some reports will have both, sometimes we will have just one and sometimes we will have none.

Today we look at Martha Stewart and her company. Martha's criminal chicanery involved her decision to avoid a piddling \$51,000 loss through her sale of IM Clone stock. This she did thanks to her broker's tip that the company would not win FDA approval for its cancer-related drug Erbitux when expected. After Martha got caught her company's stock and business initially tanked.

Once Martha's peccadillo came to light, Martha Stewart Living Omnimedia lost its radio show, lost its TV show, lost 65% of its

magazine advertising, lost 20% of its circulation and today has a serious, negative cash flow. But recently strange and irrational things began to happen to its stock price.

On July 8<sup>th</sup>, the very day she was sentenced, her company closed at \$11.81, up a whopping \$3.17 or 37% in just that one day. Martha, who holds 29.5 million shares in her company, saw that stock move provide her with a \$93.5 *million* one-day gain. I'm surprised she didn't ask to be sentenced again and again!

And just last Thursday Martha Stewart Living jumped once again, this time to \$2.57 to close at \$17.55 after the company confirmed a much-anticipated collaboration with reality-show guru Mark Burnett. He created the TV reality shows "Survivor" and "The Apprentice". The stock hadn't traded that highly since June 2002 when Martha's friend, Sam Waksal, was charged with insider trading in the scandal that ultimately led to Martha's conviction for lying to investigators.

What this stock movement means for Martha is this: In the two and one half months, from the day before sentencing this summer through Thursday, September 23<sup>rd</sup>, 2004, the value of her stock portfolio has more than doubled, and her investment in her company has increased by more than *one-quarter billion dollars!* I kid you not.

### Listen to the Music

The last time we visited my query to you was this: Tell me what common characteristic may be found in the following songs: "For What It's Worth" by the Buffalo Springfield; "Unchained Melody" by the Righteous Brothers; "Annie's Song" by John Denver and "Suite: Judy Blue Eyes" by Crosby Stills Nash and Young.

Two persons got the answer. The first is a young man who works for a hedge fund/private equity firm in Durham, NC. But since his initials are HMS and he calls me "Poppa," I can't give Chip the prize. Something about insider knowledge of music quiz questions, I think. The prize goes instead to Sid Garnett, the operations manager for The RAL Group, LLC, which as some of you know is the very best incorporation service provider in the whole U.S.! The answer? In each of those songs you will never find the title sung as part of the lyrics.

Since then, I've thought of two other songs that meet that same test. Chip supplied a third. I came up with "Weekend in New England" by Barry Manilow and "Danny's Song" by Kenny Loggins while Chip provided "Elderly Woman Behind the Counter in a Small Town" by Pearl Jam. Sure looks like different generations and

musical tastes, wouldn't you say? He introduces me to D12; I tell him about Dee Dee Sharp. The former is a sextet of Detroit-based rappers; the latter is a South Philly '60's rocker. I don't know how to dance to today's noise but then Chip doesn't know about grooving to Dee Dee's Mashed Potato either. But we do like to listen to our music.

Until early January when I check in once again, I hope your stock portfolio has smooth sailing. And listen to your music.

October 2004