

President &  
Chief Investment Officer  
H. MURRAY SAWYER, JR.,  
J.D.

Direct Dial  
(302) 427-6988

## WESTOVER CAPITAL ADVISORS, LLC

PRIVATE ASSET MANAGEMENT

1220 N. MARKET STREET  
SUITE 800  
WILMINGTON, DELAWARE 19801-2555

Phone  
(302) 427-9600

Fax  
(302) 427-8900

[hms@WestoverCapital.com](mailto:hms@WestoverCapital.com)

### A RANDOM WALK THROUGH THE INVESTMENT THICKET

My son, Chip, loves sports. He plays club soccer with abandon even though he is about to turn the big 30. He is an enthusiastic fan of his beloved Tar Heels and Philadelphia Eagles, and he runs football bowl and March Madness pools for his friends and colleagues, most of whom are young, thirty-something males. However, his pools are open to people of all ages and of either sex. I admit that I have lost ten bucks in his football pools consecutively for the last seven or eight years. Until this year, the winner three years in a row was female, a friend of Chip's, a woman from the San Francisco area by the name of Michelle.

What's interesting about Michelle is that she knows absolutely nothing about football. Nada. Zip. She picks teams based on whether she likes their nicknames. Will the Bears beat the Cougars? Will the Blue Devils fly over the Tar Heels? Say what you want about her football picking strategy but it has worked. If she were a professional investment advisor her theory would be akin to throwing the proverbial darts at the stock listings in *The Wall Street Journal*.

We acknowledge the randomness of acts and events in the world. We know that a coin flipped 15 times can come up heads for each of those flips. But we believe over time there are better ways to pick stocks.

So what are some of the characteristics of Westover's investment philosophy?

First, WCA believes in the importance of independent thinking. The word Kynikos defines a sect of ancient Greek philosophers that believed the key to life was self discipline and independence of thought. In the investment world those two keys, self discipline and independence of thought, are core elements of Westover's approach.

That independence of thought is demonstrated in many ways. One way is that a typical WCA portfolio will have no more than 30 individual stocks. Contrast that with the average equity mutual fund which has 100 or more stocks. Statistics show that 80% of the concentrated mutual fund companies, those that have no more than 30 companies in their portfolio, beat their diversified peers, year-after-year.

A second element of WCA's philosophy is that we try to recognize when a dollar bill is selling for 75 cents. I guess you could say my mother's emphasis on bargain shopping really made an impression. As WCA has remarked in earlier newsletters we like to buy good companies when they put their stock price on sale. In that way we're Joseph A. Bank investors. We buy companies when their price is less than their intrinsic value.

Having a margin of safety with respect to your investments by buying good companies at discounts increases the odds that an investment will work out. Doing this with most every stock in a portfolio creates a much better chance of doing well over time.

A third element of our philosophy is that we try to buy only certain types of companies. They are companies which, in the words of Warren Buffett, have an "economic moat." That moat provides a structural advantage protecting them from competition. Companies with wide economic moats such as Coca-Cola and Automatic Data Processing reside in profitable, stable industries. If companies can develop long-term structural advantages, the odds are high that over time they will create shareholder value.

A fourth element looks beyond the company. Good management and high growth rates are elements typically said to provide shareholder value. I'm not so sure. Neither provides structural protection, that is, an advantage built into the competitive landscape of the industry. It is an immutable law of economics that a company that generates "economic profit" (return on capital greater than the cost of capital) quickly becomes a magnet for competition. New competitors appear and sooner or later economic profits disappear across the whole industry.

We need look no further than the airline, auto, restaurant or mining industries for examples of this. Great management can't change the economic nature of an industry. Southwest Airlines for example has long been considered to have the best management team in the airline industry. Nevertheless, the industry suffers from desperate, price-gouging competition. Volatile fuel costs only add to the issues in this industry. Even the best-managed company in the industry will have a hard time earning more than its cost at capital over the long term. This makes valuation of the industry itself an extremely important part of the equation and, indeed, as important as company valuation.

Industries which are most likely to provide Petri dishes for wide economic moats have two characteristics:

1. The industry is not capital intense.
2. Customer demands are likely to grow in the coming decades, but slowly.

Industries which meet both of these criteria include information data base, banking, software, data processing, drugs, medical devices and my own industry, private asset management. Mature, slow-growth industries are attractive because the landscape is set. Competitive positions have been established.

The majority of our success comes from making the right buy decisions. Buying is much more important than selling. Very few people are good at selling and in fact, Warren Buffett admits that he is not good at this at all. The typical problem is that one sells sooner than one should.

#### **What Westover's Darts Will Hit This Quarter\***

We have two recommendations for you. The first is a regional bank, Fifth Third Bancorp (FITB). It's selling for \$44.51 and has sold as high as \$59.00 over the last 52 weeks. This healthy bank recently hit a 52-week low on January 13<sup>th</sup> when its stock traded at \$44.37. It has a yield of 2.94%, good competitive protection and should be a solid company in the years to come. It operates 17 bank affiliates principally in the Midwest. Their services include retail and commercial banking, asset management, brokerage and capital-markets activities. It has an electronic-payment processing division which moves transactions for merchants and other banks through their system. It plans to acquire First National Bankshares of Florida this quarter. Its return on assets as well as return on equity put it near the top 10% in both categories in its industry. First Bankcorp is a large-cap company with a market cap of 24,983(\$mil).

A stock on the other end of the size spectrum you may want to consider is eSpeed. This small growth company, market cap of 557(\$mil), is a subsidiary of Cantor Fitzgerald. It operates an electronic trading system for bonds similar to an exchange. Its revenues come primarily from increased volume. It also

---

\* 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.

sells proprietary software to third parties for their own use including the Chicago Board of Trade. It has offices around the globe. It has an earnings yield of 6.04% and a cash return of 8.92%. Right now, it's selling for \$9.93 and it's traded over the last 52 weeks between \$8.55 and \$25.08.

### Listen To the Music

If you think all rock-n-rollers are Neanderthals, think again. Your quiz for this quarter punctures the balloon holding that myth.

What popular 1980s rock-n-roll figure attended a well-respected Eastern boarding school and was admitted to an Ivy League school at the age of 16, having scored a perfect 800 on his math SAT before he started working for a living? Was it:

1. Jackson Browne
2. Steve Perry of Journey
3. John Oates of Hall and Oates
4. Huey Lewis of Huey Lewis and the News
5. Billy Joel
6. David Lee Roth of Van Halen
7. John Cougar Mellencamp or
8. Bruce Springsteen?

If you've caught my hint, I'll get a lot of correct responses. And as always, the first person to successfully guess the answer will win an all expenses paid trip to Suite 800, 1220 N. Market St., Wilmington, Delaware where Westover will happily conduct a portfolio analysis and review of your accounts.

But walk, don't run. And best wishes for a successful 2005!