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You Don't Need to be a Genius to Get Rich

It's no secret that we at Westover Capital think very highly of Warren Buffett. He has been successfully investing his and his company's money for many years. What is intriguing is that his success has come not from the execution of complicated strategies but, rather, by keeping it simple.

In a nutshell, Buffett, whose personal wealth now exceeds \$40 billion and Berkshire Hathaway, the company he chairs, have bought good businesses with great management at attractive prices and held on to them. That's it.

Why don't more people imitate what's worked for America's richest investor? It's too easy, right? To a large extent, I believe there is an intellectual hubris amongst Wall Street investment analysts. They've gone to great business schools. They've been taught Harry Markowitz's Modern Portfolio Theory, Eugene Fama's Efficient Market Hypothesis, Bill Sharpe's Capital Asset Pricing Model and other arcana, but in the process they've lost sight of the basics. Mr. B., who has never left his hometown of Omaha, Nebraska, has not been seduced by those same intellectual conceits.

Buffett started investing when he was 11. His stockbroker father would take him to his office on Saturdays. He read the famous value investment "Bible" written by Ben Graham at 19. Buffett believes that having an IQ above 125 is superfluous when it comes to investing. He believes that success depends on temperament and how independent-minded and patient the investor is.

At Westover we believe independence of thought is a keystone to one's success. My legal training and 30+ years of legal practice has strongly reinforced my belief in independent analysis and objective thought. You don't need to have perfect wisdom to get rich. To be successful for your

clients, you just need to have slightly more wisdom than others and a fair amount of time.

In Mr. Buffett's words "We haven't succeeded because we have great complicated systems. We've succeeded because we have simplicity itself." It is precisely because of that wisdom that we avoid options, puts and calls. We don't take short positions. We don't believe in margin transactions. Nevertheless, we do believe in asset diversification. We insist on a fair mix of bonds, cash and equities. A balance to the portfolio with respect to the sectors in which one is invested reinforces the simple idea that diversification provides a bulwark against portfolio disintegration as well as an avenue for long-term growth.

I recently looked into the cost and time it would take to get from Washington to New York by taking Amtrak's Acela Express. The price was \$106 and the time was 1 hour and 35 minutes. Out of curiosity, I then checked to see how long it would take if I took the less expensive Metroliner which cost but \$89. To my surprise the time was exactly the same -- 1 hour and 35 minutes. Given that scenario I would never elect to pay 20% more to get from point A to point B in the same amount of time. It's the same way with stocks.

For Berkshire Hathaway to buy a company's stock, that company must go through a "patch of unpleasantness," in Buffett's words. It is only by going through that patch of unpleasantness that the price will be sufficiently depressed to permit its purchase. You see, it's not buying good companies at fair prices that makes you rich; its buying great companies at bargain basement prices that puts you on the road to riches.

It's Not the Economy Stupid

Despite the general belief that the economy and the stock market are closely intertwined, that shibboleth is a myth. From 1966 through 1981 the economy grew at an average rate of 9.6% per year. For the same period of time the Dow Jones Industrial Average not only failed to grow but actually declined 0.6%.

Were the economy to grow at a slower pace, as happened from 1982 to 1999, could the market actually perform better than the last cycle? Actually, yes. While the economy only grew at a rate equal to two-thirds of the previous period at 6.2%, the Dow grew at an astounding 15.4% per year. That's why it's very dangerous to equate economic growth with stock market

success.

For what it's worth, I believe we are presently in a secular bear market which will last for the foreseeable, short term future. I think the economy will grow smartly but the market will lag. Nevertheless, I firmly believe that Westover's ability to find and identify appropriate companies at good prices will overcome pedestrian market returns for our clients during this market cycle.

Efficient Markets and Miss Martha

The efficient market hypothesis to which I made reference was a theory introduced in 1970 by Eugene Fama. It posits that stock prices always will reflect all known information about a company at any given point in time. As a consequence, stock prices are always perfectly priced. No investor can have an edge over another on finding an undervalued security. Taken to its logical extreme this hypothesis implies that one should put all his or her investment dollars in passive index funds, buying the market rather than individual stocks. And, indeed, there are investment management firms which charge investment management fees for doing exactly that. They take their clients' monies and invest it in index funds. Sadly the clients won't make even market returns since fees are deducted therefrom. At Westover we firmly believe there is a better way. We believe one can always find individual companies whose growth potential, through a combination of price appreciation and dividends, will be more successful than market returns.

Let's see whether the Efficient Market Hypothesis applies to Martha Stewart's company, Martha Stewart Living Omnimedia (MSO). If Dr. Fama is correct, that stock price in today's market will be perfectly priced. Consider that shares of MSO are now three times more valuable than they were before the scandal broke in September 2002 when a Merrill Lynch broker-assistant pleaded guilty and agreed to provide information on Ms. Stewart's trading history. At that time, MSO shares were trading at \$7.80. They are now trading at \$24.35 and were as high as \$30.36 on September 20th.

This is the stock's nose bleed price even though the company, which made money in 2002, has lost money every year thereafter. I ask you, would you buy stock in a company that had lost money in seven of its last eight quarters like Ms. Stewart's? You might not, but Martha's company is up 382% since it hit bottom on October 9, 2002.

You may have heard of the new TV show called "The Apprentice: Martha Stewart." That show apparently has been fueling MSO's stock price even though the company doesn't own it! Instead, it's co-owned by its executive producer Mark Burnett and The Donald. (Yes, one Mr. D. Trump.) Not even sweet Martha herself has an ownership interest in the show, although she is handsomely paid by it. Go figure.

Martha will be paid \$500k for every season; MSO nothing. In addition, MSO gave 2.5 million stock warrants to Mr. Burnett. The warrants give Burnett the right to buy shares in the company at \$12.59 per share, even though the company gets nothing from the production of Martha's show other than a little pub for its titular head. Those warrants, however, dilute the value of the shares held by other investors by more than 5%. They cost the company more than \$10 million recently. Were sales of Martha Stewart-branded items to double in K-Mart, that would bring no additional cash to the company due to the structure of the deal! Efficient markets? I hardly think so.

There's an interesting twist on this story too. So many other investors also believe that MSO is overpriced that the so-called "short sellers" account for 56% of the shares available for trading. That's an astounding 24 times more than the average short selling level among the 100 largest stocks in the S&P 500!

I think Warren has it right. Keep it simple, stupid.

Stocks to Examine*

As you heard earlier, an important watch word for Westover is balance. When I look at this portfolio I see that it is presently over-weighted on the growth side and under-weighted in large-cap stocks. We especially like financially healthy companies whose PEs are below their historical norms and which pay healthy dividends exceeding today's S&P average of 1.6%.

Our first recommendation is a super regional bank, Wells Fargo (WFC.) Its PE the trailing 12 months is presently at 13.6 which is as low as it has been since 1995. WFC pays an exceedingly healthy dividend at 3.35% and provides an earnings

* 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.

yield of 7.33%. It derives income streams from a strong fee-based business as well as an impressive loan business. The recent merger with Norwest has boosted profits from the existing customer base through cross-selling. It has also acquired \$29 billion of assets under management from Strong Financial. Though I am not usually a fan of mergers and acquisitions, I think both of these will benefit Wells Fargo. The business model is deceptively simple. (There's that word again.) It typically prefers to operate with slightly more employees than your typical bank. The result, however, is that customers are not kept waiting. WFC has an aggressive sales force and strong credit-worthy customers. It does not compete on price but has a very large branch network which helps to generate a steady flow of low-cost deposits which, I believe, will ensure wide net interest margins. It is presently selling at \$58.60.

The second "simple" recommendation is Coca Cola (KO). Coke's present PE is 21.2 which is really low. Back in the go-go '90's it got as high as \$69 and was at \$28 just two years ago. The dividend is a very healthy 2.58%. Coke is an absolute gorilla when it comes to generating cash flows from operations. The last twelve months have seen the largest cash flows in its history (\$6.5 billion). You may think Coke is ubiquitous world-wide and that it doesn't have much room to grow. Consider this. Coca Cola products account for only 1 in 50 beverage servings daily on a worldwide basis. That leaves plenty of room to grow! Coke plans a significant share repurchase program in 2005, on the order of \$2 billion. Volumes in China grew at over 20% last year, leading China to become the company's fifth-largest market. Coca Cola is generally regarded as the world's most valuable brand. It's presently selling at \$43.13.

Neither of these stocks is sexy. They are dull and straightforward. Simple in their own way. Just like Warren was growing up in Omaha.

Listen to the Music

As you know, I enjoy music. It's not true however that I'm caught in a time warp, only listening to music from the '60's, '70's and '80's. It's just that you, my dear reader, grew up with that music as did I, the songs and the artists from that era are familiar to many of you and I can use them to tell stories and metaphors.

My personal tastes turn to artists few of you would know -- Brian Culbertson, Gerald Albright, Richard Elliott, Boney

James, Jeff Golub, Boz Scaggs, Kim Waters, Billie Holliday, Diana Krall, Sade and Norah Jones.

Ms. Jones is a vocalist and pianist who has developed a unique blend of jazz with a bluesy, country feel. Her 2002 release of the song "Come Away With Me" went multi-platinum, sold 18 million copies worldwide and won her eight Grammy awards. So here's the query. If you've heard of Kevin Bacon's "Six Degrees of Separation" then tell me this, what's the one degree of separation between Ms. Jones and Beatle George Harrison?

I'll give you a hint. The answer may be found in the ancestral lineage of Ms. Jones. Here's a second hint: he performed at Woodstock as well as at the famous 1967 Monterey Music Festival. Here's a third: he's not an American. No cheating! We work on the Honor System here. I trust each of you to apply your minds, but not Google, to this question. George Harrison...???...Norah Jones. The first one to come up with the answer will win a \$50 gift certificate to Krazy Kats Restaurant. Honest Injun. Good luck!

And remember, you don't need the IQ of a genius to make it in the stock market. Keep it simple.

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