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IS THE SKY REALLY FALLING, CHICKEN LITTLE?

At 3 PM last Friday afternoon, September 28th, a life long friend and brand new, as of July, Westover client called me from his cell phone as he drove up to Wilmington from his Delaware home in Lewes. "How's the market doing today, Murray?" "I don't have any idea, haven't even looked," I replied. At first blush that response may seem strange indeed coming from a professional money manager. But it demonstrates the difference between having either a short-term or a long-term investing focus. As I've said many times to many people, at Westover we invest for the long haul.

Patience is as important an element for investment success as is intelligence, maybe even more important. I know Warren Buffett believes that and is on record as having said so.

Here are the words of Mary Buffett, the daughter-in-law of the Omaha Oracle. She was married to Mr. Buffett's son Peter for twelve years and has written several books with co-author David Clarke about her famous father-in-law. Mary was interviewed this year by *Forbes.com*. When asked what the most important lesson was she had learned from Mr. Buffett, she replied: "Patience and discipline. And doing something you love." If you're interested, her most recent book on which his pearls of wisdom can be culled is *The Tao of Buffett*.

Nick Murray, a famous author and financial advisor, says this about successful investing:

"Great advice never changes; that's what makes it great. Faith, patience and discipline are the attitudinal/behavioral keys to investment success; that never changes. Asset allocation, diversification and rebalancing are the keys, within the portfolio, to how it performs over time; that

truth never changes. A good advisor is saying exactly the same things now [2007] that he said at the top in 2000 and at the bottom in 2002. What has 'today's market' got to do with anything?"

Indeed, today's market performance has next to nothing to do with long-term investing but everything to do with selling newspapers and selling advertising on cable business channels.

Witness the cover story from the business section of *USA Today* for August 16th. Smack dab in the middle of the first page of the Money section was an ominous huge red graph with a downward angled arrow which covered half the page. This chilling headline accompanied the graph: "Markets Give Back 2007 Gains." The sub-head noted that investors' fear and the growing credit crisis was moving "stocks toward [a] 10% correction." The S&P 500 had closed on July 19th at a record 1,553. Less than one month later, the Nation's Paper was pleased to report the S&P closed at 1,407, down 9.4% from that all-time high.

Measuring performance from an all-time high or best is absurd. Tiger Woods won his 13th major golf title, the PGA title at Southern Hills in Tulsa, on August 12th. In the process he shot a final round one-under par 69. That's a pretty good score, right? However, it was six shots worse than his 63 on Friday. That 63 was Tiger's all-time best round in the 46 majors he has entered. He's played 179 rounds in those majors; it was in round 177 that he set his all-time best. If the *USA Today* headline writers who clucked about the 9% drop from the S&P 500's all time high had written the headline for Tiger's round on Sunday, it might have read "Woods falters. His closing 69 off 9.25% from Tiger's all-time best."

Markets go up and markets go down. Golf scores go down and golf scores go up. What counts is consistency. What counts is patience and discipline.

I had the misfortune of placing trades for my "How's-the-market?" Westover client on July 11th. This was just a week before the S&P 500 hit that historic high. Within a month, his portfolio was down 10%. Blessedly, he never called. Why? Because he's got a long-term perspective. He knows from his own investing experience that, just as pistons in a car move up and down, so too does the stock market. Today, his portfolio is well in the black. And five years from now neither of us will remember whether his initial investments were placed near July 2007 market highs or August 2007 lows. Why? Because Tiger will have certainly won more majors in the next 5 years, and the markets will have certainly set new records too.

Yes, in mid-August the S&P was at 1,407, off almost 10% from its all time high, but it then rebounded very nicely over the next six weeks. The S&P 500 closed at 1,526 on the last trading day of September, thereby making back almost all its losses of the preceding six weeks.

My advice is to ignore the daily noise. Avoid it as much as you do I-95 the day before your Thanksgiving trip to relatives. The financial advice newspaper pundits offer is no more substantial than a wisp of fog on a windy San Francisco day. Poof and its gone!

Computerized stock market trading systems also demonstrate the weakness of short-term thinking.

Both Google and Microsoft, two internet titans if there ever were such, reported their quarterly results the same day in late July. Astoundingly, Google increased its revenues 58% over the same period of time in 2006. Its net earnings increased 28%, going from \$2.33 per share in 2006 for the quarter to \$2.93 in 2007. As you would expect during a period of explosive growth, Google added a substantial number of new employees, 1,548 to be exact. This increased Google's employment by 13% when compared to the preceding quarter. But despite increasing revenues by more than 50%, earnings by more than 25%, and people by 13% the share price of Google fell 7.2% in after hours trading that day. Why? Because their \$3.56 earnings number missed the noise number from the analysts of \$3.59. Short-term, that three cent miss cost Google many million dollars in market cap, but long-term they'll make it up.

Compare those numbers with Microsoft's much more modest ones. Instead of net earnings increasing at 28%, Microsoft announced an increase of 7.3%. And instead of earning more than \$3.50 per share, Microsoft announced earnings of \$0.31 per share for the quarter. Microsoft's core business, that of selling software to businesses, continued strongly but its Xbox 360 videogame business continued to lose money. In addition, revenue from its online advertising, which directly competes with Google, saw an ever-widening loss when compared to the previous year. Nevertheless, Microsoft's stock went up \$0.59 at the close of business that day. This was a 1.8% increase. Why? Mr. Softee met the analysts projected earnings number. I don't know about you, but the last time I cracked a math book \$3.50 beat thirty-one cents.

That is an example of why we don't worry about short-term swings or give a great deal of attention to what New York analysts have to say. Our insistence on following our own path sometimes makes me feel more isolated than a Duke basketball fan at the Dean Dome in Chapel Hill, but we call it as we see it. And we have to in order to be long-term

investors. If you are patient and disciplined, that faith has its rewards. The annualized total return of the S&P 500 over the last 20 years has been 10.83%. But over shorter periods of time that return has been anything but. As an example of the importance of patience, in 2000, 2001 and 2002 S&P 500 returns were -9.1, -11.9 and -22.1%.

You'll remember that the doomsayers at *USA Today* believed the sky was falling in mid-August. Had they been a little bit patient they would have seen that six weeks later on October 2nd the Dow Jones hit an all time high. And the benchmark S&P 500 was back up too, being just 0.4% shy of its July 19th all-time high. Tiger Woods would be proud.

What If You Were As Rich as Croesus?

Suppose for the moment that you had more money than God or at least more than Bill Gates or Warren Buffett. Imagine you could buy any company in the world. Would you know the value of your various purchases relative to each other? Imagine that you bought Hilton Hotels as did a private equity group, The Blackstone Group, LP, this summer. Imagine also that you bought the Chrysler car division from its German parent, DaimlerChrysler AG, as did a second private equity firm, Cerberus Capital, this summer. Finally, imagine that you agreed to buy Commerce Bancorp as did TD Bank Financial Group on October 2nd. Mr. Gates or Mr. Buffett could each use their loose change to buy all three. My question for you Croesus is what is the relative value of these three purchases? Which would you pay the most for? And how much would you pay? Not sure? The answers can be found in the footnote.*

A Little of This and A Little of That†

It's no secret that the value of the dollar relative to other currencies is on a downward spiral. The Fed's recent action in lowering the discount rate by 50 basis points has contributed to that disparity. For the first time since the

* Notwithstanding Chrysler's long and storied history, its purchase price of \$7.4 billion was approximately one quarter the value of the Hilton Hotels buyout which was valued at \$26 billion. Commerce, which joined the Delaware market less than ten years ago, has agreed to be bought for slightly more than the Chrysler buyout, at \$8.5 billion. Would you have said Chrysler was the least valuable acquisition?

† 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. Westover Capital Advisors, LLC will provide a list of recommendations made during the past year upon written request. 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.

1976, the Canadian dollar is on par with its U.S. counterpart. And the Euro is at an all-time high relative to the dollar. That makes companies whose sales are primarily in overseas markets or whose revenues are in non-dollar denominated currencies very happy. Accordingly, you might take a look at either or both of these non-U.S. recommendations.

The first company is Siemens Aktiengesellschaft (SI). This German conglomerate has 13 separate business segments. Think of it as Europe's answer to General Electric. The markets it principally serves are industrial business systems and services (31% of sales), power generation (20%), transportation and automotive products (19%), healthcare (14%) and building and lighting products (10%). It pays a decent dividend yield of 1.33% and trades presently at \$140.87. Its forward P/E is a modest 15.4 and its price-to-earnings growth ratio is less than the industry average by approximately 25%. I like its diversity and its non-U.S. revenues. Don't be put off by its 45.7% year-to-date price appreciation. Its market cap of \$122 billion and large growth sector location makes it an ideal company to be bought today for the long run tomorrow. I think it can add another hundred dollars to that price before you would consider selling it.

Another company that fits our international theme is Arcelor Mittal (MT). This Netherlands-based company is the world's largest steel producer. We know China will be demanding steel for a long time. Arcelor operates in sixty countries. Its operations are nicely integrated also with iron mines, coal mines, coke plants and a large European metal distribution system. Its dividend yield is 1.37%. Its market cap is \$75 billion and its price on October 2nd was \$80.08. Valuation ratios are favorable also. Its P/E is 15.2 while its PEG ratio is 1.1 compared to an industry average of 1.4. Its cash return of \$4.46 is extremely healthy. I think it can push \$100 before I would start considering its sale.

Listen to the Music

I'm personally delighted to report that the winner last quarter was Jeanne Burge. Jeanne worked at my law firm in 1980 before she saw the light and went to work for Mike Weiss with whom she has since been associated for the last 27 years. She has been faithfully participating in our music quiz for the last several years. We asked you for the Christian names of Duke Ellington, Count Basie and Dizzy Gillespie. Checking with her father-in-law, Jeanne correctly identified Duke as Edward Kennedy Ellington, Dizzy as John Birks Gillespie and Count Basie as William James Basie. Jeanne, it was good to hear from you.

To say the least, my music tastes are eclectic. I very much enjoy classical music, although I don't listen to it as often

as other genres. Just as I think we sometimes tend not to appreciate the relative value of various businesses, so too I think we tend not to appreciate the period of time in which some of the world's finest classical composers lived.

The quiz for this quarter is actually a simple one. Correctly place these five composers in order of their musical era, from oldest to most recent:

- Johann Sebastian Bach
- Johannes Brahms
- Gustav Mahler
- Wolfgang Amadeus Mozart
- Franz Schubert

If you didn't know the value of Hilton Hotels compared to Chrysler or Commerce Bank, perhaps you know eras of these five famous composers relative to each other. Remember, you can't Google the answer. All my newsletter recipients agree to play by the Westover Honor Rule. You can use your own mind as well as the memories and minds of your friends and coworkers, but no open books. You can also e-mail me with as many guesses as you like. There's no charge for you to guess, and the winner gets a \$100 free lunch (or dinner) certificate, courtesy of WCA. Good luck and have some fun.

Finally, when Chicken Little tells you the sky is falling, tell Chicken to take a nap and look again later. Who knows? By then the sky might even be Carolina Blue!

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