

1838 Large Cap Equity

Fourth Quarter Review

Would it be presumptuous to begin this piece with a challenge: we are in the early stages of the next bull equity market?

During the last 3 months, the S&P 500 Index has climbed 10.7%. Three of its more cyclical components, Technology, Consumer Cyclical, and Basic Industries, have experienced gains approximating 36%, 21%, and 16%, respectively. These sectors typically anticipate changes in economic conditions, and recent stats released by our Government are showing some signs of resilience, confounding bears and pessimists. What...no panicked selling capitulation on Wall Street?...no attendant collapse in real estate values, or our dollar? It is difficult to remember, amidst the barrage of "prescriptions" that investment strategists write, that there is no repeatable script for how a bear market/recession plays itself out, beyond the fact that the stock market is a leading indicator, and we investors will surely follow. In other words, the presumption is that we investors will confirm the existence of the next bull market, only when we have proof retrospectively, a flawed way to invest. Hence, 1838's rule #1: stay fully invested.

We have kept pace with this welcomed positive market change during the last quarter, and it is gratifying to outperform in 5 out of 8 economic sectors, as compared to those of the Index. Our best relative returns have been garnered in Technology and Healthcare, two very different investment vehicles. Tech stocks are very sensitive to economic change, and it seems that investors have continued to focus on industry-dominant companies that are fortifying their positions during this slowdown. Our holdings of Intel, Cisco, Microsoft, Micron Technology and IBM top this list. On the other hand, Healthcare stocks are least sensitive to economic change, and are governed more by new product offering. We have experienced strong relative outperformance in Abbot Labs, Medtronic, and Johnson and Johnson, as all three companies continue to make announcements about successful drug and medical device introductions.

We underperformed in only 2 sectors of the S&P 500 by a notable amount, Consumer Cyclical, and Deregulated Industries. In the former area, we have maintained our investment in retail and advertising-sensitive companies such as Wal-mart, Target, and AOL Time Warner and Viacom respectively. Our retail holdings performed very well, but the media companies have not yet experienced a turn. Further, our performance in Consumer Cyclical was hampered by another disappointment from CVS. We believe that this "no expectations" stock is extraordinarily cheap and will provide strong returns in '02.

In Deregulated Industries, we had poor returns in our Mirant and Qwest Communications holdings. The debt rating agencies reacted irrationally after their spectacular miss on Enron. That company moved from an investment grade rating to bankruptcy in only a few months. As a result, Mirant was tarred despite better balance sheets and cash flow. Qwest continues its aggressive restructuring, focused on cutting capital spending. We are maintaining our small positions in both stocks.

This past year has been a difficult one for equity investors. Underperforming in a bear market during a recession is one of the distasteful experiences that any good long term stock investor accepts as inevitable and works hard to counter as the environment improves. Let us hope that 2002 brings a healthy, rewarding, and above all, safer environment. Happy New Year!