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CREATIVE DESTRUCTION

Happy Year of the Dog! It is our tradition at Andresen & Associates to send the traditional gift of Lai See, a gift of cash to express our wish for your prosperity in the coming year. As we celebrate Asian New Year, we have chosen to provide you with money from Laos. This small obscure nation has spent most of the last 50 years encrusted in Marxism and tyranny. As we enter the 21st century, the small bit of money we have enclosed in your newsletter depicts both bleak past and future hope. One side of the bill depicts Communist soldiers marching while the other side depicts children studying. May it be so...

This Christmas I gave my daughter an iPod. This miniature computer originally was designed to download music from websites. The first thing my daughter did when she received her gift was to download a season's worth of the TV detective series "Monk", ten hours of viewing for a cost of \$18. Then we watched the episodes on a family lap-top computer while trapped by snow in a cabin without electricity in the Sierras. Imagine what the Donner Party would say.

I watched all this and realized that this iPod technology had just made CD's, tapes, and most DVD's obsolete. It also will threaten all the video rental stores as well as Netflix and eventually booksellers as well. Once again, abrupt and unexpected change has reshaped the society in which we live.

An unrelenting tide of change is washing over the world, and sweeping all before it. The Third World is painfully shedding the battered exoskeleton of socialist delusion. The First World is morphing into an information-based, hyper-competitive global economy. As individuals, we are unavoidably caught in the middle.

As we grope our way to a balance between ethics, culture, and capitalism, some of what we will experience will be unpleasant and morally wrong. After all, simple raw Darwinist capitalism failed in the past as much as Marxism.

However, the dominating lesson of history so far is that market solutions work far more efficiently than government-directed solutions. Some sort of morally-modified free-market system appears to be in our future. In the meantime, it is going to be a bumpy ride.

This engine of socio-economic development, experienced individually, has always been a meat grinder. Ask anyone who experienced the depression of the 1930's, or the recent tech meltdown in 2000. Our long-term track record is that of success followed by more success. In the shorter term, we have all been tossed out of our shoes by societal changes so unexpected and abrupt they caught us all off guard.

As you can see on **GRAPH 1**, the US stock market, depicted by the Dow Jones Industrial Average, appears to plot an overwhelmingly successful path across the decades. This is a misrepresentation. Like trees, all corporations have a lifecycle. They are born, they grow, they adapt, and they pass on to fertilize new young businesses. Inside that placid graph line, the Dow Jones Industrial Average was constantly altered by its handlers to reflect the newest dominant businesses. In the 1920's, the Dow Jones Industrial Average contained Wright Aeronautical and Victor Talking Machine. Now it contains Intel and Microsoft. Within the US economy, change has been great and unrelenting.

Both knowledge and access to capital are now becoming globalized. Thanks to the Internet, millions of minds now have unrestricted access to learning and to the possibilities of innovation. Now a Russian or a Laotian or a Chilean can compete with us for our own job. This will inexorably pull American wages and profit margins towards those of the rest of the world. We are in an unavoidable economic arms race, wherein a rising tide will raise all boats...or a sinking tide will strand us. With the Chinese owning billions of dollars of the US national debt, we are becoming joined at the hip to the whole world.

With all those minds at work, we can also expect innovation and competition to rule. Both will drive down prices and reduce inflation. Both will continue to provide solutions or at least ameliorations for long-term global plagues such as hunger, disease, and war. History suggests that affluence promotes altruism. As a Third World nation becomes more affluent, experience indicates that population increases decline and per-capita education, health care, and income all increase. Former CARE package recipients become productive exporters and consumers. Environmental awareness actually increases as a nation becomes more developed. And it is really hard to drop a nuke on someone who owes you money.

In short, we are discovering that this global economy is not a zero-sum game. They do not have to lose in order for us to win. In the longer term, it is possible for all sides to benefit, if we are careful, sensitive, and flexible.

Newly-minted Third World entrepreneurs are not the naïf's which popular opinion imagines. For example, the global price of gold is up, in part due to newfound manufacturing riches in unexpected places. Newly rich shirt manufacturers in Mauritius, ski makers in Ukraine, and real estate developers in Sri Lanka are finding that local currencies are unstable and local banking laws forbid their investment in dollars or Euros. So, instead, these budding capitalists are investing in gold with their profits. Gold is highly portable, transferable, universally accepted, and untraceable. These newcomers will fit into the global economy nicely.

However, it is also true that some of our new best friends are not nice people. Many of them already despise the US politically, while, at the same time, embracing our global culture. Globalization will also ensure that misuse of advanced technology by the disaffected and marginalized is inevitable. Al Qaeda is probably the first of many to attack us through our own infrastructure.

Therefore, we need to recognize that increasing change and turmoil are probably inevitable. As investors, we need to insulate our portfolios from volatility as we would prepare a ship for a storm. I believe that most investors are profoundly underestimating the amount of chaos they will experience in their portfolios in the coming years. It will be quite possible to become wealthy, but we will have to set our egos and our assumptions aside in the process.

My conclusion is that all investors are best served in profoundly diversified portfolios of mutual funds, with a decidedly global bias, and a pronounced emphasis on avoiding risk. That's geek-speak for "We are doing the right thing". Let's stay focused on our long-term plan, including investing in those mutual funds, and stay the course. 💡

GRAPH 1: DOW JONES INDUSTRIAL AVERAGE 1900-2005



Source: Carnegie Mellon University Dept. of Statistics, from www.analyzeindices.com