

ANDRESEN AND ASSOCIATES

P.O. Box 1434 Salinas, CA 93902-1434
Phone: (831) 758-1575 or 1-800-345-9644

WWW.ANDRESENASSOC.COM

NOVEMBER 5, 2004

“AFTER THE ELECTION”

Now we know that George Bush has been reelected. The new question facing us is, “How will the next four years affect my investment plans?” We don’t know what will actually happen. However, we **should** plan for some probable events. I mentioned most of these in my August newsletter, “The Next President”. I feel that President Bush will face several unique challenges in the next four years.

George Bush needs to work to bring us back together as a nation, or there will be a backlash which sweeps the Democrats to power in 2008. The exit polling from this election revealed that most voters chose the candidate they loathed least. That is not a recipe for national optimism. We need national optimism to attract lasting investment in our economy.

As a result of our national anxiety and our massive national debt load, I do not believe the clear euphoria of a raging bull economy will develop any time soon. I believe that we are about to enter into a new, tumultuous, and potentially profitable four years, wherein astute, diversified, careful investors can thrive. Of course, the next four years will also include some unique risks, such as terrorism. I think we must plan for the most probable events, both because we will make money by doing so, and because we will avoid losses by sidestepping declining markets. In short, our economy will soon begin to crawl out from under its rock. I expect earnings growth of 3% or more in 2005, and I expect durable goods orders and hiring to increase. Barring any bad war news, I believe that the overall economic trend is positive until at least mid-2005. At that point, President Bush will begin to address compelling national economic issues such as health care and taxation, and we may need to alter our plans.

Hand in hand with this overall economic recovery, I expect that interest rates will gradually increase. Large corporations have been salting away Treasury bonds in the past six months to guard against another 9/11 style terrorist attack in the final days of the election. That artificial demand for bonds, combined with an election/war related lack of demand for investment capital, has kept interest rates artificially low over the past year.

Another trend that will gently boost interest rates is the ever-growing level of debt in our economy. Recent government budget deficits, personal consumer debt, and the real-estate mortgage mania suggest that interest rates may easily rise. This mountain of debt is going to act as a drag on our economic recovery. I expect a decent restoration of economic momentum. Due to “Debt Mountain”, I do not expect a boom. In 2003 and early 2004, I sold many bond funds and mortgage investments that I felt were at risk of profound loss due to an interest rate rise. Actually I was early, because I did not anticipate the recent Treasury hoarding which preceded this election. Now that hoarding should unwind, rates should rise, and we should see bond funds and mortgages begin to decline.

Meanwhile I also expect that oil is going to decline in price, either rapidly or slowly. There is a bit of a “fear premium” built into the price currently, which should dissipate over time. I also believe that the current high prices are damaging to the long term prospects of the oil industry. The current high prices should decrease demand as cost-driven conservation emerges, and supply should increase as more marginal production is brought on-line. Result: lower oil prices. Look for me to reduce your exposure to oil stocks, quickly or gradually, depending upon the situation.

As a result of excessive debt, the high price of imported oil, and continued outsourcing, we now have a soaring imbalance of payments. US consumers borrow against their homes to buy imported computers and gasoline, which they quickly consume. Meanwhile, our economy dawdles towards success as we shake off our recent economic miasma and with the money we earn, we buy...more imports. Of course, some of this imbalance is a natural cycle, and some of it is due to the unusually high price of imported oil. However, the result to US investors is a declining dollar, versus other currencies. These pressures suggest that we should place more of your investments overseas, because investments in foreign currencies may easily do better than investments in dollars.

Also, the global economy is growing at its fastest pace in thirty years, up 5% in 2004 and probably up even more in 2005. The US is growing at a decent but slower 3% rate. Keeping in mind that chaotic overseas markets tend to implode occasionally, I continue to believe that some superb investment opportunities exist internationally, especially in the very high risk emerging markets.

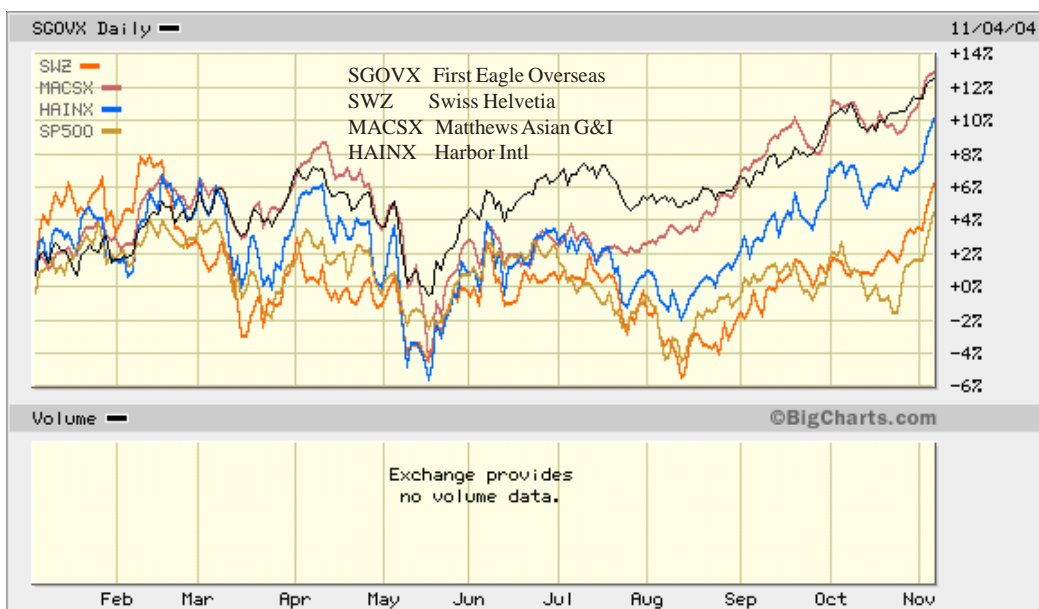
By investing overseas in the past few years, we have benefited from a growing global economy and the declining dollar. We will expand that theme, and we will be sure to pick lower risk, value-oriented, multi-national mutual funds to control risk.

Real estate is currently overpriced. We do not know if the higher interest rates will simply slow down price gains or actually burst the bubble and cause price declines. Since most people have the bulk of their wealth in real estate via their homes, the degree of market impact will profoundly affect our economy. We will not know the extent of the impact until it happens. This is one more reason to move a little more money away from domestic financial stocks and towards overseas investing.

Yet, despite everything I have mentioned, the stock markets still offer some profound bargains. All the angst of the recent elections restrained investment in stocks and mutual funds. In the past year, earnings have increased while most stock prices have largely stayed flat. As a result, some stocks are currently historical bargains. I do not find index and growth funds particularly attractive right now since they include the overvalued stocks we want to avoid. Instead we are studying mutual funds which focus on "growth and income" dividend-paying stocks in the value, mid-sized, and small cap categories. I believe these funds should outperform the indices over the next year.

Of course, geo-political events could change my expectations. We will need to watch portfolios carefully in 2005. However, historically, many times such as this have produced attractive gains to value portfolios while the stock indices went sideways. Peter Lynch of Fidelity Magellan and Michael Price of Mutual Shares both made themselves investment legends by delivering decades of double-digit gains while the stock indices turned in single digit returns. We are looking at a similar environment now. These turbulent times may not provide a lot of emotional comfort, but they can sometimes produce outsized returns for astute contrarian investors.

Remember, diversification pays! We are not going to bet your whole nest egg on one aspect of our complex economy. And please remember: we live in interesting times. The climate may change rapidly. At Andresen and Associates, we will be paying attention as the new year unfolds. ❁❁❁



So far in 2004, our international picks have beaten the S&P 500 Index, thanks to the falling dollar.