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# THE INDEPENDENT ADVISOR

Quarterly Client Newsletter

## Large Cap Tech Stocks--The Darlings of Yesterday's Investors The Laggards Of Today's--What Should You Do?

Many investors continue to like the large-cap tech stocks, such as Cisco, Oracle and Intel. Those stocks have been "creamed" in the last 16-month market decline, but investors are convinced they'll rise from the ashes and achieve their former glory. Well, if history is any guide, the next area of action in the stock market will likely be elsewhere, and that shift downward for the large-cap tech stocks could well last a long time.

Two major historical trends may get in the way of such large growth stocks in the future. As Ken Brown, a Wall Street Journal reporter, said recently, a) today's market leaders tend to lag in the next cycle and b) recent research indicates that when companies get too large, overall corporate growth tends to lag. How big is too big? The research reveals that when companies hit \$20 billion to \$30 billion in annual revenue, future growth rates decline. What tech companies fall into that range? Many are companies that investors still seem to have a lot of faith in, such as Dell, Ericsson, Microsoft, Cisco and Sun Microsystems.

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The last time investors were so interested in such a narrow group of big companies was the Nifty 50 era of the late 1960s and early 1970s. Then, big, fast growing companies such as Gillette, Minnesota Mining & Manufacturing, Coca Cola and

McDonald's soared. When the tough bear market of 1973-74 hit, such stocks declined much more than the average stock did. Many Nifty 50 stocks languished for 10 to 15 years.

Big investors, such as Peter Lynch and Warren Buffet, profited at the time by looking elsewhere for opportunities. They looked for cheap, out-of-favor "value" stocks, as well as smaller companies. In his 1978 letter to shareholders of Fidelity Magellan, for instance, Lynch wrote, "the portfolio is dominated by three categories of companies, special situations, undervalued cyclicals and small and medium-sized growth companies." --certainly not the Nifty 50 stocks.

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**"...the shift downward for tech stocks could last a long time...my advice is that the smart investor should be well diversified. Keep some large tech but make sure you've got exposure in value stocks, as well as mid-cap and small-cap growth."**

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So what's my advice? Since I'm in favor of a balanced approach and always acknowledge our inability to forecast the future, I'm not advocating a wholesale exodus from large growth into value stocks. But I certainly would maintain prudent and cautious amounts of Cisco, Microsoft and other large tech stocks. Overall, the average investor should be well diversified, with no more than 30% of the portfolio in technology. And a portion of that exposure should certainly be in mid-cap and small-cap growth funds with good long-term track records.

## Conflict of Interest of Brokerage Houses Makes Headlines

Just as many investors prefer independent, fee-only financial advisors to obtain impartial advice, so I look to independent providers of stock research, such as Value Line and Standard & Poor's rather than brokerage firms such as Merrill Lynch. Laura S. Unger, the acting chairwoman of the Securities and Exchange Commission, recently spoke on the subject of Wall Street research analysts and the "blatant conflicts" they face. Specifically, she took issue with the widespread practice of paying analysts based upon the investment banking fees generated when their firms raise money for the companies the analysts follow. Such an arrangement encourages an analyst to be overly positive to keep investment banking fees coming in. Other conflicts of interest include allowing analysts to own stock in the companies they cover-- hardly a formula for objectivity.

Hearings began just last week in Washington on the subject of analyst objectivity. Richard Baker, Republican congressman from Louisiana, is presiding, as chairman of the House subcommittee on capital markets. He is concerned that individual investors may not know how biased the advice coming from analysts (and therefore from brokers) can be.

Ever notice how brokerage firms very rarely recommend selling a stock? Now you know why. The antidote, in my opinion, is to turn to such services as Value Line for unbiased research. A better solution, of course, would be to see the Wall Street analysts clean up their act. Last week, a first step took place--14 brokerage firms endorsed a set of practices for the industry, covering broad areas like analysts' compensation, personal ownership of stocks by analysts and the objectivity of the reports themselves. Observers call it "a step in the right direction," but not a big enough one.

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## Attention Parents!

College Savings Plans, available in most states, just became more attractive. The tax legislation, signed by President Bush just last week, makes withdrawals tax-free at the Federal level, starting next year. So if you're already in one of these plans, try to avoid withdrawals until next year.

Previously such plans taxed withdrawals at the child's tax bracket, usually 15%. Some states, including NY, NJ and CT, already provided a state tax exemption. In fact, New York's plan also offers state tax deductions for contributions, for New York taxpayers, of \$5,000 per year or \$10,000 for a married couple filing jointly.

Several tips: 1) if you think your child might be eligible for financial aid, don't pile too much into a College Savings Plan. Earnings on such plans are considered student income, which often weighs more heavily against a potential aid package from the college than parents' income; 2) consider your own state's plan first, since, like NY, tax deductions or matching contributions to residents may be available; 3) Look carefully at the plans, since they vary in terms of flexibility and costs. Another state's plan may actually be better for you. Go to [www.savingforcollege.com](http://www.savingforcollege.com) for detailed comparisons; 4) strongly consider selecting an age-based portfolio for your child. This way, the College Savings Plan automatically makes the composition of your child's portfolio more conservative every couple of years, so that by the time college starts, risk of loss has been reduced to a prudent level.

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## ABOUT THE ADVISOR...

*Christopher Kuehne is an independent, fee-only, Certified Financial Planner (CFP) and Registered Investment Advisor. He has worked in the financial services industry for 18 years in various capacities, including 12 1/2 years on Wall Street as a Vice President at Merrill Lynch and Bankers Trust Company. Mr. Kuehne has an M.S. in Economics from Carnegie-Mellon University, is a member of the Financial Planning Association and the National Association of Personal Financial Advisors (NAPFA).*