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First Quarter, 2001

STAYING THE COURSE

In light of the recent drop in the stock market, we thought we'd review some of the central tenets of our investment thinking and philosophy. These were developed by our firm's founder and by the late David L. Babson over the course of their long careers. They are rooted in common sense and are, therefore, timeless.

Over the last five years, some investors saw their portfolios increase dramatically in value, and then in a matter of months watched as a significant portion of these gains evaporated with a poof. But those investors who developed and maintained a sensible long-range plan for their portfolios fared much better.

Just as you need blueprints to construct a house, and a business plan to build a business, having a plan for your portfolio and staying with it through thick and thin is crucial for long-term success. In this recent period where earnings didn't matter and valuation was for fuddy duddies, many investors were lured by rumors, greed and bad advice. They ended up speculating instead of investing. Now that a feeling of gloom has set in, these same investors run the risk of selling stocks when they should be buying.

Instead of letting emotions rule the decision-making process, investors can save themselves a lot of trouble if they ask some basic questions. What do you want to accomplish with your capital? What guidelines should you follow in selecting suitable investments? And finally, what is the best attitude to have when market psychology swings back and forth and there is strong pressure to follow the herd?

Long-Term Planning

The first thing to realize is that your objectives as an investor may differ markedly from those of other investors, such as your neighbor, co-worker, or company pension plan. And it is important to keep in mind the possibility that your fellow commuter, who boasted of "ten-bagging" his money in one hot stock, may not even have an investment objective.

All investors should have a clear and realistic understanding of what they want to accomplish by investing. A retired investor who enjoys traveling and helping the grandchildren out with their college tuition will have a different objective than a young couple just starting out. And the young couple just starting out will have different objectives than a charitable foundation or endowment fund which pays no taxes but typically requires a high annual cash flow.

Once you have defined your investment objectives, the next step is to choose the best means of balancing present needs with future goals. An important step is to determine the appropriate mix of fixed income securities versus common stocks in the portfolio. Several factors are taken into consideration, including the investor's age, living style, tax bracket, investing "temperament" and retirement and estate planning needs.

In thinking about which stocks to own, the investor should recognize that companies differ greatly in terms of their fundamental nature and characteristics. Some companies offer stable but below average growth and a higher than average dividend yield, while other companies provide moderate growth but less stability and an average yield. Still others combine strong and fairly consistent growth in earnings with a low or non-existent yield.

In recent years, the trend of many companies has been to retain more earnings within the company to fund current and future growth. One recent study showed that firms have become increasingly less likely to pay dividends. The dividend yield of the Standard & Poor's 500 Composite Index is currently at about 1.2%, some 66% below its historical average of 3.5% over the last 30 years, as shown below:

S&P 500 Composite Index

Year	**Dividend Yield**
1970-1979	4.1%
1980-1989	4.1
1990-1999	2.3
Average 1970-1999	3.5%
2000	1.2%

With yields at historically low rates over the last decade, many investors have focused on owning shares of leading growth companies. These companies tend to have stable, steadily expanding domestic operations and a significant presence in faster growing overseas markets, as well as outstanding management teams. They also tend to increase their dividend each and every year, even if they offer a below-average yield.

Our investment policy is basically to identify companies with superior long-term earnings prospects and to continue to own them as long as their management teams are fulfilling their mission. This will not produce the best results in each and every year, as factors other than strong, above-average fundamental characteristics often come into short-term play. But over a sufficient period of time, it will provide investors with above-average results attained with below-average risks.

A Sense of Perspective

To be sure, staying the course applies to investment counselors as well as investors. While the constant media attention to daily fluctuations encourages a short-term perspective, it is worthwhile to review some of the popular investment strategies of past decades, including long-term growth stock investing.

Over the years, there has been a succession of popular investment strategies aimed at achieving above-average results. They include the formula plans of the late 1930s and 1940s, in which stocks were sold on a predetermined percentage basis in a rising market and bought back during declines; the preference for high current yields in the 1950s; "performance" investing in the 1960s; the low price/earnings "smokestack" concept of the mid-1970s; modern portfolio theory of the early 1980s; and the momentum strategy of the late 1990s.

All of these approaches were initially based on an element of truth and seemed to work for a while, so they attracted a growing number of disciples. In the end, however, each of these popular investment strategies gave way to the next -- primarily because the changing economic and investment environment invalidated its basic premise.

The formula planners rigidly sold their stocks just as the huge post World War II bull market began. In the 1950s, most investors emphasized income and stability over the growing fear of "another 1929." As p/e ratios soared higher, the new crop of "performance" managers in the 1960s discarded all previous standards of value -- and, in the end, suffered horrendous losses. And later in the mid-1970s, the cyclical smoke-stack stocks fell victim to stagflation.

Growth investing was a highly successful strategy in the 1950s and 1960s and gained a rising number of followers. By the 1970s, the "nifty fifty" concept had become widely popular. Most of the new converts to the growth philosophy did not really understand the emphasis it placed on the investment characteristics of the company as opposed to the market status of its shares. To many a "growth stock" was simply an equity that sold at a high p/e ratio, paid little if any dividends, and had a good earnings record that was expected to continue in the future.

The recession in the mid-1970s caused many former growth stock investors to shift their focus towards low p/e basic industry stocks and as a result, many growth companies subsequently underperformed the market for an extended period of time. This tarnished the reputation of growth investing until the 1980s when a combination of economic and tax reforms captured investors' focus once again.

As time goes by, very few investment managers hold steadfast to a consistent philosophy. While we do our best to modify our approach to fit the needs of income-oriented investors, we count ourselves among the handful of firms advocating the long-term ownership of companies with identifiable growth characteristics.

Holding for the Long-Term

The great majority of investors seem to believe that the secret to investing success is "to buy low and sell high" and to repeat the process over and over again. Under this philosophy, a stock is nothing more than a piece of paper on which to make an easy profit when and if it goes up.

The wide publicity given to price fluctuations, to short-term changes in earnings, and to temporary but insignificant new developments, all tend to create the impression that the stock market is just an enormous game rather than a genuine auction of capital assets by the investing public.

Yet what happens in the securities market at each major downturn should make it obvious that the buy-low, sell-high philosophy is a cruel fallacy. When attempted repeatedly, it is bound to produce poor -- even disastrous -- results, because it requires a combination of shrewdness, courage, independence, timing and luck, ingredients that no human being can hope to experience consistently.

The vital fact to keep in mind is that building up one's assets is a project that usually spans a period of many years. If the stocks selected are those of strong, expanding companies, history shows that the rewards of investing in their long-term progress will be surprisingly large in the end.

Just as importantly, the investor should not panic during bear markets and sell out his holdings. The shareholder of fundamentally sound companies can look upon a drop in the price of a good stock not as a catastrophe but as an opportunity to buy more. What these securities may do in terms of price in a week or a month or even the next few years after their purchase is not the main issue. The true test of the soundness of the selections will be how much their earnings and dividends have increased after five or ten years.

Sticking to this long-range program can also prevent the investor from making another common type of error -- selling a suitable stock because its earnings suffer a quarterly drop or because it runs into one of the slow periods that occur for even the best-managed companies. Having a plan gives the investor the patience to hold on to the right stocks even during their recurring periods of unpopularity.

There are many paths to success, and it is a fact that given enough time most well-conceived investment plans tend to work out. The worst course of action is to skip from one plan to the next, changing course mid-stream and never giving things time to work out. Having any plan is better than having no plan at all. And of course, having a good, well thought out plan and sticking to it is best of all.