

Where We Stand

In what might be viewed as a slight departure from past quarterly newsletters, we thought it might be constructive to add some detail to our investment philosophy. The financial markets are captive to near daily releases of market moving data that serve mostly to confuse investors. Volatile energy prices and an uncertain world political environment contribute further to the uneasiness. These are but a few of the many factors that affect our investment decisions.

There has been much speculation in the media of late about a real estate bubble. The much talked about increase in value of homes, both new construction and resale's, reminds us of a speech given by Federal Reserve Chairman Alan Greenspan in December, 1996. In that speech he referred to "irrational exuberance" in the stock market, alluding that he thought prices had risen too far. Interestingly, eventually he was right. However, in the 3 plus years between that warning and the market's peak in early 2000, the Standard & Poor's 500 index more than doubled, gaining 105%. We should point out that even in the dark years of 2000-2002, that index never did decline to the December 1996 speech levels. While we would never try to predict future prices of home or any other class of real estate, it seems reasonable to us that there may be overpriced geographies, much the way there are often overpriced sectors of the stock market.

Another talked about phenomenon these days is the aging of the baby boomers and future actions they may take that will affect the financial markets. There is discussion that this group will shift from an "acquisition" of assets to a "disposition" of assets phase as they head into retirement. To us, it seems a stretch to conclude that this huge class of investors will dispose of all of their financial assets, move to a log cabin, and live out their lives in exile. As this piece is being written, the yield on 10-year treasury notes is just under 4%. While we do believe that higher rates are in the cards, we do not believe that they will go anywhere near the historical long term return of common stocks of over 10%. Rather, it seems to us that ownership of assets that have the potential to increase in value while paying out an increasing income stream in the form of dividends (at a preferential tax rate we might add) will continue to be an important component of this demographics investment mix.

Another hot topic is the social security system. Who knows what will happen, but it is widely accepted that reform of some type is necessary. Whatever does occur, it seems certain the responsibility of providing for retirement income will continue to shift away from the corporate and government sectors and towards the individual. Generation X (generally those born between 1965 and 1980) and Gen Y (those born in the 1980's and 1990's) must grapple with the issue of how to provide for their own retirement. A daunting task to say the least, and it would appear to us that equities may well be a large part of the solution to the problem.

At this point you may be wondering where the preceding commentary is leading. Abbot Financial is generally, but not exclusively, viewed as a “large cap value” manager. While there may not be an exact definition of value that all investment professionals can agree on, there are attributes upon which most can reach a consensus. Briefly, the value process consists of mining the equity universe for companies that have a history of rising revenues, profits and dividends. These companies must be leaders in their industry, and have management capable of effectively and profitably running their company thru changing economic environments. Screening tools can bring an investor to a short list based on chosen parameters, but this is where the selection process really begins. There are times when good companies are not good stocks, and that is where adhering to value principals will help keep an investor out of trouble. Examples would be some of the technology leaders such as Microsoft and Cisco Systems, and even the industrial giant General Electric, that today are selling at a fraction of their all time highs set in 2000. Back then, not many would argue about the quality of the company, but value issues were lost on investors, and too many that proved to be an expensive oversight.

Here at Abbot, we firmly believe that macro issues such as those mentioned above, as well as others such as emerging economies in Asia (India and China) will have a positive effect on the stock market and will continue to favor the value style of investing. The investment process is a work in progress, and we will continue to work to position client portfolios to profit in the months and years ahead. As always, we welcome your questions and comments.

Scoreboard 1st Half 2005

Dow Jones: -4.71%

S& P 500: -1.70%

NASDAQ: -5.45%

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