

# THE TANDEM REPORT

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## MARKET COMMENTARY: WHY 2000 WAS A YEAR TO APPRECIATE

Finally. It took a while, but investors appear to have learned some valuable lessons about investing. And the best news is that it wasn't even a very expensive lesson, when viewed in context. Yes, 2000 was brutal on the speculators, and painful for the rest of us. Yet, the decline was mild compared to what might have been.

So you ask what good came from a year that saw the Standard & Poor's 500 decline over 10%? Well, quite a bit, frankly. For starters, we learned that adding ".com" to your name was not a viable business plan, and that the "old economy" was not dead, and the "new economy" still had a lot of growing up to do.

For the previous five years, the market had enjoyed unprecedented returns. Valuations of stocks had reached levels that concerned reasonable people. History teaches us that Bull markets rise to excesses, and Bear markets fall to extremes. The cost of restoring order can be substantial. In the past year, we sur-

vived a restoration of some order without giving back much of what we had earned.

By any reasonable measure, stock valuations reached rather lofty levels. Even the best companies were priced for perfection. The market had built in so many expectations that anything short of exceptional could prove catastrophic. At Tandem, we found it increasingly difficult to identify reasonable values in the market, and as a result, the amount of cash in our accounts grew. But the market kept chugging through the end of the decade.

As the ".com" craze came crashing down, the NASDAQ suffered huge losses. Blue Chip companies were not spared. But here is the good news. Stock valuations fell to more reasonable levels without creating panic. The economy continued to grow, earnings continued to rise, and as a result, the decline in quality stocks was contained. We now are beginning to see values the we can comprehend, and in

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## ECONOMICS AND THE STOCK MARKET: THE CORRELATION BETWEEN THE STOCK MARKET AND THE ECONOMY

The business press has reported that the economy is slowing, corporate earnings growth is declining and the Federal Reserve is cutting interest rates to head off a recession. All this sounds ominous for the market. Right? Not necessarily.

The market moves up and down without much indication as to why. Often, good

news for the economy is bad for stocks, and bad news for the economy is good for stocks. There is an important correlation between the stock market and the economy that is at work, but isn't always clear. Investors put money to work based on their collective expectations of a reward at some time in the future.

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# THE TOP 10 HOLDINGS IN OUR COMPOSITE

## AS OF 12/31/00

The market's gyrations resulted in quite a re-shuffling in the order of the ten largest holdings in the Tandem Growth Composite. One new name appeared, Mellon Financial, and one company dropped out, American Express. The major pharmaceutical stocks rallied in spite of the market's decline, causing Merck and Pfizer to leap over AES, General Electric and AMGEN.

As you know, we are not active traders or market timers. We believe in the companies we own, and give them ample time to reward us. From time to time, however, fine-tuning a portfolio becomes necessary. Some of this can account for the movement within the top 10. During the quarter, we took some profits in AES, AMGEN and General Electric, while we added to our positions in Dover, Mellon and Pfizer. We simply wanted to reduce our exposure to some of the names that had enjoyed big runups, while increasing our holdings in some of the more undervalued stocks.

1. Merck & Co.
2. Pfizer, Inc.
3. AES Corp.
4. General Electric
5. AMGEN, Inc.
6. Johnson & Johnson
7. Dover Corp.
8. T. Rowe Price
9. Mellon Financial Corp.
10. Cisco Systems, Inc.

More detailed information about this composite is available upon request.

## WHY 2000 WAS A YEAR TO APPRECIATE

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fact buy. And while no one enjoys a year in which the market averages are all negative, the decline we experienced doesn't seem as substantial given the previous five years.

More importantly, wild speculation has dried up. Perhaps now we can proceed by relying on solid fundamental analysis, rewarding business for their successes, not their Super Bowl advertisements.

If the economy continues to slow, it may be awhile before the market fully recovers. But it is comforting to us to know that the best slogan or gimmick doesn't make the best stock. The year 2000 was no fun, but it was necessary. It taught some valuable lessons, and allowed us to be as optimistic as ever about the future. The technological revolution continues, and we can get on with the serious business of investing in the right companies at the right price, knowing that there are still rewards to be had as the old economy adopts the virtues of the new.

## TANDEM NEWS

In December, we mailed a copy of our Form ADV to all of our clients. By law we are required to offer the form annually. Over the years, no one has requested a copy. As Tandem has grown, changes to the form have been made. In 2000, we had to register as an investment adviser with the SEC because the total of our assets under management required us to do so. Firms with less than \$30,000,000 can register with the states in which they do business, but once assets exceed that level, firms are required to register with the SEC. We thought it prudent to send the form, rather than offer it, since many

clients have not seen it for years. We hope that it did not cause any confusion, and welcome any questions you may have.

Another bit of news finds us celebrating our tenth anniversary. Tandem was incorporated on October 5, 1990. We wish to express our profound gratitude to those who have given us the opportunity to serve. As we begin our second decade, we commit ourselves to work even harder to help you reach your financial goals. Thank you for allowing Tandem to be a part of your financial success.

# SPOTLIGHT ON GENERAL ELECTRIC

## GENERAL ELECTRIC (NYSE: GE)

Recent Price: 45

Dividend Yield: 1.2%

Earnings Yield: 3.3%

P/E Ratio on 2001 EPS: 30.4

Earnings Per Share:

<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001(E)</u>
0.93	1.07	1.28	1.48(E)

General Electric is nothing short of remarkable. The company manufactures aircraft engines, appliances, plastics, lighting, locomotives, turbine generators, power generation units and medical systems. In addition, they own NBC and GE Capital – a huge financial services firm that accounts for nearly half of the company's earnings. GE is an earnings growth machine, and the market has rewarded the stock handsomely over the years for its dependability. The driving force behind the company for the past twenty years has been Jack Welch, the legendary CEO of the company. Mr. Welch announced his timetable for retirement some time ago, but only named his successor in October. The stock has suffered somewhat because of the uncertainty surrounding the leadership position. We are confident that GE will continue its record of success under Jeffrey Immelt, named to succeed Mr. Welch at the end of 2001. Mr. Immelt has spent his entire career at GE, working in multiple areas of the company.

What we are less confident of is Mr. Immelt's credibility with Wall Street. We liken this situation to that of Coca Cola when their chairman of many years passed away. Often times, companies with highly respected CEOs enjoy the benefit of the doubt from investors. Their successors typically must earn that same measure of credibility on their own, and the market has been known to punish any perceived missteps that investors may have been more apt to forgive under the predecessor.

However, GE continues to be a core holding for most of our accounts. We have great respect for the way they run their businesses. Each segment is extremely profitable, and has the number one or two position in their respective markets. GE has embraced technology in a way that we view as the model for success in the ongoing technological revolution. The company has avoided becoming GE.com. Rather, they have used the internet to extend services and better manage production and inventories. As a result of these initiatives, the company has seen earnings growth rise from low double-digit rates annually to a growth rate in the high teens. This is a remarkable feat for a company this size. We can think of no other company that deserves to be held as such a model for success.

While we do not profess to know what is in store for the price of the stock during this transition phase, we believe the company will remain a force for some time. We view any weakness in the stock as an opportunity to own the best at a discounted price.

## THE CORRELATION BETWEEN THE STOCK MARKET AND THE ECONOMY

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The expectations of future economic growth and inflation impact the anticipated return on investments. Thus, if investors *anticipate* a slowing economy, or higher inflation, they *sell* stocks. In a nutshell, this is what happened in 2000. The market in effect predicted an economic slowdown, so the market declined before the economy did.

Now that the slowdown appears to be upon us, the market will move from this point based on its expectations for the future. If interest rate cuts are viewed as inadequate or perhaps even the wrong medicine, it could spell trouble for stocks. But if the Federal Reserve acts in a reassuring manner, giving confidence to investors that the future is bright, the market can actually rally in the midst of a recession.

Market cycles precede economic cycles. One could even

argue that market prophecies about the economy are self-fulfilling. Often times, a market boom or bust can lead to an economic boom or bust. What we must remember about the market is that whatever the economy is doing *at this moment* is irrelevant. What investors anticipate the economy will do going forward determines how investors act.

So, it is not only possible, but probable that at some point we will have a stock market resurgence during an economic downturn. The next time CNBC warns of a recession, ask yourself what your expectations of the future are. We invest by trying to look forward, not by analyzing what has past.

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Tandem Investment Advisors, Inc. was founded in 1990 to provide professional portfolio management to investors. Today, we manage in excess of \$30 million in assets for over 100 relationships. If you would like more information, please contact one of us at the following:

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