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***Sharp Investing* is a quarterly Publication focused on investor education. For a subscription, contact Sharp Investments at:**

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Wipeout! Internet and Technology Stocks Finally get Their Just Desserts

By Daniel R. Sharp

Intel, Microsoft, Cisco, Lucent, Oracle. What do these stocks have in common? Most would say they are great technology leaders. Others would say that they are all "bargains" as the NASDAQ correction in the year 2000 approaches 40%. After all, most were selling well above current levels just a short six months ago, so they must be worth the higher prices at which they traded. These world-class companies are solid, unlike many of the fly-by-night internet companies that soared in 1999 only to crash and burn in 2000.

The Internet Index is down 49% so far this year and over 60 internet companies have seen their stock prices reduced 90% or more ($10 turned to $1). Most investors agree that the internet craze was a frothy frenzy fueled by speculation, but it is now over, leaving these new unprofitable companies priced about where they belong.

However, the same investors that NOW would never think of investing in the all-out gamble that is the internet "industry" think that they are being safe and prudent by investing in the giant technology leaders listed above. After all, Intel is selling for less than half of what it did a few months ago, Cisco is off 40% from its highs, Microsoft is at a two year low and more than 50% off its highs, and Oracle is more than 30% down.

Most investors understand that these are industry-leading companies. Most investors understand that, yes, they are well off their recent highs. Most investors will then use these two

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The Markets are Going Down! What do I do now?

The market correction that investors are currently suffering through is a valuation correction as opposed to an economic correction. In a valuation correction, investors sell off stocks with extremely high multiples and reinvest the money in the sectors of the market that have lower valuations. This is a distribution correction, and with the exception of occasional panic-

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points to rationalize an investment in the name technology stocks.

What most investors fail to do is evaluate what these companies' stock prices should be worth based upon sound fundamental business valuation techniques. Just because a company is a "great" company and its stock is cheaper than it once was, does not make it a good investment. The amount of profit the company is expected to earn for each investment dollar you put into it cannot be ignored.

For example, Intel is projecting growth as low as 4%. Even with the current pricing, Intel trades at 25 times earnings, a rate that implies that Intel should be producing 25 cents of earnings for each dollar of stock purchased. Instead, Intel may be producing 4 cents of earnings for each dollar invested. Now look at a company like Whirlpool. Whirlpool is projecting growth of 20% but trades at less than 10 times earnings. This means that the market has priced Whirlpool stock as if it should be producing 10 cents of earnings for every dollar invested, yet Whirlpool may produce as much as 20 cents for every dollar invested. A dollar in Intel gets you 4 cents in earnings. A dollar in Whirlpool gets you 20 cents in earnings.

Intel is still *five times* as expensive as a non-technology blue chip industry leader like Whirlpool. That is a huge premium that was twice as large just a few months ago. What in the world would have made an Intel penny of earnings worth 10 times a Whirlpool penny of earnings? You can argue that Intel is more cutting edge, with greater opportunities and potential than Whirlpool, but those kind of arguments are appropriate for a 25% or 50% premium over an old economy blue chip, not a 1000% premium!

The rest of these technology leaders are in the same boat; good companies, high growth, but in most cases extreme valuations when compared to other blue chip companies with similar levels of earnings coming from less exciting lines of business.

Historically, investors have awarded companies multiples of earnings that average about 7 in depressed economic times and multiples that average 20+ in economically prosperous times. The best of the best historically have been granted earnings multiples of around 30. Over the last three or four years many of these technology leaders have been awarded earnings multiples in excess of 100 times, a completely unsustainable level. Microsoft traded at over 100

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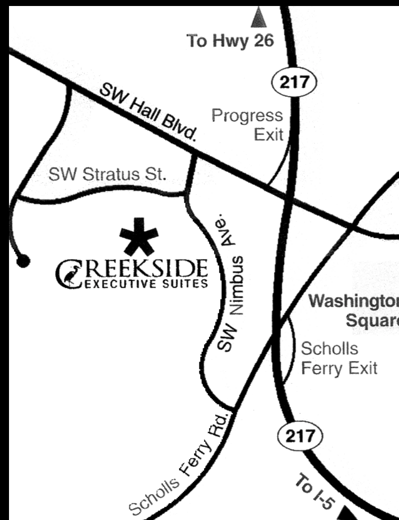
You are invited to a special, free presentation:

Creating Wealth through Value Investing

6 p.m. Tuesday,
November 14th, 2000

Creekside Executive Suites,
11000 SW Stratus,
Beaverton, Oregon
First Floor Conference Room
limited seating, to reserve a seat call 503-520-5000



As of October 15th 2000:

- The Dow is down 11.4% for the year 2000
- The NASDAQ is down 18.5% for the year 2000
- Value based investing is up over 15% for the year 2000!

Investing styles run in three to five year cycles. We are only in year one of a strong value cycle. Over long periods of time no strategy has produced better returns than investing in undervalued companies. Learn why and what it can mean for you!

Presented by
Daniel R. Sharp
Registered Investment Advisor

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times earnings at one point, now it is down to 30 times earnings. Cisco traded at well over 100 times earnings at one point, now it is down to 60 and probably on its way to 30 as well. Whether Cisco gets to 30 times earnings by a flat stock price and increasing earnings or a decreasing stock price and flat earnings is uncertain - but what is certain is that they will not sustain a PE of 60 for ten years, let along the triple-digit PE they carried a few short months ago.

I believe that the reason these kinds of valuations have not seemed unusual over the past several years is that many internet stocks traded at even higher multiples than the technology blue chips, making them seem like relative bargains in comparison to the ridiculous valuations investors placed on new, untested, unprofitable companies that happened to hang a "dot.com" on their name.

The truth is that there are no examples of *any* company sustaining an earnings multiple in excess of 30 for a ten year stretch and I certainly do not see a reason for that to be any different going forward.

The question investors must ask themselves is whether they believe a company now trading at 50 times earnings will get back to 100 times earnings or whether a company growing at the same rate trading at 10 times earnings can reach 20 times earnings. I know what my answer is, and what the market has been saying for the past year. **$**

What to do? ..continued from page 1

induced freefall days, money isn't leaving the market, it is simply moving from the overvalued stocks to the undervalued stocks. This year there have been periods of several weeks where all stocks saw reduced valuations, but for those willing to buy in the undervalued sector, this proved an opportunity to load up in areas that continue to attract money in the new millenium. The net effect has been that value stocks have outperformed growth stocks this year by a giant margin - over 30%!

In an economic correction, changing interest rates, inflation, economic growth, etc., can reduce valuations among both overvalued and undervalued stocks.

We are not in an economic correction, interest rates are likely headed down; the economy, while slowing, is still very healthy, and, although oil prices have spiked, there has been no signs that higher energy costs are translating to an inflationary cycle.

So why is the Dow right where it was nearly two years ago? Why has the NASDAQ plunged nearly 40% from its record highs? A lot of it has to do with how these market averages are calculated. The more overvalued a company, the greater effect they have on the market index, both in moving it up and down. For example, Intel, Cisco, and Microsoft are only three companies out of the nearly 5000

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Is Your Portfolio Right for your Investment Goals and Risk Tolerances?

A complimentary investment consultation can be arranged at your convenience in person or over the phone. Fax or mail us your current account statement and our Portfolio Managers will discuss your goals & risk tolerances, and analyze your portfolio. We can help you determine the management style that best fits your personal portfolio needs. You will be briefed on the most profitable path to creating wealth, value investing, and gain techniques that can be applied to your investment portfolio.

For a free consultation, please call 503-520-5000 or 888-760-9046
or fill in the information below and fax to 503-520-0530

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Please contact me for an appointment…

- ❑ **…this month**
- ❑ **…in 3 months**
- ❑ **…in 6 months**

Name: ____________________

Phone: ___________________

Email: ____________________

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that trade on the NASDAQ, but they are 25% of the NASDAQ composite average, so when they take a 40% downturn, the NASDAQ average declines 10% just from these three stocks alone.

In a valuation correction, the most expensive stocks come down in price, the least expensive stocks typically benefit from the money distributing to better opportunities, but the net effect is that market averages stagnate or come down because of the greater effect of the overvalued stocks on the market averages. So even though both the NASDAQ and DOW have seen substantial declines this year, the average stock is actually up in the year 2000, and value stocks in particular are coming to life as recipients of the distributing demand for stocks from overvalued to undervalued. This is great news for those that have not followed the herd into internet and technology stocks at any price, but not so good for investors that may not realize how exposed they are to companies trading at historically high valuations even with all the bloodletting that has gone on so far this year. Most mutual funds have high concentrations of the high valuation stocks.

So what should the average investor do? If you own funds, look at the top ten holdings and the fund valuation (available at morningstar.com). If you own individual holdings of very high valuation securities you need to be aware of your exposure to this valuation correction.

My advice would be to diversify into some of the thousands of stocks ignored over the past several years that are extremely cheap with strong growth prospects and lighten up on the NASDAQ 100 stocks that still look quite expensive in spite of the correction. **$**

Value Investing: The purchase of companies, through the stock market, for less than their economic value due to temporary unpopularity (lack of investor demand). This is the opposite of growth investing, which is buying companies at a premium in the hope that other investors continue to push their prices higher and higher regardless of what the business is actually worth.

ADDRESS CORRECTION REQUESTED

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