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Inside this Issue

1 Is your 401k *really* safe?

1 Investing in Foreign Markets: Necessary or Hype?

2 Free Seminars – All New Topics for Spring!

3 Are you between jobs and wondering what to do about your 401k?

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Sharp Investing

Is your 401k *really* safe?

By Daniel R. Sharp, Ph.D.

Part one of a two part series

You and you alone are ultimately responsible for the various types of risk inherent in your defined contribution plan. This article provides a strategy to minimize the various risks while still creating wealth for your retirement.

Recent headlines (Enron debacle, tech stock crash) have highlighted the importance of reviewing your 401k in order to minimize the various types of risks that can exist in your portfolio. Over 40 million American workers have a 401k, and for most, this is the primary source of retirement funds. There was a period of time, from about 1995 to 1998, in which most 401ks did very well. As a result, many investors became complacent, inadvertently putting themselves needlessly into risky situations that resulted in losing most of the returns over the recent difficult years that were made during the good years. There are many types of risk, some more prominent in 401ks than in other investment portfolios. You can take control of your own retirement by defining the risk factors in order of importance to a 401k and then taking action to minimize your overall risk over the long run.

The risks, in order, are:

1. **Diversification risk**
2. **Risk of not meeting goals**
3. **Market risk**
4. **Risk of fraud**

continued on page 2

Investing in Foreign Markets: Necessary or Hype?

Conventional wisdom holds that 10-20% of any investment portfolio should be allocated to foreign-based companies. An investor hopes to diversify away from a weak U.S. economy or capitalize on a strong, fast growing foreign economy by direct investment in companies

continued on page 3

Is your 401k safe? continued from page 1

By far the greatest risk in most investors 401k plans is a lack of diversification. This risk is so important and often ignored that the remainder of this article (Part One) will discuss diversification.

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A 401k plan must offer a minimum of three investment choices, one of which has to be a "safe" choice, such as a money market or another guaranteed interest fund. Many times one of the other limited choices is stock in the employer's company. In many cases, companies match employee contributions through stock, and this match can eventually skew the bulk of a 401k into the same company that employs you. ***The average 401k plan has 39% of investment allocated to the employer's stock.*** Your regular income already depends on this single company, and often you are encouraged to buy company stock on an after-tax basis via a discount to the current market price, and so minimizing the amount of company stock in your 401k is usually a prudent idea. Just ask Enron employees if they wish they had minimized the amount of company stock in their 401k's. Those that did were not hurt nearly as bad as those that held a high percentage of company stock. No matter how glowingly management describes their outlook for your company, *one should never hold more than 20% of assets in any one company if you have the ability to diversify.*

Many companies require that you hold their stock, but investors should check with their plan administrators to see if they are allowed to diversify some or all of the company stock. In extreme cases, some company retirement plans can force you to hold almost 100% of your assets in company stock, but taking advantage of an opportunity to diversify is almost always a good idea. Sometimes this can be done immediately, or upon reaching a magic age with the company (55 in a lot of cases), or by prudently rolling your 401k assets into a self-directed IRA upon leaving employment or retiring. I can't think of a single company that is so safe and secure that I would want most of my retirement assets tied up in it.

In the next segment, we will explore the other three risk sources to your 401k and offer strategies to neutralize unnecessary risk on your way to creating wealth. **$**

The Verdict is In!
The S&P was down over 13% in 2001
The NASDAQ was down over 20% in 2001
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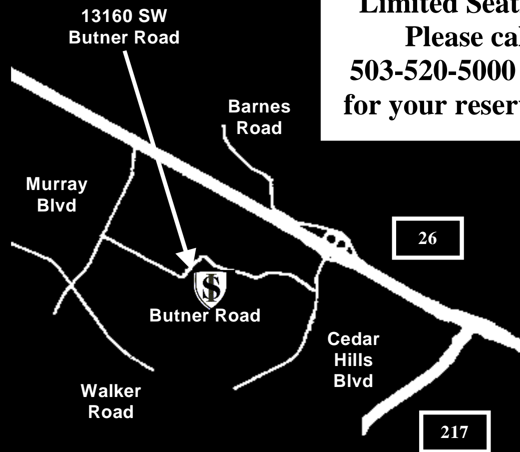

Investing styles run in three to five year cycles. We are only in year two of a strong value cycle. Over long periods of time no strategy has produced better returns than investing in undervalued companies. Learn why and what it can mean for you!

Presented by
Daniel R. Sharp, Ph.D.
Registered Investment Advisor

Foreign Investing ..continued from page 2

from other countries or buying funds that specialize in the ownership of foreign stocks or that specialize in a particular foreign economy. This seems to make sense until the track record of foreign investment is studied. Looking at the last 31 years (about as far back as data on foreign investing is available) it can be seen that over the long-run, *the stock of U.S.-based companies have provided about 50% greater total returns than the stock of foreign-based companies.* In addition to providing lower returns, foreign companies are more expensive investments. Most investors will use mutual funds for their international investing, but foreign funds have the very highest expense ratio of any group of funds – mainly due to the high cost of research necessary in following companies and economies that lie overseas.

History also shows that foreign stock markets are very highly correlated to U.S. stock markets, just as the economies around the world are highly dependent on the U.S. economy. With the increasing globalization of many large U.S. companies over the past 20 years, the world economy and the U.S. economy are inextricably tied together. As the U.S. goes, so goes the world.

What this means is that investors pick up virtually no diversification benefits from foreign investing. You cannot escape a poor U.S. economy by foreign investing. You also cannot escape a short-term U.S. panic by taking safe haven in foreign markets.

Did you know that in the 10 days after September 11th, an event that occurred in the U.S., against the U.S., and intended to disrupt the U.S. stock market and economy – that only one foreign market (Switzerland) did any better than the U.S. stock market?

There is a reason why the theoretical benefits from foreign investing do not match up with the actual historical results. When the U.S. economy is doing well, the U.S. stock market is the place to be. When things are not as strong domestically, the effects felt around the world are inescapable and there is no avoiding the reverberations by investing in foreign markets.

Because of a combination of our size, economic strength, relatively low tax structure, capitalist system, and most importantly, freedom to pursue economic prosperity, there is no better environment for corporations to profit than in the United States of America.

However, there are occasional periods when the U.S. economy is doing well and certain foreign economies may be growing even faster than the U.S. for a short length of time. There are two ways to capitalize on these

continued on page 4

Are you between jobs and wondering what to do about your 401k?

We can help you determine whether you should leave your 401k with your previous employer, roll the 401k to your new employer, or roll your 401k to a self-directed IRA, and most importantly, when to make these moves. Analysis of the companies or funds, the levels at which they were purchased, and their future prospects and reasonable expectations can all be beneficial in getting you back on a steady path to creating wealth. 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.

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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.

Foreign Investing …continued from page 3

strong economies. The easiest way to profit is to target U.S.-based multinational corporations that derive a significant portion of their revenue from the economy in question. The second method is to use ADR's (American Depository Receipts) to invest in other-nation-based, multinational corporations that also derive significant revenue from the foreign economy targeted. There are over 800 ADR stocks that trade on the New York Stock Exchange and can be purchased as easily as a domestic stock. ADR stocks are required to provide standard GAAP accounting financials to the SEC, just as a domestic company. This allows an investor to evaluate a foreign company on a familiar yardstick as opposed to having to become a student of a particular country's accounting system just to understand the financials of the company you are interested in.

Neither of these strategies to provide exposure to foreign-based economies will diversify your portfolio any more than any other stock, but they will allow you to enjoy potentially strong returns temporarily generated by the foreign economy without the high cost of international fund investing.

Foreign investing does not enhance diversification, and neither are returns enhanced in general via investment in foreign funds. A better way to approach foreign investing is to evaluate ADR's like any other domestic company, and invest in a foreign company if it meets the same criteria you apply to a domestic company. If you are interested in pursuing investment in a particular company, use ADR's or Fortune 500 domestic companies to gain your international exposure, but always keep in mind that no other stock market in the world has performed better than the U.S. market over the long haul, and there is no hiding from the occasionally weak U.S. economy. **$**