February 29, 2000

Dear Client

The attached sheet contains the return calculations for your account(s) for 1999.

In a slight departure from previous years I would like to share with you some of my views about the stock market.

I recently finished an excellent book on the history of financial speculation entitled “Devil take the Hindmost” written by Edward Chancellor. Chapter two begins with a quote from Edwin Leferve, author of Reminiscences of a Stock Operator (1923):

> “Nowhere does history indulge in repetitions so often or so uniformly as in Wall Street. When you read contemporary accounts of booms or panics, the one thing that strikes you most forcibly is how little either stock speculation or stock speculators today differ from yesterday. The game does not change and neither does human nature.”

In the preface of the book is a passage from Fred Schwed, a Wall Street practitioner and author, who suggested that trying to distinguish between investment and speculation was “like explaining to a troubled adolescent that Love and Passion are two different things. He perceives that they are different, but they don’t seem quite different enough to clear up his problem.” Schwed concludes “Speculation is an effort, probably unsuccessful, to turn a little money into a lot. Investment is an effort, which should be successful, to prevent a lot of money from becoming a little.”

What is so striking to me as an observer and participant is how much in common the current infatuation with the Internet, all things technology, and biotechnology has in common with the many previous manias. This is not to suggest that the Internet or biotechnology won’t have a profound, even revolutionary impact on society. Indeed it has already changed the way we gather information, communicate, and even shop for certain items. As for biotechnology, it has made it easier to target specific causes for disease and to introduce new treatments at an accelerated pace. But a brief look at previous manias reveals many other instances in which the introduction of new technologies or services fueled enormous speculative booms. Canals (1790’s), railways (mid 1800’s), radio companies, automobile companies, airplane companies (1920’s) all spawned hundreds of new stock issues, garnered a frenzied public interest, skyrocketing stock prices, and ultimately the collapse of all but a handful of companies. Even those that survived and prospered (RCA) often took many years to reach their earlier highs.

From an investor's standpoint, the issue is not whether these industries are new or even revolutionary. The issues should be: 1) which companies are going to earn significant money, 2) when are they going to make it, 3) how certain is one about the five year outlook, 4) and how much does one have to pay for those future earnings. Warren Buffett recently pointed out that after many decades of "wonderful economic development" in the U.S., that there were approximately 400 companies earning $200 million or more after taxes per year. This is about the earnings level necessary to justify a $3.0 billion market capitalization. He goes on to suggest that maybe in five years there will be 450 companies earning $200 million after tax, many of those will be companies earning between $150-$200 million today. Thus in five years perhaps an additional twenty or so companies will come from today's small or development stage companies. Yet the current market has dozens and dozens of companies in the high tech area alone with market capitalizations of over $3.0 billion. Many newly minted initial public offerings are getting $3.0 billion the day they come out. This is simply not sustainable, and many will be disappointed. Again, I can't resist borrowing from Chancellor's book. Quoting from a letter written to the Financial Times at the height of the railway speculative mania:

> "There is not a single dabbler in Script who does not steadfastly believe- first, that a crash sooner or later, is inevitable; and, secondly, that he himself will escape it. When the luck turns, and the crack play is *sauve qui peut* , or devil take the hindmost, no one fancies that the last mail train from Panic station will leave him behind. In this, as in other respects, ' Men deem all men mortal but themselves'."

The present fixation on trend following, or as its euphemistically known "momentum investing", has produced some startling statistics. A recent study by the brokerage firm Sanford C. Bernstein analyzed recent data from the NYSE and NASDAQ. The study pointed out that last year 79% of NYSE listed shares, and 200% of the NASQAQ base traded hands last year. In the 50 most heavily traded NASDAQ shares, the average holding period was just three weeks. Does anyone think that business fundamentals change that quickly, or are many engaged in what the economist John Maynard Keynes described when discussing stock market speculation as having "reached the third degree where we devote our intelligences to anticipating what average opinion expects the average opinion to be."

That stock prices ultimately reflect a business's earnings or cash flow generation is axiomatic. Stock price behavior in the short term and even the medium term is subject to the vagaries of the market. Tastes, beliefs, sentiment, in short a variety of emotional factors often influence prices. But in the end, it is free cash flow available for a company's shareholders that matters.

Many of our shareholdings and those associated with the "old economy" fared poorly last year, and the trend continues into this year. These companies operate in areas with high barriers to entry, have long records of high earnings growth, and are leaders in their industry. Some are companies that have had temporary earnings declines, but are strong businesses with defensible franchises. The characteristic they all share are a stock market price well below calculated intrinsic value. More and more high quality companies in a variety of industries, with high returns on capital, understandable businesses, and favorable growth prospects are trading at levels not seen in years. Many are priced well below their private market values.

I have no idea how long present trends will continue. However, it makes no sense to abandon a rational approached that has worked reliably for years, for an approached that is currently fashionable.

As always I appreciate the trust and confidence you have placed in me.

Very truly yours,

Eckart A. Weeck