



Wesco Annual Shareholders Meeting



Charlie Munger

Recently, I had the opportunity to hear billionaire investor Charlie Munger at Wesco's Annual Shareholder's meeting. Charlie Munger is a longtime business partner of Warren Buffet, the second wealthiest man in the world.

Wesco is a publicly traded company that specializes in the re-insurance of banks. Munger and Buffet's Berkshire Hathaway own 80.1% of Wesco.

In the 1960's, one share of Berkshire Hathaway was worth about \$40. Today, that one share would be worth about \$90,000. Needless to say, Munger and Buffet are regarded as two of the greatest investors of all time.

Berkshire Hathaway is a publicly traded corporation that makes investments and owns a portfolio of companies. Some of the subsidiaries include GEICO, Dairy Queen, See's Candy, and Helzberg

Diamonds. Berkshire also owns shares in Coca-Cola, Gillette, and the Washington Post, to name just a few.

Mr. Munger had many interesting things to say including the fact that Berkshire Hathaway and Wesco are sitting on more cash now than at any time in history. They do not see many bargains in the market. I happen to agree with their view.

Mr. Munger's main point concerned was ethics. He feels that ethical values have eroded over the years since he started in business. He spoke of the many scandals that are taking place in the business world right now. Two examples he gave were Martha Stewart and Enron.

Mr. Munger said that what made Berkshire Hathaway's investment style so successful is that they had intellectual principals. They would wait for an opportunity and apply these principals. He pointed out that if you excluded their top 15 investments, they would have an ordinary track record. Another philosophy of the company is that they do not overdiversify. I believe in this way of investing as well. If you overdiversify, the best you can hope for are average results.

Cash is King!

At this time in the market, there are very few good deals to be found. Almost everything is either risky or over-valued. American stocks are over-valued, bond rates are rising, and international stocks are expensive as well. I would recommend (and so would Warren Buffet and Charlie Munger) to invest in cash and short term bonds and wait for a good deal.

The Standard and Poors 500, an index of 500 publicly traded companies in America, is trading at about 22 times earnings. This is very high. If the market decides to value these stocks at a lower multiple, that could mean a large drop in stock prices.

At Holmes R. Osborne III, Inc., we initially invest all clients' money into cash. We invest in this manner because we do not rush into the market and make hasty decisions. We bide our time and wait for a deal.

Almost no firms invest in this manner. With most firms, your money is immediately invested in the market. What if you invested in September of 2001, or October of 1987, or perhaps now? You could see a large drop in your portfolio in a short amount of time. Most investors do not have the stomach for this type of volatility.

MSFT and UNM

In the last newsletter we wrote about Microsoft and Unum Provident. Both of these stocks have not moved much. UNM is down about fifty cents and MSFT is about break even. We continue to buy these stocks for clients.

Beware of Bond Funds

Bond funds can be a good way to invest in lower volatility investments that pay a coupon. However, as interest rates rise, bonds fall in value. The longer the maturity, the greater the fall. Take for example a 30 year bond that has a 5% yield and trades at par (\$1000). If rates immediately rise by 2%, that bond will fall in value to almost \$750. That is almost a \$250 drop in value! This bond could even be a Treasury bond, secured by the United States government. This doesn't matter when interest rates rise. Of course you'd get your full face value, but in 30 years!

In the past few years bond funds have done very well. This is due to the fact that as interest rates fall, bond prices rise. However, in this interest rate environment, rates are starting to rise. Rates have risen dramatically over the past month (May 2004).

If you are invested in a bond fund in your 401K or any other account, be aware! Stay away from bond funds that invest in longer maturities, say 5 years and beyond. Consider bond funds that have shorter term maturities of less than 5 years.

At our firm, we invest in individual bonds. We feel that our clients will pay less in fees than a mutual fund. We also feel that we have greater control over the bonds. For clients who want to assume less risk, we invest a greater percentage of the account into bonds.

Stocks to Watch

1. Sonic: fast food
2. Cheesecake Factory: full service restaurant
3. Goldman Sachs: investment banking and brokerage
4. Merrill Lynch: investment banking and brokerage
5. O'Reilly Automotive: auto parts store located in the South and Mid-West
6. Best Buy: electronics retailer
7. Home Depot: home improvement retailer
8. Chico's: women's clothing
9. Jones of New York: retail clothing
10. Abercrombie & Fitch: clothing retailer for young people
11. Health Management Associates: hospital management
12. Citigroup: investment banking, banking, and insurance
13. Microsoft: software
14. Unum-Provident: health, life, disability, and long-term care
15. Berkshire Hathaway: diversified holding company
16. Circuit City: electronics retailer
17. Coca-Cola
18. Pfizer: pharmaceuticals
19. Merck: pharmaceuticals
20. Cadbury-Schweppes: soft drinks and food distributor located in Great Britain
21. Legg Mason: retail brokerage
22. H&R Block: tax preparation and financial services
23. M&T Bank: regional bank located in Buffalo, NY
24. Krispy Kreme Doughnuts
25. PF Changs: Chinese Restaurant

Lord Abbet Small Cap Value

In the 1990's during the stock market bubble, I went against the trend and bought a small cap fund for clients when I was at Merrill Lynch. This fund invested in regional banks, small manufacturers and retailers, and other stocks of this nature. Recently, while reviewing a client's statements, I noticed that the fund is up 100% after fees.

I was able to see value in a crazy market. In the late 90's, if you had invested in technology stocks or the S&P 500, you would still be down in value. Now is not a good time to invest in this fund because small companies are overvalued. I am still looking for a bargain like this but have seen very little to invest in.

Knowing when to sell

When talking to people, I notice that many are afraid to sell their real estate or other investments because they will have to pay taxes. Taxes are a way of life in the U.S. Don't ever be afraid to take a profit and pay taxes. Some of the worst investment decisions are made because people hold too long and lose a selling opportunity.

When you go into an investment, you should have an idea of how long you plan on keeping it. Some investments you hold forever, and some are held for a short while. Regardless, you are probably going to have to pay taxes at some point in time.

Experience

Holmes Osborne began his career as a financial consultant for Merrill Lynch Private Client Group in Naples, Florida. At Merrill Lynch Mr. Osborne assisted clients in asset management and estate planning. After Naples, Mr. Osborne managed trust portfolios for Merrill Lynch Trust Company (a division of Merrill Lynch's mutual fund division) in Boca Raton, Florida. The trust department managed over \$1 billion in clients' assets. After Florida, Mr. Osborne worked in management for Farmers Insurance Group in Los Angeles, California.

Mr. Osborne has a degree in finance from the Martin J. Whitman School of Management at Syracuse University. Licenses held are Series 7, 63, 65, and 26. Member of the Association for Investment Management and Research and Los Angeles Society of Financial Analysts. Mr. Osborne is also President of the Syracuse Alumni of Southern California.

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