# GSI Market View

2nd Quarter 1998

**Tops down and bottoms up.** Connotations to these phrases are numerous, but we use them in terms of our approach to financial analysis. ***Tops down***. This is simply industry jargon for a macroeconomic examination of current trends translating to the methodology for security selection. ***In short, what's going on in the world and how does it relate to what we may or may not buy?***

***Bottoms up*** investing, on the other hand, ***entails the examination of securities on an individual issue basis.*** Management, financial condition, ratios and peer to peer comparisons are of ultimate importance here.

Which is right? Some investment managers may choose one or the other. ***Our discipline requires that both be used in making a final judgement***, helping us to determine the balance between stocks and bonds, industry diversification and individual security selection. Capturing current and future economic trends and then applying them to individual securities with superior products, management and financial health, are factors we look for in security selection.

**Tops down.** We are living in a world economy and it is our view that ***the entire world is not on it's "overvalued death bed."*** Many of our Asian counter parts seem to have a bit of long-standing pneumonia. Japan, the historic Asian engine, has an extremely large debt burden, both internally and externally. This has created a high percentage of non-performing loans, placing downward pressure on an already faltering economy. The good news? The current circumstance may force the Japanese to manage their economy more responsibly in the future. Already, a financial stimulation package is being used due to internal and external pressure on their political leaders. South Korea, Indonesia, Malaysia and Singapore are feeling the pain as well, but they also are taking action to turn their economies around.

***China seems to be the bright spot***. If there is a potential "life raft" for Asia, it is China. The Chinese people seem to have both the will and the sheer numbers to turn this part of the world around. They also now have Hong Kong. ***Ultimately, much of the long-term Asian success will depend upon the reformation of the Chinese financial system and the successful privatization of many its corporations***.

***Europe is steaming along in spite of the uncertainty created by the forthcoming European Union (EU)***. Latin America and Mexico have stabilized and have become productive. ***One real question remains, how about the US?*** Interest rates and inflation are still considered to be tame. However recent rumblings by the Federal Reserve have sent shock waves through the domestic marketplace driving security prices down (this is commonly referred to as "Moral Suasion"). First quarter corporate earnings results are rolling in with very few disappointments to be found. What we are seeing now is upward earnings revisions due to overly pessimistic prognostications at the end of the first quarter. The common stock market provided healthy returns in the first quarter, moving up more than 13%. ***A sign of overvaluation? Unless interest rates rise, we think that might be true for the short term but not the long term. In fact we think that a 5-10% correction in stock prices would be healthy because of spectacular first quarter results.***

**Risks from a tops down perspective however are abundant.** Rising inflation potential, an economy deemed too steamy, and a stock market that may have moved to fast; all would seem to give the Fed a reason to intervene. *This could be done either directly (via an actual tightening) or indirectly (via moral suasion*). Our politicians (including the Fed) have used moral suasion or talking the markets down in the past. It generally works over the short term, but fundamentals eventually take over. ***U.S. economic fundamentals remain positive, and until they change, we feel good about the markets.***

**Now bottoms up.** As is clear to anyone that has a relationship with us, we at GSI are "growth" stock managers by discipline. ***We spend the majority of our time evaluating the growth potential of the companies that we own***. History has shown us this much, that if interest rates and inflation remain low, growth stocks will appreciate in value. This has been and continues to be the case with many of our core holdings.

***Our major concentrations continue to be in technology, finance and healthcare, with each of our stock positions evaluated on an individual basis***. Macroeconomic conditions suggest that these are the places we want to be long-term. Despite the abundance of circulated dissinformation, capital spending on information technology is not slowing (maybe diverted to Y2K on a short-term basis). Given low inflation and a reasonable interest rate environment, finance companies will continue to make money, albeit the new way (merger mania) or the old fashioned way (interest and fee income). Finally, health care reform, although not by any means dead, does not seem to pose any near -term threat to the profits of our medical stocks. People will continue to age and become ill. Many will pay whatever is necessary to become well, with or without insurance reimbursement.

***Over the past few months we have strengthened our weighting in consumer stocks***. This has been done in an effort to further capture the spending patterns of the baby-boomers. ***Again, we select stocks on an individual basis based on their respective peer group position and how they may capture future macroeconomic trends***.

**An issue that warrants attention in a macroeconomic sense is Y2K.** What is it and what does it mean to you? Quite simply, Y2K refers to the year 2000. Why is it important to us and to you? ***It is at that point that many older computers (as their current hardware and programming dictates) will be unable to operate based on the fact that they will not be able to differentiate between the years, 1900 and 2000***. Years ago, in an effort to conserve costs, programming language was written primarily in 2 digits, not four. This may not seem significant to many, but it is an issue of importance. One should remember that this extended bull market has been driven, to an extent, by technological innovation similar in magnitude to the industrial revolution at the end of the previous century. In short, almost everything now is computer based and runs the risk of "crashing" if the respective hardware and software is not 4 digit tested. Computer chips in everything from toasters to older cars to ATM machines run the risk of becoming inoperable as the turn of the century occurs.

**Who is safe? Who is in jeopardy?** It seems as though many of the larger private corporations have and continue to make an effort to become Y2K compliant. In reality, this needs to be accomplished by late 1998 in order to conserve enough time for testing and revision. ***Smaller companies, in addition to the operations of the federal government, seem to be the most vulnerable***. Only time will tell what impact the turn of the century will have on our computer systems and, subsequently, us.

**Referrals.** They are the life-blood for this and any other service-oriented business. Please keep us in mind when uncovering potential investment management opportunities. Our experience, flexibility and strong performance record could be a benefit to those who wish to work with us. Thank you.

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