GSI Market View

2nd Quarter 1999

"What makes 1999 different is that a historic shift is taking hold, and it's reshaping everything: how we shop, how we interact with our governments, how we learn, what we do at home."

- *One school of thought says a mass medium has been born when it's used by 50 million people. Radio took 40 years to reach that threshold. TV took 13 years. Cable TV, 10 years. The Internet did it in less than five. As I write this, more than 140 million people are online.*
- *The Internet isn't creating new businesses. It's creating new business models.*
- *The greatest competitive advantage in the technology industry is no longer technology.*
- *The PC era is over.*
- *We're only at the beginning – more is coming.*

The above statements were made by Louis V. Gerstner, Jr., Chairman and CEO of IBM in their 1998 Annual Report. Periodically, we read through a corporate annual report that causes our minds to reflect, because it is forward thinking and the narrative cuts through stereotypical information to allow a clear sense of direction that the company is taking. Jack Welch did this with comments in GE annual reports as did Warren Buffet for Berkshire Hathaway.

Gerstner places IBM carefully on the growth path of the Internet. *The new business model comment simply means that the way we do business will change*. For example, banking will shift on-line from making a trip to the bank. *The technology statement means that technology changes so quickly that it is more important how you help customers use technology than the technology itself*. Comments on the PC era being over means that now the PC serves a critical access point to the Internet where most of the activity is conducted. *Finally, stating that we are only in the second inning in Internet development means that the low cost of computing components - processors, memory, storage, etc., permits the gathering of real time information*. For example, soft drink companies tie together their vending machines to see what is selling now, and auto companies collect information on the performance of their cars, as they are being driven.

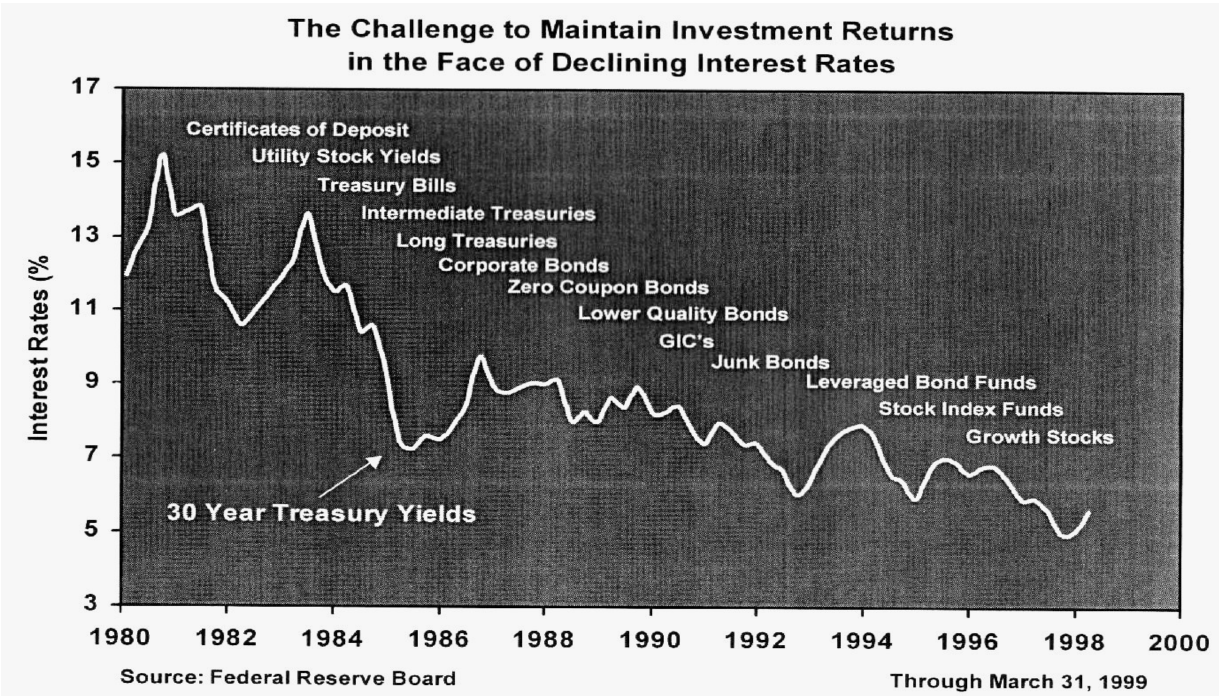
Some ways that IBM is benefiting is that Internet-based purchasing *should save IBM nearly a quarter of a billion dollars in 1999. In addition, e-commerce sales for the company last December reached $38 billion a day*.

Only a few years ago, the PC was the new paradigm. Today, it is the internet. These two forces are changing the economic framework in which we live and how we spend our time. *Older generations are being dragged into usage of the new tools while younger generations are leaping to the task*.

How is the economy being affected? *Growth. Worker productivity, Lower inflation. Lower interest rates. Lower debt levels. Healthy capital markets. And more.*

How is our life style being affected? *We can shop on the internet. Cars need less servicing. Travel plans can be formalized with the push of a button. Communication with others using e-mail can be accomplished quickly at a low cost in distant location*. One client uses this medium to communicate frequently with his missionary relative in a remote area in South America. Applications for Internet usage are endless, and we will experience many changes in the new millennium.

If these trends continue, and we expect they will, interest rates will move lower and growth stocks will benefit. We were shown an interesting chart at a recent conference sponsored by Norwest Bank (now Wells Fargo). It shows how investors move down the ladder of lower interest rates using different investment vehicles to maintain investment returns. It is reprinted below:



Note how investors have had to change their types of investments to maintain investment returns. Treasury securities provided double digit returns in the early 1980's when inflation was high*. As interest rates declined (now roughly 5% to 6% on Treasuries) over the past 20 years growth stocks have become the investment medium providing high returns*. Stocks like Intel, Microsoft and Cisco (all Internet players) have been driving the S&P 500. We think this will continue.

The popular thought now for stock market success is rotation. The notion is that large growth stocks are overpriced, so money should be shifted into cyclicals. This is not new thinking; it is really an old idea. *Too many reasons against this thinking prevent us from making such a move*. Growth stocks tend to be one decision stocks while cyclicals are two decision stocks. To benefit fully from investment in cyclicals, one must buy and sell them right. This is not easy. Then, for taxable accounts, taxes have to be paid. One has to be right about the economy, and that is difficult to predict.

Growth stocks, on the other hand, tend to continue to grow through an economic cycle. It is critical, however, that they maintain their rate of growth. It is not easy to find stocks that grow consistently, but that is the task of the growth stock investor. *Our approach has been to diversify our list of holdings using stocks that have varying rates of growth*. Therefore, we are able to buy into industries such as financial, and selective consumer and energy stocks which are in addition to technology and health care stocks.

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