



We begin this newsletter with two quotes.

“To think is easy. To act is difficult. To act as one thinks is the most difficult of all.”

Johanne von Goethe.

“Strategies are intellectually simple, their execution is not.”

Larry Bossidy, Chairman and CEO of Allied Signal,

Glenn and I felt these to be apt and powerful descriptions of the investment management process.

We also thought that it might be interesting to address two issues not dealt with in our past newsletters but pertinent in our society today. *The first issue is, why hire an investment manager?* Now that information is so abundant and inexpensive, why not do it yourself? Just access the necessary information from the Internet or other media outlets, make your buy and sell decisions and retire early.

As an answer to these questions, permit me to pose two questions to you. *First, would you go to a surgeon (assuming a procedure is necessary) who has never performed the respective operation? Second, would you engage a defense attorney who has never been in the courtroom?* Of course these questions are rhetorical in nature. They are however, pertinent. Look at the case involving the surgeon. He or she knows through years of training and education what to cut, how deep to cut, what to avoid and many other important issues regarding the respective procedure.

The defense attorney that you would seek has also spent years of time studying and applying his/her trade in the courtroom. He or she not only knows the law inside and out, but knows what questions to ask, how to ask them (dependant on the person being asked), courtroom procedure and etiquette and has a firm grasp on precedent.

The point is that investment work, like these other professions, requires years of study, experience and application. To think that one can simply read a little bit and execute his or her strategy is somewhat naïve. The difference is that the other two professions highlighted above are restricted by a degree or series of degrees. In short, not everyone can be a doctor or an attorney. Our profession requires no single degree. This, itself, is worthy of a separate newsletter.

Additionally, our job descriptions include much more than pure investment work alone. We have to have a fairly solid *understanding of the tax code* as it pertains to the investments we own. We are required to *perform amateur psychology* (not every client or situation is the same) on a regular basis and must be ready to *respond to the requests of our clients* in prompt fashion. Finally, we have to have *in-depth knowledge of the security markets and practice discipline in the selection process.*

In short, this is a tough and complicated business that requires full-time attention.

The second issue offers a completely different perspective. *It relates specifically to the pricing of many of the stocks that we hold, predominantly growth stocks. How many times have you heard that Microsoft is tremendously overvalued? How many times have you been told that its price-to-earnings multiple of 52 is over twice that of the S&P 500 (roughly 24 times)? So, Microsoft couldn't possibly be viewed as a VALUE stock, could it? Maybe, says Edward Keon, Director of quantitative research at Prudential Securities, Inc. Keon believes that because over 67% of Microsoft's profits come from sales that are booked in the same quarter, one must adjust the earnings of the S&P 500, viewing it on a cash basis to be comparable. What that means is that the earnings forecast for the S&P500 is reduced from \$54 to \$31 when viewing it on a cash basis. In short, *the revised multiple of the S&P 500 is 42 times.* This compares much more favorably to the 52 time multiple of Microsoft. From there it becomes easier to argue the company's valuation as it's premium to the market is smaller.*

*As a second measure, Keon looks at the anticipated growth rate of Microsoft for the next 5 years (the consensus is roughly 24% annually). When compared to the anticipated growth rate of the S&P 500 for the next 5 years (roughly 15% annually), one sees that Microsoft trades at roughly 2.2 times its anticipated future growth rate while the cash-adjusted S&P 500 trades at roughly 2.8 times. A Value stock? maybe so. In any case, this same rationale can be applied to many of the "overpriced" technology stocks that we own. We firmly believe that in order to hold oneself out as a growth stock manager in this market today, **one must own technology stocks.***

Regardless of the stocks that we own, Glenn and I employ a GAARP, or growth at a reasonable price approach to security selection. Although many have heard this term it is often misunderstood and mistakenly applied by many in our business. To us it is our core philosophy even in the face of many of the names we own being called "too expensive" by traditional measurement standards. *In a nutshell, we try to value the future cash flows of the companies we own, discounting them back to the present, giving us a better picture of how expensive we feel these companies truly are.* It is a method that has worked well for us since our inception and is currently gaining a lot of attention in the media.

Finally, in an effort to further serve our clients, we have developed a secure portion of our website (www.gsinvestments.com). Here our clients can gain access to their respective portfolio information on a customized and secure basis (password and ID protection on the way into the website and encryption on the way out of the website) at any time of day or night. Information will be available first on a monthly basis, and eventually, a weekly basis. As an additional benefit, the securities owned in the respective portfolios will have hyperlinks to research that we feel important. Please call either Glenn or me for inquiries regarding this or interest in the services provided by GS investments, Inc.

Let me close by saying that people tend to hire us because of our vast **experience**, the feeling that they can **trust** us implicitly and the knowledge that they will be **well taken care of** at GSI. Please remember us when coming across individuals or organizations that need investment management assistance.

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