

EVEN BLUE CHIPS DIE

JULY 2007

Break out the party hats and noisemakers! The Dow has hit 14,000. At the July 19th close, Maria Bartoromo of CNBC looked as if she just received a 500% raise, stock options, a G5 and Marty McFly's DeLorean time machine to take her back to "go-go 90's". When it looked as if the milestone wasn't going to occur, CNBC's Bob Pisani looked as if his dog died on air. Fox News had computer graphics with fireworks and explosions. I could go on and on, but we would rather deal in fact and perspective rather than hype and real cool computer graphics and sound effects. So instead, right here in the *Markowski Monthly*, we are going to suggest something that none of the business programs will:

Insert drum roll, fireworks and cool graphics here.

We Predict Wal-Mart and General Electric will no longer exist.

That's right, you heard it first right here.

How can that be you say, two Dow components, cornerstones of our economy, titans of industry will no longer be in business?

I am here to tell you they won't be the first titans to fall and they will not be the last. But sooner or later they will go out of business.

In 1602, the Dutch East India Company or VOC (Vereenigde Oostindische Compagnie) was established to carry out various colonial activities in Asia and the Pacific Rim. The VOC was the very first blue chip; the very first company to establish stock, the first multinational corporation. This company was so blue that it issued an annual dividend of 18% for over 200 years. Oh yeah...VOC went bankrupt in 1800.

The concept of Creative Destruction was introduced in 1942 by economist Joseph Schumpeter; it describes the process of transformation that goes hand in hand with innovation. Schumpeter's idea is that capitalism creates entrepreneurs that in turn invent, which then allows for economic growth while simultaneously destroying the value of existing companies. To put it in layman's terms, **"Creation builds and destroys and trees do not grow to the sky!"**

Eventually, and using history as a guide, somebody will build a better mousetrap and that bluest of blue chips will be no more. Do you think that many people alive in 1700 would or could ever believe that The Dutch East India Company, a global monopoly, would be bankrupt a century later? The irrational belief that it can't happen to me and my investments, whether it be stocks, bonds or real estate are impenetrable, is a one-way ticket to financial ruin.

Nick Murray of *Financial Advisor Magazine* cites the more recent example of the pharmaceutical giant Merck. Merck with its brilliant scientists and doctors have consistently created breakthrough drug after breakthrough drug and have bettered the quality of life for mankind. For decades its stock was an unquestioned core holding for portfolios around the globe. Not only did the stock perform exceptionally well, but the company's dividend compounded at double digit rates. Murray points out that at one point in time in the 1990's Merck's cash dividend adjusted for splits was higher than the stock price was 30 years earlier. Then the music stopped.

On September 30, 2004 Merck announced that it was going to withdraw its anti-inflammatory drug Vioxx due to evidence that the drug might be responsible for an increased rate of heart

attacks. The next day Merck's stock price opened 27% lower and continued the spiral as the proverbial blood was in the tort attorney's water. In a matter of days television commercials were being aired coast to coast by law firms encouraging people that had taken the drug to call the (800) number and sue. When all was said and done Merck's stock was down 70%. Its current price is about half of where it was seven years ago.

In the late 1960's and early 1970's Wall Street gave us its "Nifty Fifty", a list of stocks that investors could buy and hold forever. Included on that list were Polaroid, Burroughs, Joe Schlitz Brewing, K-Mart and International Harvester to name a few. Look them up today and see what happened. In the 1990's we were told that this "**time it is different, it is a new economy, and earnings don't matter.**" Enron was named *Fortune Magazine's* most innovative company of the year for six years straight. Fast-forward to today, U.S. Treasury Secretary Hank Paulson was recently quoted by *Fortune Magazine*, "**This is far and away the strongest global economy I've seen in my business lifetime.**" Now I happen to agree. The global economy has turned many crises into speed bumps due to the spreading of risk. However, that doesn't mean to put on a pair of rose-colored glasses and declare the death of the business cycle.

It is easy for the press and salespeople to push extremes. Words like "**crash, all-time high, record close, huge sell-off etc.**" evoke emotion. Emotion is a sales elixir. Watch any good advertisement; whether it is for automobiles or mutual funds, the goal is to create an emotional response not a rational one. The media loves to build icons, and they also love to tear them down...more news at eleven. The rock star treatment that 20 year-old CNBC declared geniuses received on the business programs in 1990's was laughable, but served its purpose. It was all an illusion, smoke and mirrors, a dog and pony show; but both parties, Wall Street and the media got what they wanted. The media exists to sell advertisements. (Why do you think CNBC would cancel its Wall Street Journal Editorial Review show and create a show like Mad Money?) Wall Street investment firms in their brokerage capacity exist to sell you stuff. It is interesting on how all of those internet mutual funds happen to come out at the end of the technology boom; or all the new gold and commodity funds that have popped up recently, or now all the emails I receive trying to convince me to put my clients assets in these all new green socially conscious funds.

The simple reality is...If its "**hot**" it sells, and when it's hot you should be selling, not buying. Wall Street has an uncanny ability to hand you an umbrella the day after it rains, and do it wearing a nice suit, and a smile.

In January of 1999 I wrote a column here in the *Markowski Monthly* entitled Icarus and the Stock Market, where I used some Greek mythology to caution people about the run-up in the markets. I made the comparison between the young man Icarus, who decided not to heed his fathers warning of flying too high and its deadly result to the prevailing "**What me worry**" attitude and wisdom of many 1990's investors. President Harry S. Truman stated, "**The only new thing in the world is the history you do not know.**" Nick Murray adds to this and I wholeheartedly agree, "**Or the history you have chosen to ignore because you've decided that you're exempt from it.**"

Whenever there is a stock market record or a major market sell-off my telephone lines light up. Calls come in not from worried clients, but from radio stations around the country inviting me to give my take on the spectacle. Do I have an opinion on why the markets are doing what they are doing? Yes. Should I make sweeping investment decisions based upon this opinion? No. I like to make decisions upon what I know. I know that the markets cannot go up forever in a straight line. I know that compounding works both to the upside and the downside. I know that you can get wealthy by under-diversifying, but not **STAY** rich by under-diversifying.

The illusory nature of icons is fascinating. The world we live in is filled with cure-alls, quick fixes, and false prophets. People want to believe that someone magically has all the answers and short-cuts. They call Warren Buffet the "*Oracle of Omaha.*" Why? Anyone who has studied

Buffet and what he has accomplished knows that he didn't build Berkshire Hathaway with an Ameritrade account or a crystal ball while watching James Cramer.

The modern discourse of behavioral finance pioneered by Daniel Kahneman, who was recently awarded the Nobel prize in economics for his work; teaches that, whereas traditional finance and economic theory is based on the notion that individuals will make decisions that are in their best economic interest which in turn is based upon facts and a rational analysis of all available information. However, it is currently apparent, that it is an inaccurate thesis. Kahneman argues that individuals will often make irrational choices that are predictable and unfortunately repeated by the same individual even after the fallacy has been discerned. Wall Street is well aware of this, Madison Avenue knows this, and now you do. Successful people are able to recognize their inherent strengths as well as weaknesses and the same holds true for investors.

So, we didn't tap a keg, roast a pig, or set off fireworks at the Markowski household the day the Dow hit 14,000. So what did July 19th 2007 mean to me? Hmm...Well, it is the 200th day of the year... Three days until my vacation... I need to take my daughter to ballet tomorrow...

Please Understand...financial planning first, asset allocation second, portfolio third, all the rest is just static.

SOURCE MATERIAL:

Marcinko, David E. Financial Planning Handbook For Physicians and Advisors 2005 Jones and Bartlett

Ricklefs, M.C. A History of Modern Indonesia Since c.1300 1991 MacMillan

Murray Nick Love Never Means Having to Say You're Underdiversified *Financial Advisor* June 2007