January 2, 2003

To our Clients and Friends,

A client recently asked us to review an annuity that she was considering for possible investment. The annuity was offered to her by an insurance company of dubious credit quality but of exceptional marketing prowess: The contract came wrapped in a slick brochure promising a “guaranteed” stream of fixed future payments, “financial security” in our client’s later years and of course, the mother of all catch phrases, “**peace of mind**.”

Unlike most insurance companies, which cloak their fees and expenses in the fine mesh of legalese, this one proudly (though inexplicably) stated it would charge her a modest 3.0% of principal per annum as the price of apparent safety. We say “modest” because we have seen annuities that cost more than double that amount when all of the administrative, advisory and sub-advisory fees have been counted. We also say “apparent” because if the insurance company runs into financial difficulty (and it is already on shaky ground,) or its executives commit fraud, or some other event comes to pass that causes the company to go belly-up, then the guaranty may prove worthless. The conditions that would lead to this negative scenario don’t seem farfetched given what has transpired in recent years. Anyone remember top-rated Executive Life?

Interestingly, the guaranteed income promised to our client would sum to the same dollar amount as the initial investment. In other words, she would pay 3% annually for a total return of (drum roll, please…) 0.00%. Not exactly something you’d strive for, yet annuities and similar investments marketed as “safe” have become increasingly popular. You’re in good hands, good neighbor.

All of which leads to the point of this letter: ***No investments are absolutely safe.*** Your eventual reward (return on capital) is directly related to the amount of risk you are willing to take and the amount of time you can afford to wait. Markets move in cycles, and every investment has its day in the sun, be it blue chips, bonds, real estate, or high technology.

We know that the next great thing can’t be accurately predicted, so we diversify across sectors and companies to reduce the risk of having too much in the wrong place at the wrong time. As James Glassman recently noted in the Washington Post, the historical return from equities has been 10.5%, while Treasury bonds have returned about 5.5%. Those are average returns over the past 75 years, and do not hint at the volatility we’ve seen in the past five. Time gets us to the averages, or hopefully something better, while diversification helps us avoid the company-specific disasters that abound.

As the New Year begins, **US stocks look inexpensive compared to Treasuries**, though new sources of global tension (nukes in North Korea, oil in Venezuela) may keep a lid on investors’ **willingness to accept risk**. A showdown with Iraq appears imminent, but the stock market would likely cheer a speedy resolution. We are optimistic that tax breaks will help dividend-oriented stocks outpace non-dividend payers in the coming cycle, and are positioning portfolios accordingly. We hope for a return to more “normalized” markets this year, and wish you and your families good health, happiness and prosperity.

Sincerely yours,

Mitch Schlesinger
Chief Investment Officer