

This letter is dated January 1999

Fools Rush In

1998 was a frustrating year for careful investors and a great year for the speculators who made fast money on internet stocks.

Let's take a look at the ballooning internet stock prices. In my opinion, the socioeconomic impact of the internet will rival that of the telephone and the printing press. So why haven't I put your money or mine in any "web" stocks? The answer is that a speculative frenzy has pushed prices to sky-high levels that careful investors refuse to pay.

For perspective, consider that America Online has a greater stock market value than Pepsi, Gillette or even the largest company in the world—General Motors. Gamblers have pushed the value of white-hot eBay to \$10 billion while eBay's gross revenue was only \$12.9 million during its most recent quarter.

The 1982-83 personal computer company boom serves as a revealing comparison. High-flying PC stocks like Commodore and Atari eventually crashed and burned and the group as a whole underperformed miserably over the following 5 years. The PC leaders of today—Compaq, Dell and Gateway 2000 didn't even exist when PC fever over-took Wall Street. Careful investors had an opportunity to invest in Compaq about 10 years later in 1992 at 10 times earnings when the gamblers had moved on to bid up biotechnology stocks in yet another speculative frenzy.

Now let's consider the biotech mania of the late 1980's and early 90's. Biotechnology has made a phenomenal contribution to medicine over the past 10 years yet most investors who jumped on the first big Wall Street wave drowned. Over half the biotech companies that went public in 1991-92 have since gone out of business. In 1998, 6 years after the boom, careful investors had the opportunity to invest in Amgen--the top ranked biotech company in the world—for less than 20 times earnings.

Now you know why I think the “web” stock boom will eventually turn into a bust and speculators will again get burned. When the balloon bursts and a new fever overtakes the gambling crowd the careful investor will have an opportunity to invest in the strong profitable internet companies that survive. Until then we will stay out of the frenzy looking a little old fashioned and out-of-step with the market.

Phil McCauley III
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Closing prices as of 1-4-99: AOL - 148 13/16, PEP - 40 11/16, G - 47 13/16, GM - 70 7/8, EBAY - 240, CPQ - 42 5/16, DELL - 74 3/16, GTW - 53 5/8, AMGN - 107 3/8

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