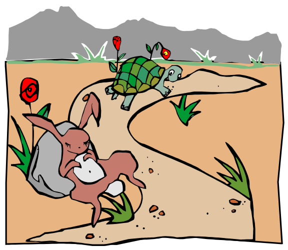
Jolley Asset Management
Investment Outlook

Volume 1, Issue 10 Fall 2000

"The Hare and the Tortoise"



The Hare was once boasting of his speed before the other animals. "I have never yet been beaten," said he, "when I put forth my full speed. I challenge any one here to race with me." The Tortoise said quietly, "I accept your challenge." "That is a good joke," said the Hare; "I could dance round you all the way." "Keep your boasting till you've beaten," answered the Tortoise. "Shall we race?" So a course was fixed and a start was made. The Hare darted almost out of sight at once, but soon stopped and, to show his contempt for the Tortoise, lay down to have a nap. The Tortoise plodded on and plodded on, and when the Hare awoke from his nap, he saw the Tortoise just near the winning post and could not run up in time to save the race. Then said the Tortoise: "Plodding wins the race." Aesop

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When examining investment styles and strategies one could easily label the "value manager" as the "Tortoise" and the "growth manager" as the "Hare". Just a year ago, no one gave "value" (the tortoise) much of a chance; aggressive growth strategies (the hare) were all the rage and indeed these strategies did jump way out ahead of the more boring, conservative value strategies. In the financial markets, however, we should come to expect the unexpected. Value has handily outperformed "growth" in seven of the last nine months. In the quarter just ended, the Barra Value Index returned 8.81% while the Barra Growth Index declined by 8.79%. That represents a return differential of over 17.5%. History has shown, that while the value style may not capture all of the positive return in a strong bull move, the value manager will likely earn their keep by preserving capital and outperforming the benchmarks when the markets become rocky. That is precisely what has happened over these past few months.

Investing is very much like a long race or marathon; the winner, may not be the one who sprints out to the early lead. To be successful in investing one must be able to ride through the bear market so that they can participate in the next bull market over the horizon. It is our belief that investing with a n "margin of safety" under the value principles of Benjamin Graham, gives the investor the best chance to succeed at investing over the long term. We are the first to acknowledge that there are times when it becomes difficult to adhere to a value discipline. Value investing is not a simple to philosophy to practice. Many who attempt or claim to be value-oriented fail to maintain the discipline or patience required to succeed. However, it is that very discipline and patience that enables the value investor to avoid getting caught up in speculative bubbles, even during periods of short term under performance.

One of the dominant themes in value investing is to manage downside risk with regard to portfolios and the individual securities that make up those portfolios. The value investor attempts to accomplish this by appraising the value of the underlying business (many times referred to as "intrinsic value"), and then buying the common stock when it trades at a discount to that valuation. The difference between the market value and the appraised value is what Benjamin Graham called the "margin of safety" (the wider the discount, the greater the "margin of safety"). This is clearly where most value investors and growth investors differ. While the value investor expects to profit from the narrowing of the discount between the market value and intrinsic value, the growth investor is attempting to buy companies where they are basing the investment decision on expected future earnings. As Ben Graham points out in *The Intelligent Investor*, "Thus he may be said to substitute these expected earnings for the past record in calculating his margin of safety." Graham goes on to say, "Thus the growth-stock approach may supply as dependable a margin of safety as is found in ordinary investment--provided the calculation of the future is conservatively made, and provided it shows a satisfactory margin in relation to the price paid." Graham points out in *The Intelligent Investor* that the price paid is often times the problem in growth stock investing. According to Graham, "The margin of safety is always dependent upon the price paid."

While clearly most growth issues have corrected from their highs, we believe the prices being paid today are still too high. The S&P 500 trades at a lofty 28 times earnings and companies such as Cisco Systems, EMC, Sun Microsystems and JDS Uniphase have trailing price/earnings ratios over 100 times. While these are great companies with great prospects, they are "priced for

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"perfection" and we believe offer no "margin of safety". In the "go-go" days of the early 1970's the "nifty-fifty" were considered to be one-decision buy and hold stocks despite the high price earnings ratios. It was thought the earnings would always grow and ultimately push the stocks to even higher levels. However, if one were to look at McDonalds you saw the case where the price/earnings ratio declined from 85 times in 1972 to a price/earnings ratio of 9 times in 1980, despite continued rising earnings without any blips. In summary, we agree with Mr. Graham; we believe the price one pays does matter, and a great company does not always represent a great investment.

As we discussed in our Spring Investment Outlook, there were many casualties among "value" managers early in the year, as the public pulled significant amounts of dollars from value funds with the majority of those funds reallocated to the more aggressive NASDAQ. Never mind the fact that as of June 30, 2000, the NASDAQ had a trailing price/earnings ratio of approximately 128 times, versus approximately 22 times for the Dow Jones Industrial Average. While logic would imply that such a shift of funds was irrational, the speculative forces, coupled with the enormous media hype resulted in a speculative blow-off in the NASDAQ that will not likely be duplicated in our life times. We feel extremely fortunate in that our independence as an investment firm has allowed us to speak candidly about our views of the market, and the flexibility to invest in long term strategies that we believe will lead to long term wealth creation for our clients.

Index	3rd Qtr 2000	YTD 2000
DJIA	2.36%	-6.28%
S&P 500	-.97%	-1.39%
S&P Mid Cap	12.14%	22.20%
S&P/Barra Growth	-8.79%	-6.43%
S&P/Barra Value	8.81%	4.38%
Value Line	2.94%	-2.59%

While many of the market indices have pretty much fizzled this year, the market has become more egalitarian, with more stocks rising than falling. What we have had so far in 2000 is essentially the opposite of what transpired in 1999; the average stock is faring better than the major indices. The S&P Mid-Cap Index has advanced sharply in the first nine months of 2000, as investors have begun to shift out of the "nifty-fifty" into some of the "not so nifty" 450 (the bottom 450 names in the S&P 500 Index). As we have emphasized for some time, once you migrate down in market capitalization the market is really not that expensive. This is backed up by the fact that the median stock in the Value Line Index trades at approximately 14 times earnings versus 28 times for the S&P 500. The markets have witnessed strong performance from previously ignored sectors such as electric utilities, financials, energy, aerospace, and tobacco; while the once hot technology and communications sectors have faltered. We would expect that for the intermediate term, that these trends will continue, as the speculative excesses continue to be wrung out of the system.

The biggest concerns facing investors over the second half of this year are the three E's. Earnings, the Euro, and Energy.

Earnings: The previous FED rate hikes coupled with the higher energy prices seem to be slowing the domestic economy, and with that comes the risk of lower corporate earnings. According to Chuck Hill of First Call/Thomson Financial; 339 companies have issued warnings that third quarter profits would be worse than expected, up more than 28% from this time a year ago. Weakness has shown up across various industries including selected technology, telecommunications, retail, consumer products and basic materials companies. Energy, financials, and utilities (classic defensive sectors) appear to be faring the best in this slower growth environment.

Euro: Weakness in the Euro has significant implications with regard to the earnings of many of our multinational corporations, which dominate the S&P 500. U. S. based multinationals have seen earnings estimates revised downward due to weaker European demand and negative foreign currency translations. We believe that this is creating a potential investment opportunity as many of the multinationals with dominant brand franchises appear to offer good value as many are trading at or near multi-year lows. While "intervention" efforts by the Central Banks usually are futile, we believe there is a decent chance that the Euro is likely to recover over the next year.

Energy: Just when we all bought gas-guzzling SUV"s, we get slapped with surging energy prices. While the Clinton administration has attempted to address the sky high-energy prices by its action with regards to the Strategic Petroleum Reserve; it is not likely to have a lasting impact. Winter weather and lack of refining capacity is likely to keep oil prices significantly above year ago levels. This will likely have a dampening effect on consumer spending and domestic economic growth. Sectors such as retail, transportation and chemicals have all seen downward earnings revisions due to the higher energy costs.

Summary

In summary, like all investors we remain concerned about the slowing economy and the potential impact to corporate earnings. However, we believe market timing is a futile exercise that ultimately leads to poor investment performance. We remain committed to owning what we believe to be high quality, undervalued equities for the long term. While value investing will definitely have its setbacks, we believe any such setback will be a "temporary" loss of capital versus a "permanent" loss of capital that often occurs in speculative investment strategies. We feel excited and vindicated now that value investing has once again returned to favor. While our commitment to value never wavered, we are relieved to be in an investment climate where once again, fundamentals do matter.

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