

THE WALL STREET TRANSCRIPT

Connecting Market Leaders with Investors

Common Sense Investing in a Down Market



KENDALL J. ANDERSON is the Chief Executive Officer of Anderson Griggs Portfolio Management. He is a U.S. Army veteran and a graduate of Arkansas Tech University where he received a Bachelor of Science degree in Business with a minor in Economics in 1979. He earned the right to use the Chartered Financial Analyst designation from the CFA Institute in 1993. Over the past 30 years, he has held numerous positions in the financial services industry and has been

interviewed and quoted by various industry publications on investment management, theory, practices and applications. He is the firm's Senior Equity Analyst and has established an outstanding track record for portfolio management expertise. The firm's Focused Growth Separate Account is rated 4-Stars Overall as of December 31, 2008 by Morningstar derived from a weighted average of the Focused Growth's three and five year Morningstar Rating metrics, which are based on risk-adjusted return performance. The firm's Focused Growth Separate Account was ranked number one by *Money Manager Review* for US Large-Cap Growth Managers by returns for the one year period ending December 31, 2004 and is currently rated number 20 for US Equity Large Cap Growth Managers for the one year period ending December 31, 2008 by risk.

SECTOR – GENERAL INVESTING

(AAB500) TWST: First, would you talk about Anderson Griggs and how you came to have that common sense investing philosophy?

Mr. Anderson: We are a small investment adviser located in Rock Hill, South Carolina. It's about 20 miles south of downtown Charlotte, North Carolina, home to a couple of big banks, or what used to be big banks. For the last 20 years, we have been fighting a war that started

about the time of the 1987 market crash. It's a war between investors and speculators. To be honest with you, we've been losing the battle. I don't care for that very much. The common sense approach came about based on all of the work that we have done over the years and this war. So I believe I need to share a little history of this "war" with you.

Prior to the 1987 crash, 75% of all common stock in this country was owned directly by individuals with an average holding

period of over nine years. The 1987 crash came along and the world, at least the investment world, changed. Our generals, who are the executives of both mutual fund companies and broker-dealers, directed this change. They bought into a strategy promoted by our academics and they enlisted a huge army of over 600,000 financial advisers and consultants. The generals created products and used their army to distribute. This is how successful they have been. As of December 31 our generals have created over 26,000 mutual funds and their army has driven people from becoming an owner of a business, to where the average person today owns 75% of all stocks through their mutual funds. What we have done is separated what people own from themselves. Because of this we have evolved into a bunch of speculators hoping that markets go up without any knowledge of what we own. Our approach has been like that of a traditional investor before the explosion of products and distributors.

Before we invest, we want know a few things. These things are the same that any typical businessman would want to know. We want to answer five separate questions. The first is, "Where is my money?" If I put money out at risk, I want to know what I own or with whom I am partnering. The second question I need to answer is, "What do I want my money to do for me?" Do I want it to pay income or do I want it to grow? The third is, "What are my risks and dependencies?" The fourth question is, "What's my cost?" And the final question is, "How are we doing?" We always need to identify a means of comparison to answer that question.

I am going to put that in contrast between an investor and what I consider today's consultant-driven speculator. The average person who invests through a mutual fund has a real problem with the first question, "Where is my money?" How can you answer that? With 26,000 mutual funds out there, each one of them owning shares in or lending money to 100 or more companies, how can it be possible to answer? There are only a couple of people who actually know, or should know, what is owned. The first one is the portfolio manager and the second is the custodial bank that's holding the securities. Most people are pretty good in determining what they want their money to do, but they have no understanding of their risk and dependencies. They are literally taking the ultimate risk and that risk is, "I hope the market goes up — maybe I will make some money." Of course when it goes down, they panic and they sell and that is pretty much what we have seen going on in the last 12 months.

On the other hand, if you are an investor, and, say, you own 100 shares of **Colgate-Palmolive** (CL), you know the market price is down, but you are not going to panic. You are not going to panic because you are going to look at **Colgate** and say to yourself, "Man, this company has been in business for 100 years. They have got billions of dollars. They are making things like toothpaste and mouthwash and even

though the economy is bad, people are still going to buy their stuff." They have been doing this over and over again for years. They have been a consistent growth story and you can hang on — you don't have to sell. By knowing this about **Colgate**, when the price goes down you have this knowledge to anchor yourself to.

In the last year, we have had panic going on. People are indiscriminately selling. We say that they are panicking because they really have no idea what they own. They are just scared into selling and I cannot blame them for that. To make things worse, their consultants and their advisers don't know what they own. Even though we say advisers are paid to hold their clients' hands, how can they calm them when they have no idea what's going on? That's where the common sense idea of knowing what you own will allow you to make a decision to stay the course or sell in times like now.

Last year I saw a bit of light at the end of the tunnel and a glimmer of hope that people are starting to get a little smarter. They are starting to say to themselves, "Hey, I need to know what's going on," and that's a positive thing. And of course, that's when they will begin healing and do well going forward.

TWST: Tell us about your client base. Is it mostly high net worth individuals?

Mr. Anderson: It is. In fact, we truly enjoy working directly one-on-one with people. It's probably, for all practical purposes, not the best business approach for the investment management business. I would be far better off just giving up and hiring a whole bunch of distributors to sell some product, but to me, that's really not enjoyable. I truly enjoy sitting across the desk, looking at somebody square in the eyes

and saying to them, "Let's talk about you, let's talk about your future, and let's build a portfolio that meets your longer-term needs." That's the enjoyable part of the business. That really directly relates to the individual investor.

The industry has segregated the high net worth investors from the others. Yet people are people and the vast majority of individuals, whether classified as high net worth or the mass affluent people with the \$100,000, \$200,000 or \$300,000 — all can use our help, now more than ever. I personally don't think they are getting it from the normal source out there.

TWST: And it's a lot more work I'm sure, now that the market is in such a downturn, to answer their concerns and manage their expectations.

Mr. Anderson: It is and it isn't. I'm not sure in our case which one applies, as we really have not seen the level of concern from our clients. That doesn't mean it's not there, it's just that I haven't seen it. Maybe

Highlights

Kendall J. Anderson says his investment style is common sense investing for conservative investors. The stocks in his portfolio are in three different categories: consistent growth companies, special situations and late-stage turnarounds. He has a broad diversification of stocks from all economic sectors. As far as the overall market is concerned, everything is down right now. Because of this he is working harder than ever at shifting the emphasis from the removal of risk and holding cash or short-term bonds to adding risk in the form of common stocks. There are excellent companies out there in all sectors. The prices are extremely inexpensive relative to the long-term earnings power of these businesses and investors should be taking what excess money they have and putting it to work.

Companies include: Peabody Energy (BTU); Chevron (CVX); DIRECTV (DTV); Colgate-Palmolive (CL); Procter & Gamble (PG); Monsanto (MON); Dominion Resources (D).

it's because we have consistently been providing the very same message we always have, or it just may be that I am kidding myself. To be comfortable with yourself and your investments you must have transparency and knowledge of what you own. With full knowledge of what we own, we can look one by one at our investments and make a decision. The fact is, as I look back over the last 12 months, I believe we have a positive growth in the number of clients we work with. To me that's pretty good. It could be because we do a lot of direct correspondence with our clients as well as indirectly through our Website. I think our work is as comfortable as it can be because we started the process with a base of knowledge and consistency. It's extremely important for people today to be able to have something they can hang their hat on and say, "I don't need to sell simply because the share price is down." Here is an example. I own shares of **IBM** (IBM). I can truly believe that **IBM** is going to be in business. I look around, I go into an office and the computers are still running. We still need to have them. With that, even if the stock price is down 20% or 30%, I can believe in the business. If investors have tied themselves to a business as an owner and they understand that the company they own is providing a positive cash flow from the operations of the business, they don't have to panic. On the other hand, if my clients had a whole portfolio of mutual funds, I think I would have a whole lot of problems.

TWST: Tell us about the products that you offer to your clients; your Focused Growth, Focused Balanced and other portfolios?

Mr. Anderson: Focused Growth is a pure 100% equity portfolio that we have been offering since March 2000. I have to laugh; I always have great timing. Right before the whole market fell apart is when we started offering a 100% common stock portfolio as a separate account. It is strictly a large cap portfolio. We have just finished another Super Bowl and maybe I can use the sport to help explain the process that we go through in the management of our investment portfolio.

The MVP of this year's Super Bowl was a wide receiver who is five foot eleven inches tall and weighs 195 pounds. He had an excellent day, well enough to be considered the best football player in the nation on that particular day. Our approach to the Focused Growth objective has been not concentrating on the individual star, the MVP, but the whole team. Getting back to the football analogy, let's say we could clone that most valuable player and we can put 11 of the this same MVP on the field at one time against the opposing team and play the game over. If this could be done, the results are not going to be the same. In fact, I would say that there is not going to be much of a game at all. The complete team, the team with the 350-pound tackles, the six foot five inch quarterback, and the wide receivers are going to win very easily. Our approach to the investment process is to field a complete team of players and be the coach of those players. As the coach, we are not necessarily looking for the single star player. We are looking for the best player in the best position to be on the field so that we win the game.

Our competition for the Focused Growth objective is the S&P 500. The players for team S&P 500 are published daily and fully available for our review. We know every player, we know every position and it's our job as a coach to understand the opposition and then put our best player forward to compete against the whole team. The S&P 500 is made up of players in 10 different economic sectors. There are the big heavy-weights like technology that represent 16% of the portfolio. Then there are the lightweights, the materials and the utility sectors, that represent 3% and 4% of the index. We don't want to have a team full of tackles.

We don't want to have a team full of wide receivers, but what we want is to make sure that we've got some good players able to compete against the entire team S&P 500. That's how we construct the portfolios. We look at industries and who the companies within the industry are and construct a portfolio to compete. If there is 16% of S&P 500's market cap in technology, we might have 18% of our portfolio in technology. We might have 12% of our portfolio there, but we always want to have at least some players at all times able to stack up against that competition.

In the long run, in order to win, you must have a whole team. We have rules to mandate this. These rules require us to have no more than 125% above the S&P sector weights, and no less than 75%. Where we ultimately end up between these minimums and maximums depends on what our outlook is and the quality of the companies that are available for us to buy.

TWST: Still, a lot of the norms have shifted over the last six months or so. Have you seen any shifts in emphasis in your investing?

Mr. Anderson: We always see shifts. That's the basic makeup of the market itself, of course. To emphasize this we can look at the financial sector. A year ago financials were about 20% of the S&P 500's market capitalization; today it is about 10%. Obviously financials have come down in size relative to the rest of the S&P. Our portfolios, because of our rules, were automatically adjusted downward to those levels relative to the market. As far as the overall market, everything is down; in fact, the old saying about throwing the baby out with the bath water has been absolutely true over the last 12 months. Because of this we are working harder at shifting the emphasis from the removal of risk and holding cash or short-term bonds to adding risk in the form of common stocks. There are excellent companies out there in all sectors. The prices are extremely inexpensive relative to the long-term earnings power of these businesses and you know, for most investors, instead of running away today and hiding, they ought to be truly taking what excess money they have and putting it to work.

When we look over the years and ask ourselves how our famous investors have gotten rich, it seems to be a familiar story. They were able to buy when things were depressed, when there was worry, when there was fear and hang on to it. Those are the real winners in the long-run game of investing. Right now we are at a point in time where things are starting to change, you read the newspaper and you think it's going to get worse, but the fact is things are changing. They are changing for the positive. I would say, if you've got some money get it to work today because you will truly be happy further down the road.

TWST: Does that mean that you have sensed the bottom in the market?

Mr. Anderson: I think I have. There was a fear-driven selloff last November, which we believe was the low of the market.

Obviously no one can tell, but there are some positives going on that could help the markets and us going forward. Most of the people who were scared to death have sold out. The markets are simply an auction. Sometimes you have selling going on based on mechanics derived from fear, such as the fear that every hedge fund is run by Bernie Madoff, forcing those funds to sell to meet their investors' demand to return to cash. We believe this selling is over.

We have another problem coming along and I hope it won't be as damaging, and that's the private equity problem that I see looming down the road, but I think most of the panic selling has taken place. Most

individuals looking at the economy today think it's going to be nothing but terrible, and because of that they are not buying. They are sitting on the sidelines. They've already sold out and are just sitting there. They are worried to death and of course that causes me to think we are fairly close to this bottom if we haven't already hit it. Since November the S&P is up about 10%. This is a lot better than the 0.5% earned in a money market or T-Bill. We just need one or two positive events to take place and then you will see a mad rush back into common stocks. It may not be three months, it may not be six months, but I think for sure sometime this year we are going to have a nice little run in the stock market and it's better to be in there now than it is to wait for it to happen.

TWST: Where do you have exposure factors and where are you deliberately avoiding and underweighting?

Mr. Anderson: We try to avoid underweighting a sector by more than 25% of the sector's S&P weight. If we cannot find a company that we consider worth owning now it may be necessary. When searching for our individual companies we try to find and hold companies that we can place in one of three investment categories.

We want companies that are consistent growers, companies that are in a special situation, and companies that are potential turnarounds. Because the market has sold off so far, we have an ample supply of companies to come very close to an equal weight against all the sectors in the S&P 500 except one. The one area we do have problems with still is the financial sector. There will be opportunities in financials. It's just that they have not reared their head enough to where we feel comfortable jumping in and buying any individual company right now. Other than financials, we are pretty much equal weighted.

We can walk through them little by little, and maybe name a few of the companies for you to show where our exposure is. We will start with turnarounds. During normal markets, a turnaround could be a fallen angel ready to get back on her feet. It might be a company that went through a period of very business specific risk and they have had a hard time with it. The solution may be a change in management, a restructuring of debt or the sale of a division until things start looking a little better. Buying shares in a turnaround can really add a tremendous amount of return to a portfolio.

Today we have had this massive selloff where the turnarounds are available at bargain prices not based on a unique problem within an industry or a company. You can get some really good quality companies that have sold off based on a perception of something taking place. In the middle of last year, when oil prices were at \$147 a barrel, people couldn't get enough energy stocks. Today we have oil prices at \$40 a barrel and all of a sudden everybody thinks that oil is going to \$20. Part of that is politics saying that we're going to harm everybody and every company that doesn't go green. We want everyone to remove all emissions and so on. But the fact remains that there is still not enough oil in this world accessible at \$30 and \$40 a barrel to fill our current needs for years into the future no matter how much green energy is created. I think you can go through the energy industry, the **Chevron** (CVX) and the **Schlumbergers** (SLB) of the world. These are companies that are going to do extremely well in the future. All it's going to take is for our economy to grow a little. When, not if that happens, oil prices will go back up simply on a supply/demand scenario.

The other area I think is a bargain is the coal industry. We've got this huge fear of dirty coal and our politicians are saying we are not going to let anybody use any coal. I am going to remind people of a

couple of things. First, 50% of all the electricity used in this country is produced from a coal fired utility plant. Now you need to ask yourself, are you going to shut your lights off? Are you going to quit heating your office when it is 25 degrees outside? It is silly for us to think that all of a sudden we are never going to use coal again. These thoughts have taken a company like **Peabody Energy** (BTU), which is the largest coal producer in this country, and priced them at 4, 5 and 6 times their earnings in an industry that's mandatory, necessary and whose product cannot be changed or substituted for in a short period of time. This is where common sense comes in.

If you look at what it really is and forget the short-term problems that you are hearing on the television, you can buy an important company at a respectable price. It seems everybody has a buy on the railroads, yet a lot of their money comes directly from **Peabody Energy** and the other coal producers for its transport. It doesn't make sense to like one thing that transports the coal and not like another thing because it mines it. We are going to have electricity and no one is going to shut the power off. We are going to have a need for coal for many years into the future, so take a look at the energy sector for turnarounds.

Now let's look at the consistent growers. These are currently everybody's favorite. The last couple of years there were very few investors who wanted them. These are the consumer staples. The consistent growers in the consumer staples include **Colgate Palmolive** and **Procter & Gamble** (PG), companies that are extremely attractive long term and short term. And, yes, they are going to have a little difficulty in growing earnings. The fact remains they are still wonderful companies. These are companies that are providing goods and services that individuals need in both good times and bad.

Let's move on to health care. Everybody can look in the mirror and see they are getting older. We are getting older by the day, as is most of the world. We all know that as we get older, medical costs increase. It is a testament to the greatness of the world and its medical service industry that our average life expectancy has continuously increased. Anybody who thinks that the need for medicine is going to decline over the next four to five years is kidding themselves.

In the healthcare sector, the first companies you'd want to look at are the drug companies. They are also today's favorites, but there are still some good companies out there that are at relatively attractive prices. **Abbott Labs** (ABT), **Bristol-Myers Squibb** (BMY) and **Eli Lilly** (LLY) are the three drug companies we own and recommend. If you are worried about patents going off, take a look at **Medco Health** (MHS), it's a generic distributor. Then there are the device manufacturers such as **Stryker** (SYK) and **Medtronic** (MDT) that can go in and fix up our joints today, which we all know tend to fall apart as we grow older. The healthcare industry is something that is attractive today and the prices are cheaper than they have been in quite some time.

Consumer discretion is another market sector that is unloved and offering a few bargains. It is about 8% of the S&P 500. Take a look at **Walgreens** (WAG), which we've owned for a long time and feel very comfortable with. **DIRECTV** (DTV) is not necessarily a consistent grower but more of a special situation. People say that they drink more when times are tough. Well, I think they are staying home to have their drink in front of the TV. **DIRECTV** is a prime provider of that service and it has been reflected in its growth rate. This company is in the right place at the right time with the right product, which is our description of a special situation. That is also

true for most of the healthcare companies. They are providing services at the right time for the right demographics, providing powerful incentives for us to buy these things.

Another special situation is **Monsanto** (MON). **Monsanto** gets a bad rap. This is a company that can be understood with a little common sense. If you think about what's been going on in this nation over the last 100 years, you can see that what used to take 95% of the population working as farmers to feed us can now be done with only 2% of the population farming. These farmers are producing so much food that they are feeding not only the 300 million people in this country, but they are exporting food all around the world. **Monsanto** is one of the companies that we can thank for that. Yet if you listen to too many non-farmers, or read some of the blogs, you will find people who will tell you that **Monsanto** is terrible because they are genetically altering genes. The only difference between what **Monsanto** is doing today and what farmers did 30 years or 40 years ago is that they are doing it in a lab instead of in a field. In the field, they used to grow different types of corn and cross-pollinate them to create a genetically altered seed. Today, because this genetic alteration process has been transferred to a lab, we start thinking there is something evil about it. The fact is, they are creating huge amounts of increased yield to feed many more people around the world. Farmers are going to plant seeds whether it is a **Monsanto** seed or another one. In fact, **Monsanto's** products are a 100% net positive to a farmer. Although the stock price is off 20% or 30%, their future as a business is very bright. As long as we have growing populations and more people moving from the farms to the big cities, we are going to need more food from fewer farmers and **Monsanto** and their shareholders will be rewarded.

Monsanto is considered by Standard & Poor's to be a consumer staple. In our book we think of it as a material company and carry it as such in our sector weighting methodology.

Utilities are another lightweight sector full of consistent growers. This sector has recently had a good run, but they have sold off a little bit lately with the market. It is nice to be getting paid while you wait for things to unfold. Some of the utilities still pay a very high quality dividend and it is nice to get cash off your investments every once in a while. This alone will help you hold on when the share price goes down more than you like. I think **Dominion Resources** (D) is a company that is well worth buying and holding today. I believe their dividend will increase into the future and continue to provide people with a consistent minimum rate of return.

Most of us know that bargains are available today. You know some are going to do better than others and some are going to have a better day than others. There are a lot of companies out there that are similar to the ones that we've just talked about that are going to provide both average and professional investors with some great opportunities over the next year or two.

TWST: What is your view on the decline in the global economy and its effect on international equities or companies with considerable international operations?

Mr. Anderson: My view has always been pretty much the same. Economies everywhere, whether they're in the United States, France, England or even China, are the reflections of the requirements of their citizens on businesses and governments. Whether it is a business or a government, their whole purpose in life is to provide goods and services that individuals demand, one person at a time. Right now

in the United States, most individuals are restructuring their personal balance sheets. They are changing their demand structure. Businesses are rapidly adjusting to that lowered demand. Why do you have layoffs? The answer is simple: you are not producing or selling a product that enough people want. This is normalcy not only here, but around the world. For the short term we are saying yes, the global world is restructuring. This is normal.

Even with this restructuring going on we can still look at buying shares in **Procter & Gamble** or **Colgate**. Is there a person in Brazil who is going to quit brushing their teeth, simply because we are in a global meltdown? I think they are probably going to continue to brush their teeth and that they will also be brushing their teeth with a toothbrush. That's the wonderful thing about **Colgate**. Toothbrushes wear out and need to be replaced with new ones, which will more than likely be provided by **Colgate**.

With that in mind, think of how you want your money invested if the whole world has a problem. Where do you want to be invested if you want to minimize your risk? One of our five questions was, "What are my risks and dependencies?" When we look beyond business risk there are a couple of other risks US citizens must accept if investing in non-US stocks. One is a currency risk and the other is political risk. To minimize these risks we choose to stay right here in America and own large and powerful US companies. I mentioned **Chevron**. Even though **Chevron** has operations in hundreds of countries, they happen to be headquartered in the United States under the United States economic and political system. We are eliminating that political risk by owning **Chevron**, yet we are getting exposure to every consumer in the world by owning **Chevron**. As for currency risk, **Chevron** is doing business with all of these other countries. They are doing their own currency hedging so we don't have to worry about it. They are doing it for us. As owners of **Chevron**, we would expect them to do that for us. You will hear economists and pundits like myself saying the dollar has gotten stronger or the dollar is going to get weaker. If you are a speculator, that's important to you because in the one or two months you hold a stock, a change in the value of currency might have some impact on your returns. But an investor is not somebody who's looking to capitalize on something in a month. What an investor concentrates on is tying their money to a company and allowing that company to build value over time. These investors who have taken this route are the real winners in the investment game. You don't see Warren Buffett out there buying an index fund. You don't see him out there buying a leveraged ETF. All you know is that he will go out there and he'll lend some money to **Harley Davidson** (HOG) or he will buy shares in **Procter & Gamble**, but those shares will sit there for a long time. I think he has been pretty successful. He is one of the richest guys in the world. And that's the scene that's been going on forever. Our job is to try to get individuals to accept that model because it's the way for them to win and that's what they need to do.

TWST: What about your sell process. What triggers an exit from your portfolio?

Mr. Anderson: There are really a couple of different triggers that cause us to sell. From our football analogy, we want to have a full team playing all the time. That means if an industry changes or a sector of the stock market changes that impacts the S&P 500, we will change. The example given earlier holds true here and that would be financials. If they were 20% of the S&P 500 market cap, we would want to be fairly

close to that 20% weighting. If financials drop to 10%, that is going to force us to sell and buy somewhere else, simply to maintain a full team. That is the same thing any coach would do. That is the same thing we have to do as a portfolio manager. Stock-by-stock, the process is both somewhat of an art and a science. We believe we can gain an advantage, especially in the large cap arena, by once again concentrating on the individual and what creates the desire for that individual to buy or sell a stock. Those drivers of demand are based on what John Maynard Keynes described as a beauty contest. Not only do we have to know what we believe is beautiful, but we have to know what everybody else looks at as beauty, independent of our own thought. When we look at each individual company, we are looking for things that either drive demand for the shares on the upside or drive them to the downside. These are simple things that are based on human nature. Take an analyst's earnings revisions, for example. If you are a salesman, and remember there are over 600,000 of them, and you have faith in your company's analysts, you probably have an approach toward the buyer somewhere along these lines, "One of our best analysts just raised his earnings estimate on company B. You should buy a position now before the company releases its earnings." If you are a salesman, you are not going to go out there and sell something that an analyst tells you is junky. And as an analyst, you are not going to provide a buy signal for a company whose earnings you think are going to fall. If we see where analysts are raising their earnings estimates, we know that's going to drive demand. Their army of sales people is going to call the buyers of their services, and that alone is going to drive the stock price up. We pay attention to a company's long-term earnings growth rate. We want the companies that we own to continuously grow their earnings. This growth rate is a desirable trait and the stock price will reflect it both in increasing demand from non-owners and decreasing the supply of stock available for sale. A consistent growth rate also has a real impact on analysts and their recommendations.

We also are going to pay particular interest to companies that surprise the whole world with an exceptional earnings report. When you see earnings surprises that are on the positive side or earnings that are higher than everyone expects, you will see a change in demand for that company's shares. This is not a short-term demand driver, as unexpected increases in earnings will also lead to rising expectations and increased earnings estimates by analysts. The increased price of the shares will also increase demand by speculators who believe in momentum. The opposite is also true. When there is a surprise on the downside or earnings less than expected, the whole process is reversed and many times will result in a sell.

Finally, a company will be replaced if they lose those one or two unique products that were considered by us to be their special situation. This could result from any hundreds of actions that we can't foresee.

We want to hold our portfolio intact long enough to reap the benefits of ownership. If it looks like those benefits are no longer going to be provided to us as an owner, we will make a change to where we believe the future will unfold a little better.

TWST: Has the turnover been higher this year as the result of the actions in the market?

Mr. Anderson: No, there has been more tax incentive turnover, especially for our high net worth clients. We have taken a number of tax losses throughout year. Actually, managing portfolios for tax efficiency never shows up in our performance numbers, but it can add from 1% to 1.5% of net return to an individual investor. Tax selling will also

be reflected in the turnover rate. Historically, our turnover has run between 40% and 60% a year. This year it is going to be a little bit higher because of the tax work.

That brings up one more of our questions, "What is our cost?" Turnover is costly. When we talk about those 26,000 mutual funds, when the average holding period in 1987 was nine years and today it is nine months, what does that do to our cost?

I want everybody who owns a mutual fund to think of this. Last year, of those 26,500 or so mutual funds in Morningstar's database, the average operating expense ratio was over 3%. Maybe somebody is a lot smarter than everyone else, but if you are trying to overcome a 3% cost disadvantage and still think you are going to beat the market, that doesn't seem like you are using any sense.

The other thing is that if are you sitting in front of somebody and they say that they can actually pick a mutual fund, get real. I probably should not yell at this industry, but then again, I think the industry has been part of our problem.

TWST: How can an adviser sit down and legitimately look at you and say I have got some asset to pick?

Mr. Anderson: I'm not sure if they can. To think that anyone can choose one out of the 26,000 mutual funds out there, without any idea of what's in them, seems unlikely. How can you know when one fund is better than another when you have never met the manager, have no real idea what the management process involves, and know that the fund itself is constantly changing? As a separate account manager that seems to be a battle we can win, yet we have still been losing. Because of this mass selloff last year, maybe we have got a little opening where people will come back to reality and start saying, "You know, I can own a business, I can share in the profits of that business over time, which makes me an investor, or I can play the game of buying and selling and hope I can roll the dice and win enough to win long term."

TWST: What do you think affects your focused portfolios and your common sense approach to investing? What is distinctive about that compared with all the other options out there?

Mr. Anderson: We have been described as a widows and orphans manager. I am not embarrassed to admit that. We have a fiduciary responsibility. We want to take care of our clients and we want to do the best job we can. We want to report everything to them in black and white so our clients can fully understand their risks. These are items that I think are the minimum any person should expect from any manager. Where the world has changed is that people are not receiving that. You don't receive the guidance or the understanding and you don't receive the knowledge that you should be getting. If people would have just answered question one, "Where is my money?", the \$50 billion losses to Bernie Madoff would never have happened. He never shared with anybody where their money was. You would think if they had just asked that question, "Where is my money?", none of that money would have been lost. If you are concerned about security and safety, independence, 100% openness, 100% knowledge of what you have, and would like an intelligent discussion of how you are invested, then our approach should give you some comfort. If you want to continue to play the losing game as a speculator, for whatever reason you have, then we are probably not a manager you would enjoy.

There are people who will tell you that you are silly for buying and holding onto something. You are silly for buying individual stocks. The accepted approach today is that if you build an individual stock

portfolio you are a speculator, whereas if you buy mutual fund you are an investor, and that is wrong. From us, people will at least get a straight answer. We are not going to hide from them. They are going to know exactly what is going on in their portfolio and I think that is a real positive thing for people.

TWST: Earlier you mentioned a problem with private equity. What challenges do you see in this year that investors should know about now?

Mr. Anderson: The bulk of private equity investments, are not held by individuals. The bulk of private equity money comes through endowments, and pension and profit sharing plans. The problem is that you have a lot of money at risk in an area where no one really knows how much it is worth or how to value it. A few years ago we had mentioned that the real problem at that time was hedge funds and we said it is going to bring the crooks out. It's going to bring the crooks out because of the pay structure.

Today in private equities, you have the same thing. You have the ability to create wealth for yourself as a private equity manager or a fund of funds manager in private equity based on no real market. The managers themselves are valuing what their private equity investment is worth and their fees are based on what their values are. It is like saying, "Okay, I am going to charge 1% to manage your portfolio but I am going to decide today that instead of being worth \$1 million, I have decided, based on a discounted cash flow model, that it is really worth \$2 million, and therefore I ought to be able to charge you more money." Here is the problem for my clients. If private equity is today carried on a retirement plan's books, say at \$10 million, and the real value of it is \$3 million, what will that pension plan or endowment sell to raise cash when they can't touch the private equity portion? What they have to sell are the same stocks that my customers own, those big blue chip companies. Those plans will raise cash by selling those first simply because they can raise their needed cash in a heartbeat. This is a problem that could go on for years.

Because of the problems with our economy, the private equity investment that was suppose to be a three-, four- or five-year holding period may turn into a 20 year holding period. During this time these plans are going to need to get cash. They have cash obligations, and that may continue putting selling pressure on those big blue chip stocks that we own. I was listening to a presentation by a fund of funds in private equity and they were telling me how wonderful it was because they could buy a limited partnership interest from an endowment that wants to sell it because they need the cash, and they could buy that interest at \$0.50 on the dollar. Then I asked what value they carried it at? Instead of valuing it at what they paid for it, they value it at what the general partner decides it is

worth, which is twice what they paid. That makes no sense and it's going to cause some problems down the road if it hasn't already started.

Of course, last year we mentioned annuities and these are investments that are far more complicated than people know. They will ultimately cause some heartache. Yet they are selling well because of two reasons. One is that it pays one of the highest commissions available to our army of financial consultants. Secondly, because interest rates are so low that people are struggling to find an income stream and annuities can arbitrarily set their new money rate high enough to attract a lot of money. Recently we have seen more money go into high yield junk bonds, which once again is a risk-reward relationship that doesn't make sense for most people. I think there is a real struggle going on today because of the problems in the stock market. But those blue chip common stocks right here in the United States of America is what most people should look at today, because they are the one investment that is providing a real bargain.

TWST: Is there anything that you would like to add?

Mr. Anderson: I think I need to close by doing a little bit of my civic duty. This time of year, February and March, we get a lot more phone calls from our good friends out in New England and the upper Midwest. I think it is because everybody is just sick and tired of the cold and the winter. What I'm going to do right now is to invite everybody who is reading your publication, especially my New England friends, to come and visit our great state of South Carolina. You know you can get on an airplane and you can be here in a couple of hours, or you can just get into your car and drive to South Carolina by jumping on Interstate 95. Please remember when you come to bring a lot of money and spend it here. Our state truly needs it. In fact, we'll treat you real well with our special tourist tax created just for you. Quit dreaming of warm weather. Get in your car and come on down and visit. If you want to, give us a call or stop in just to say hello.

TWST: Thank you. (PS)

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