SIGMA INVESTMENT COUNSELORS

Sigma Summaries

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FOCUS ON THE PREDICTABLE

I recently came across this article that I think hits upon some of the major beliefs that have shaped our investment decisions during the past year.

Base Investment Policy On What You Can Predict
Thursday, January 17, 1974.

One of the biggest obstacles to good investment results is the tendency to place too much emphasis on the short-range outlook. At times, the majority of investors seem to believe that the whole future is wrapped up in the headlines of the day.

With all the attention it gets, however, near-term forecasting is usually not very rewarding. Most of the projections made a year ago were so wide of the mark that some economists have even stopped releasing their detailed forecasts.

There is an obvious reason why the immediate future often does not turn out the way it is supposed to. Many things simply cannot be accurately or consistently predicted by anyone, no matter how informed or knowledgeable he is.

The present is a case in point. The big imponderables of the moment – the Mideast crisis, the oil situation, world finance, and the power struggle in Washington – are very important. Yet, these concerns are just new versions of the unpredictables that are always in the picture, as illustrated below:

<u>The Perennial Unpredictables</u>
1. *What stock prices will do next week, next month or next year.*
2. *Which way the political winds will blow.*
3. *When the economy will change direction and for how long.*
4. *Where the course of international developments will lead.*

For as long as we can remember, the amount of effort spent on trying to predict the above unpredictables has been way out of line with the investment results it has made possible. In fact, we don't know of a single investor who has been successful over the years because of his ability to forecast short-term developments.

On the other hand, many individuals and institutions have achieved above-average investment results by basing their policy on long-range trends. Unlike the short-term imponderables that pop up from time to time, some of these can be predicted. Here are examples:

<u>The Predictables</u>
1. *The population and labor forces will continue to grow.*
2. *More people will need more goods and services.*
3. *Research will develop new products and new techniques, creating more jobs, greater productivity and higher demand.*
4. *The dollar's buying power will keep shrinking.*
5. *Well-managed companies with favorable long-term characteristics will continue to make above average progress in earnings and dividends.*

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This list of predictables could have been drawn up at any time in the past three decades. And throughout this long period, they have had a far greater impact on investment results than the previously cited unpredictables.

The last two predictables are likely to have the most influence on how investors fare in the years ahead. Inflation will continue to move along at its fastest pace in peacetime history. So preserving the purchasing power of investment capital will be a top priority. As we see it, the best prospects for accomplishing this are in owning the shares of companies which are able to increase their earnings more rapidly than the cost of living goes up.

David T. Wendell, David L. Babson & Co,

Isn't it interesting to ponder these comments for a moment and consider their relevance in today's investment environment? As the writer stated in his letter to investors, this commentary could have been written in 1944 as well as 1974. I think it is still applicable in 2004. We, as investment managers at Sigma Investment Counselors, face similar imponderables to those managers thirty and sixty years ago. And, while I would expand Wendell's concepts to a more global perspective, I concur with his basic premise; we must remain disciplined in our approach toward investing and not be drawn astray by imponderable projections that have a low probability of accuracy.

Today's imponderables, which include political uncertainty both home and abroad as well as any resulting consequences from the mutual fund scandals, are not the areas where we feel we can properly assess the investment implications over the long-term. However, we do believe we can add value to our client's portfolios by spending more time and effort trying to discern long-term fundamental trends and the good companies that will benefit from them.

We believe strongly that long-term growth of principal and income should be the primary goal of equity investing. And through independent research, we believe having a thorough understanding of the basic characteristics of a company's business is the most effective means of determining its future growth potential. Finally, and this is where discipline really comes in, we believe buying superior growth at realistic valuations is essential for good long-term results.

In 2003, we focused our new investments in solid companies where we believe we are buying superior growth at realistic valuations. And borrowing a thought from my colleague and former Detroit Tiger, Dave Bergman, we believe our overall batting average will improve over time if we swing for singles and doubles to consistently score runs instead of swinging for the fences and striking out. We strive to purchase stocks where the risk/reward is in our favor and our probability of having a successful investment is greater. And while noting that luck and timing play a large part of investing over the short-term, we believe disciplined buying and selling is the key to successful investing over the long-term.

Reflecting on the last twelve months, one could certainly not have been very confident of such a broad market improvement if they were reading the newspaper headlines. The uncertainty of the Iraqi situation and the general malaise of the business climate last February made many investors nervous. But by focusing on long-term trends and underlying fundamental improvement in our companies, we were able to maintain our position in these good quality stocks. Equally important, because of the market uncertainty in the first four months of 2003, we were able to purchase many new positions opportunistically that would not have been possible in a more stable environment.

At Sigma, we have always realized the importance of doing our own research. We need only to look at the numerous Wall Street scandals over the last several years to understand the value of independent, fundamental research. I saw first hand the gullibility of many experienced investment managers during my years on Wall Street. I witnessed the unbelievable influence and power that a star analyst (at least in his own mind) like Jack Grubman of Worldcom fame, had on many highly regarded firms. The only way an investment management firm is going to have successful investment results over the long-term is through diligent, independent research, seeking trends that will result in superior long-term growth.

One important theme that permeated many of our investments in 2003 and will continue to be an important element in 2004 is productivity improvement. During the recent economic downturn many of our companies were busy diligently improving their own cost structures and product lines. These efforts have positioned them to enjoy strong, positive leverage as their business has begun to improve. Managements that focus on what they can control, just as we should as investment managers, are going to be far more successful over the long-term.

A good example of this management discipline is present at Emerson Electric. During the global economic downturn, Emerson managers were busy restructuring their operations on a global basis so they would emerge as a stronger competitor when the economic recovery occurred. They were thinking ahead to the implications of how China and other emerging forces were going to affect their businesses over the long run.

And while I chose Emerson to single out as an example of a forward thinking company, I could have easily mentioned dozens of other companies we own that are thinking and acting in a similar fashion. Emerson, and companies like it, is the type of company you will see us continue to invest in. We like companies where we feel we have a good understanding of the management philosophy and direction and where valuations are reasonable.

Another important theme we focused on in 2003, that will be carried forward in 2004, is seeking companies with consistent and improving dividend growth. With the benefit of the dividend tax reduction in 2003, the combination of capital appreciation and dividend yield is more compelling as a major driver of total return. In our opinion, the return of corporate managements as well as investors looking at the importance of dividend growth as an integral part of total return will be an important feature in 2004.

As you can see from my previous comments, the types of leadership companies we are looking to invest in are focusing on productivity improvement and therefore, strong cash-flow generation. They should also be the best candidates to expect increasing dividend growth over the long-term.

Intuitively, without spending a lot of energy trying to figure out what tomorrow's headlines are going to be, we expect good quality companies with strong cash flows that are paying solid and increasing dividends to attract more investor capital over the long-term.

You can expect our approach of emphasizing diligent independent research combined with a good dose of common sense and an opportunistic eye to remain central tenets of our investment philosophy in 2004 and beyond. Clients of Sigma Investment Counselors should expect us to manage their portfolios in a straightforward, understandable manner that allows us to better achieve their long-term goals and objectives.

As we move into 2004, you will see us write and talk more frequently about things we have a better chance of predicting and less about those things we cannot control. We will focus on the predictables not the imponderables.

We are blessed at Sigma to have a very talented group of people who are as focused as I am on delivering strong long-term results for all of our clients.

Best wishes for a prosperous New Year.

Written by: Roger N. Steed
Chief Investment Officer

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Please remember to contact Sigma Investment Counselors if there are any changes in your financial situation or investment objectives.

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Sigma Investment Counselors is pleased to provide a copy, and hereby offers to deliver the brochure to any client upon receipt of your written request.