



Sigma Summaries

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Eyes Wide Open

Every Thursday, Sigma portfolio managers meet to discuss important investment and research related subjects that are affecting companies we are invested in as well as those companies we are following for potential purchase. Typed in bold on the agenda that outlines each week's scheduled topics are our major investment tenets. One of these tenets that we think about every day is a simple expression that carries with it significant importance: **Think Globally.**

We are investing in a world that is changing every day. As a result, we must regularly analyze the confluence of events that are shaping and impacting the global marketplace to enable us to invest opportunistically. These developments include the ongoing global expansion of the Internet, fiber optics and borderless communication. We are also witnessing a global economic playing field characterized by better educated workers and millions of new competitors and participants from China, India and Russia that now have the ability and power through technology to compete aggressively for jobs and a piece of the global market.

Pulitzer prize author, Thomas L. Friedman, has written a thought-provoking book titled, *The World is Flat*, and *A Brief History of the*

Twenty-First Century that vividly depicts the developments that have shaped the global marketplace that we live and invest in today. Friedman eloquently describes the forces that have flattened the global marketplace and what the new world of globalization means to individuals, companies and governments. The flat world is a borderless marketplace that has the potential to be a great benefit toward innovation and productivity but also brings with it fear and concern that companies must utilize every brain fiber they have in their R&D labs and corporate planning teams in order to compete successfully in today's world.

The emergence of the global marketplace can be both a blessing and a curse. For some companies, it provides an opportunity to sell goods and services into new markets as well as reduce the cost of manufacturing. A classic example may be Dell, which uses low cost components from around the world to build and ship the best and lowest cost computers to customers both here and abroad in a matter of days, not months.

On the other hand, domestic markets are no longer insulated from lower cost and innovative foreign producers and inefficient manufacturers run the risk of losing market

share to these foreign rivals. Sadly, the U.S. auto producers are struggling as a result.

One of the most interesting developments of the new flat world is that successful companies have realized that they can't survive and compete solely on their own abilities any longer. Increased global collaboration between companies is becoming far more common in complex assignments. It requires companies to work together in order to deliver the most value to the customer. Everyday, we observe examples of companies like Microsoft, General Electric, Johnson and Johnson, and Cisco announcing deals with other global partners as they sign new contracts, both domestically and abroad.

Reflecting these trends, we have compiled an increasingly international orientation in our client portfolios. While part of this trend is attributable to an explicit desire to add international stocks to the portfolio, the shift has also come about implicitly as we have simply been drawn to certain stocks that happen to have substantial international exposure.

For example, we recently initiated a position in London-based Lloyds TSB Group, a financial-services firm operating primarily in the United

Kingdom. We were attracted to the company's above average yield and attractive valuation. Similarly, our recent addition of Telecom New Zealand was also prompted by its high dividend yield and attractive valuation. While neither company has any significant financial interests with the U.S., the flattening global marketplace has also lowered the barriers for investing abroad as well.

Another recent addition is Teva Pharmaceuticals. Teva has its headquarters in Israel yet a majority of its sales are to the U.S. and Europe. Our interest in Teva was based on our desire to participate in the generic drug industry. As one of the largest generic drug manufacturers in the world, the company is steadily expanding its market reach around the globe. When we initiated our research on this company, our focus was squarely on the company's attractive fundamentals and bright outlook and not based on the fact that we were investing in a foreign drug manufacturer.

Another case in point may be Unilever. Unilever is one of the largest producers and marketers of branded and packaged consumer goods in the world. While U.S. consumers will recognize many of their brands such as Ben & Jerry's ice cream, Dove soap, Lipton tea, and Hellmann's mayonnaise, there are a host of other brands that are marketed in 90 countries around the globe. This company has a unique corporate structure in that part of the company is English, the other part Dutch. Here again, the attraction was based on our belief that the company would be successful in restructuring its operations and meaningfully improving its profitability.

Aflac may be best known in the U.S. because of its humorous advertising campaign involving a duck. Domestically, the company is a leading provider of supplemental insurance that provides income when a worker becomes temporarily or permanently disabled while working. What many investors are not aware of is that Aflac is also the leading provider of cancer and supplemental health insurance in Japan and in fact, 70% of its revenues come from Japan.

Regulatory issues have stifled U.S. telecommunications drive for improved profitability for many years. Outside the U.S., many countries are providing a more favorable regulatory environment allowing well-managed companies to deliver sustainable growth. Vodafone Group is the world's largest provider of wireless telecommunication services, with more than 150 million subscribers. Vodafone has the scale and breadth to negotiate attractive contracts with governments as well as cell phone and infrastructure equipment suppliers. The company has recently added properties in fast-growing markets such as Africa and Eastern Europe that will fuel continued subscriber growth. Vodafone is positioning itself today for those millions of new participants who will be coming into the global marketplace.

Several years ago we focused on outsourcing as a major global theme and wrote about this trend in a Sigma Summary. We highlighted several companies that are benefiting from the outsourcing movement and why it is occurring. Manpower was one of those companies and today the company continues to deliver a very

compelling value proposition to its customers that enable them to enhance their productivity. One fact that may be surprising about Manpower is that over 80% of its revenues and profits come from international markets and the U.S. is actually the third largest revenue segment for the company. Today, Manpower has a global network of over 4,300 offices in 67 countries that allows the company to deliver temporary and permanent staffing, employee assessment, training as well as career transition and consulting services to global, multi-national or local companies. They have been a leader in using network technology to communicate with and train their employees around the world. They are working more and more with major customers like IBM to provide an entire portfolio of services around the world in the appropriate local language and culture.

While the innovative developments of this borderless, technology driven world seem to have strong momentum as more emerging economies join the worldwide supply chain and their workers experience a higher standard of living and a better quality of life, we also realize we are vulnerable to many destabilizing forces. Quasi-political organizations like al-Qaeda have the same ability through borderless technology, such as the Internet and satellite TV, to communicate and collaborate with other like-minded people in order to disrupt and destroy the movement toward globalization. Governments, corporations and individuals will need to work hard in the future to coax those groups that are disenfranchised from the global marketplace into believing that it is

more beneficial to be part of the globalization movement than trying to destroy it.

Oil has the potential to be a very destabilizing force over the next several decades as governments and companies are driven toward securing energy supply for their growing populace. We are likely just getting a taste for what we will be dealing with in the future with the current takeover attempt of Unocal by the Chinese energy group CNOOC, partly owned by the Chinese government. U.S. politicians are citing many foreign security concerns and threatening, potential protectionist barriers. It will be important to monitor how this plays out to see if it stalls or reverses the global integration movement. One can easily imagine how this real world play can turn ugly and begin to unravel the positive collaborative drive toward greater global prosperity.

Assuming the global economy continues to grow as more emerging

countries provide the incentives for their populations to join the prosperity party, the need for truly global collaboration among governments and international companies to provide innovative energy solutions to this growing need is paramount.

Companies like ExxonMobil know that they must prepare today for a world that will look much different in 2030. They realize that it will take a multi-prong approach to satisfy the world's energy needs in the future. Exxon has been preparing for the world we live in today for many years and fortunately is well positioned to benefit. Now, management is planning for 2030, and those plans entail a great deal of cooperation among governments in order to satisfy the growing global energy demand. Exxon believes that the interregional gas trade, via pipeline and liquid natural gas will grow dramatically from 25 billion cubic feet per day to 110 BCFD by 2030. Heavy capital investments into resource recovery, gas-to-liquids

technology and high-speed screening will allow the company to maintain its leadership in the new productivity driven flatter world.

As we **Think Globally** about this dynamic world we live and invest in, we must continue to open our eyes to these new developments that are affecting the profitability and sustainability of the best companies in the world and be prepared to change as quickly as they do in order to invest successfully in the future.

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