SIGMA INVESTMENT COUNSELORS

Sigma Summaries

July 2000

Mid-Year Review 2000

We must admit we are relieved the second quarter has drawn to a close. The swiftness and degree to which stocks have fluctuated have left even seasoned professionals feeling a bit weary. Stock price volatility during the past six months has been unprecedented and also partially reminiscent of the volatility experienced during the second half of 1987. At that time the market fell by over 20 percent in just a few days, yet ended the year with a small net positive gain. This year, we watched in the first quarter as the NASDAQ rose 24 percent from the first of the year through March 10th. From this peak, the index fell more than 30 percent within one month. As we close out the quarter, the NASDAQ is nearly back to its level at the beginning of the year. While the moves in the broader S&P 500 market index have not been as extreme in either direction, the end result is much the same. That is, there has been virtually no change in the S&P 500 index year-to-date.

Having not jumped on the dot-com bandwagon, where the damage was particularly severe, Sigma portfolios withstood these wild price swings relatively well. We believe that on a long-term basis, the events of the second quarter will serve our portfolios quite well. We find that in times such as this, the market tends to treat most stocks with the same level of "irreverence". That is, both fundamentally strong and weak companies often experience similar reductions in their share prices. Such periods often enable nimble and diligent investors to research, uncover and take positions in fine companies at favorable prices. Although both were at depressed prices, our actions during the quarter included swapping out of a stock and into another with more favorable long-term prospects. We also were able to initiate positions in securities that have been on our radar screen for some time but, until recently, were too rich to own.

Of course, changes in portfolios are made with an awareness of the importance of tax efficiency by maintaining low turnover and minimization of capital gains taxes. However, we are also sensitive to the "trap" of steadfastly clinging to yesterday's winners, "hoping" that these company's managements will ultimately find ways to grow their companies as they did in their heydays.

A more important footnote to this exercise, and one that drives our investment process, is a growing recognition that the world is changing more rapidly than ever before. Investment themes and the "winners and losers" are also changing more quickly than ever. A portfolio that was designed in the 1980's, perhaps laden with consumer goods companies, would have performed fabulously during that decade, but miserably in the 1990's. Similarly, a regional banking oriented stock portfolio would have produced great gains in the early 1990's (due to mergers and acquisitions) but would have been left bruised and bloodied during the past few years due to dis-intermediation and non-bank competition. ***Our most critical task is to continuously identify how future developments will impact the economy, sectors, industries and individual stocks, and then position portfolios accordingly.***

Broadly speaking, the portfolio modifications that were implemented during the quarter represented a shift out of some stocks that have performed well over the years, but no longer offer the compelling growth that they once did, such as the branded consumer goods companies.

It has been increasingly difficult for the companies dominating this sector to realize both the unit volume and price increases that have been the cornerstone of past success.

On the other hand, we remain very enthusiastic regarding the opportunities that exist due to the emergence of the Internet. While we, and the market, have recognized that more Internet companies will fail than succeed, the Internet is here to stay. Those companies that emerge from the current industry shakeout, a shakeout that is common to most nascent industries, will not only recover but may possibly go on to immensely reward their shareholders. As a result, we elected to increase our exposure to this industry as a complement to our existing weighting in technology. Similarly, we increased our exposure in biotechnology. This industry finally has evolved into an explosive period of profitability due to new drug approvals after years of extensive and expensive research and development.

Another area where we have been conducting a significant amount of research is within the telecommunications arena. A revolution in the pace of technological improvements has spawned new markets and a significant increase in demand for telecommunication services and products. This growth is expected to continue for some time to come, enhancing our attraction to this sector and encouraging us to look for additional investments in this space.

Finally, we initiated an investment in a leading independent power producer after exiting the regulated electric utility industry last year. Today, the $250 billion U.S. electric power industry is undergoing dramatic change, due largely to deregulation. Beginning in 1998, consumers were able to buy electricity from the producer of their choice. This, combined with the lack of new generation over the past decade, has resulted in capacity shortages and blackouts/brownouts across the country and has created a very attractive market for the low cost, clean burning independent power producers. The U.S. domestic independent power producer industry is still in its infancy and is well positioned for explosive growth for many years to come.

We would be pleased to review specific purchases and sales that were implemented in our core portfolios as the result of the strategy highlighted above. Please contact any of the investment advisors at Sigma for more detail.