

# REVIEW & OUTLOOK

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**INDEXES**

(Close as of: 5/11/01)

DJIA:	10821.31
S&P 500:	1245.67
NASDAQ:	2107.43
S&P 400:	508.71
S&P 600:	221.26



## THE ECONOMY - The Week In Review

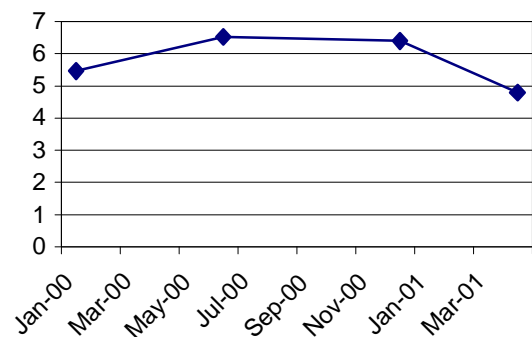
### Fed Rate Cut

The Fed cut interest rates again today, lowering its target for the federal-funds rate by one-half of a percentage point to 4%. This was the fifth rate cut this year. The federal-funds rate is now the lowest it's been since May 1994.

Many on Wall Street feared that the Fed might have gone too far with this rate cut, citing concerns about inflation. But the Fed stated in a press release that accompanied today's rate cut that: "With pressures on labor and product markets easing, inflation is expected to remain contained." The Fed went on to say that it continues to believe that "...the risks are weighted mainly toward conditions that may generate economic weakness in the foreseeable future."

We were pleased to see this rate cut for several reasons. First, we believe that the stock market had already discounted

**Federal Funds Rate**



Source: Federal Reserve

this expected rate cut in its current pricing. If the Fed had not cut rates, the stock market would have probably reacted very negatively. Second, as we have said before in this column, we believe the Fed is strongly committed to keeping the economy out of recession and growing at a healthy pace. This latest rate cut demonstrates to us the level

*(Continued on page 2)*

## INVESTMENT STRATEGY

Investing is best done in an organized way with a clear game plan. There are many ways to organize the investment process. This article will look at the *Dorsey Wright Four Step Checklist* as one approach.

### Technical Analysis

Technical analysis takes many forms. The method primarily used by Dorsey Wright & Associates is *Point & Figure Analysis*. Point & Figure analysis is designed to track the fluctuations in the

*(Continued on page 8)*

## THE ECONOMY - The Week In Review

(Continued from page 1)

of commitment that the Fed has for ensuring this growth. And, most importantly, this lowering of rates may help to keep consumer spending going at a strong pace. It has been the consumer that has been largely responsible for keeping the economy out of recession so far.

### Other Economic Reports of the Past Week

The past weeks economic reports continue to be a mixed bag.

The Wall Street Journal reported that corporate profits for the 1700 companies that it tracks declined by 43% in the first

quarter. The primary cause was a profit squeeze whereby sales declined and costs, particularly labor and fuel costs, rose.

Industrial production declined 0.3% in April. This followed a 0.1% decline in March. Capacity use dropped to 78.5% in April from a revised 78.9%. The producer price index, which measures price changes in the manufacturing sector, rose 0.3% in April. On a more positive note for the economy, though, business inventories dropped 0.3% in March.

Further good news for the economy came from the reports on retail sales and consumer confidence. Despite rising unemployment, both retail sales and con-

(Continued on page 8)

## ECONOMIC FORECASTS

(As of May 11, 2001)

<u>ECONOMIC FACTOR</u>	<u>Actual</u>				<u>Forecasts</u>	
	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>
<b>Percent Change</b>						
Real GDP	4.4	4.4	4.2	5.0	1.9	3.3
GDP Price Index	2.0	1.3	1.5	2.1	2.1	2.0
Gross Domestic Product (GDP)	6.5	5.7	5.8	7.1	4.0	5.3
Consumer Price Index (CPI)	2.3	1.5	2.2	3.4	3.0	2.5

### Variables In Levels

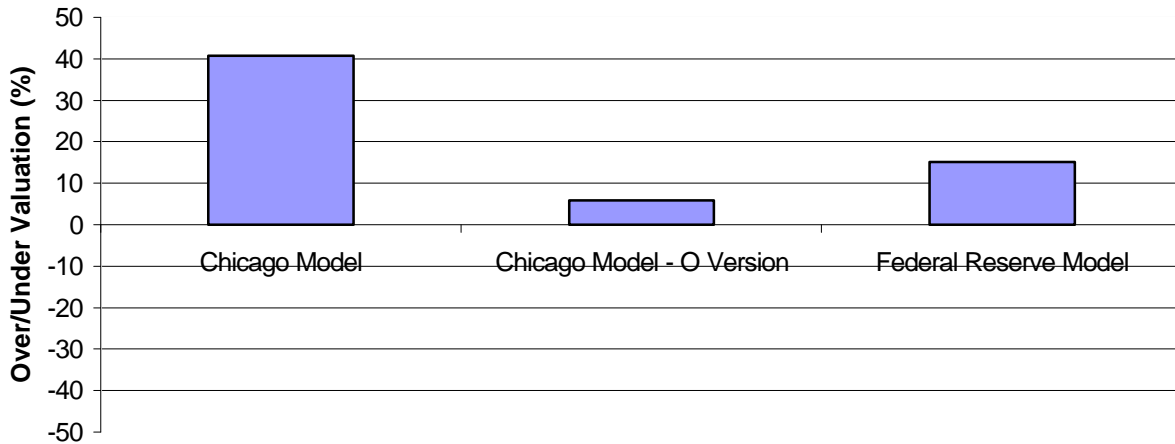
Unemployment Rate	5.0	4.5	4.2	4.0	4.6	4.8
3-Mo. Treasury Bill Rate	5.06	4.78	4.64	5.82	4.3	4.5
10-Yr. Treasury Bond Yield	6.35	5.26	5.64	6.03	5.0	5.3
30-Yr. Treasury Bond Yield	6.61	5.58	5.87	5.94	5.4	5.5

*“The past weeks economic reports continue to be a mixed bag.”*

# STOCK MARKET VALUATION

(AS OF MAY 11, 2001)

## S & P 500 Valuation



At the present time (May 11, 2001), we believe the stock market, as represented by the S&P 500, is overvalued by about 15%. This is down from an estimated overvaluation of about 19% in the previous week.

One of the great things about financial modeling is that it allows you to examine and analyze your assumptions. The three models charted above use different sets of assumptions for earnings growth rates, interest rates and other factors; and thus give three different perspectives on the current stock market valuation. The *Chicago Model - O Version* and the *Federal Reserve Model* show overvaluations of 6.0% and 15.2%, respectively. Both of these models use fairly aggressive assumptions for earnings growth rates. The *Chicago Model*, which uses a more conservative set of assumptions for earnings growth rates as well as past earnings and interest rates, shows an overvaluation of 40.8%. While we do not

necessarily believe that the market is overvalued by 40.8%, it should be noted that many of the assumptions used in the *Chicago Model* are realistic. If the market were to accept these assumptions as representative of future conditions, there could be further significant declines in the indexes. It is important to be aware of this possibility and to monitor the variables that are inputs to the models for any signs that possibility is becoming reality.

The workings of these models will be explained in a future article in this weekly commentary. For now, let it suffice to say that we tend to favor the Federal Reserve Model and, even given its aggressive set of assumptions, believe that it is currently giving the most accurate estimate of the stock market's overvaluation at around 15%.

# STOCK HIGHLIGHT: PHILIP MORRIS COMPANIES, INC.

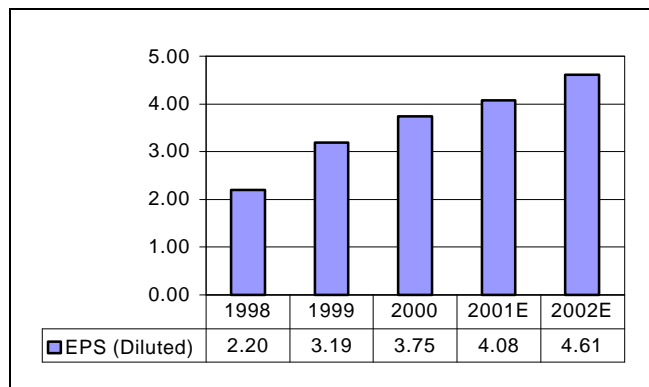
Price (5/11/01):	\$51.75	Beta:	0.25
52-Week Range:	\$23.0000 to \$53.8800	Shares O/S (Basic):	2.20 billion
Dividend:	\$2.12	Market Capitalization:	\$113.85 billion
Dividend Yield:	4.1%	Fiscal Year End:	December
EPS:	\$3.82	Industry:	Tobacco
EPS Growth (5yr):	11.7%	Float:	2.02 billion
Avg. Daily Vol.	7,398,545	ROA (3/01):	12.21%
P/E (Basic ttm.):	13.55	ROE (3/01):	55.30%
P/B (3/01):	7.68	P/E/G	1.35
P/S (3/01):	1.41	P/E/G (2001E EPS):	1.27
Profit Margin (3/01):	10.0%	5Yr Est EPS Growth:	10%
Current Ratio (3/01):	0.59	Symbol:	MO
Debt/Equity (3/01):	2.05	Exchange:	NYSE

## BUSINESS

(Source: Excerpted from Philip Morris Companies Inc.'s Form 10-K for the Fiscal Year Ended December 31, 2000)

Philip Morris Companies Inc. is a holding company whose principal wholly-owned subsidiaries, Philip Morris Incorporated, Philip Morris International Inc., Kraft Foods Inc. and Miller Brewing Company, are engaged in the manufacture and sale of various consumer products. A wholly-owned subsidiary of the Company, Philip Morris Capital Corporation, engages in various leasing and investment activities. The Company is the largest consumer packaged goods company in the world.

## Diluted Earnings Per Share



FOCUS LIST - 4/2/01

Company	Symbol	Price 3/23/01	Current		P/E	5 Yr.		PE Ratio	Div (Ind.)	Beta	Sector	Mkt Cap (millions)
			FY EPS Est	Est Crmt FY		g Est %	EPS					
Anadarko Petroleum Corp.	APC	62.60	5.65	11.1	15.9	0.7	0.20	0.74	Energy	15676.9		
Applebee's Int'l, Inc.	APPB	34.25	2.73	12.5	15.4	0.8	0.11	0.53	Consumer Staples	864.3		
Arkansas Best Corporation	ABFS	17.25	2.80	6.2	9.7	0.6	0.00	0.83	Transportation	351.4		
Constellation Brands Inc.	STZ	66.50	5.19	12.8	17.4	0.7	0.00	0.88	Consumer Staples	1369.6		
Energen Corporation	EGN	31.74	2.31	13.7	11.8	1.2	0.68	0.26	Utilities	974.9		
Esterline Technologies	ESL	19.75	1.88	10.5	11.0	1.0	0.00	0.78	Capital Goods	407.9		
Fastenal Company	FAST	54.13	2.56	21.1	24.4	0.9	0.09	0.63	Basic Materials	2053.4		
Golden State Bancorp, Inc	GSB	26.85	2.68	10.0	10.3	1.0	0.40	0.91	Financial	3604.3		
Henry Schein, Inc.	HSIC	33.38	1.92	17.4	15.6	1.1	0.00	0.76	Health Care	1397.9		
Jones Apparel Group, Inc.	JNY	37.25	2.96	12.6	18.9	0.7	0.00	1.18	Consumer Cyclical	4444.8		
Lincare Holdings Inc.	LNCR	53.13	2.67	19.9	21.3	0.9	0.00	0.29	Health Care	2767.4		
MBNA Corporation	KRB	30.21	1.85	16.3	20.1	0.8	0.36	1.61	Financial	25732.3		
Philip Morris Companies	MO	43.40	4.06	10.7	12.6	0.8	2.12	0.24	Consumer Staples	96501.2		
Phillips Petroleum Co.	P	54.37	6.47	8.4	10.8	0.8	1.36	0.67	Energy	13880.7		
Robert Mondavi Corp.	MOND	46.25	2.96	15.6	17.9	0.9	0.00	1.05	Consumer Staples	738.3		
Soletron Corporation	SLR	21.04	0.90	23.4	29.9	0.8	0.00	1.98	Technology	13582.0		
Tellabs, Inc.	TLAB	46.25	2.10	22.0	28.1	0.8	0.00	1.95	Technology	18986.3		
Timberland Company	TBL	51.50	3.45	14.9	18.8	0.8	0.00	1.31	Consumer Cyclical	2044.4		
Toll Brothers, Inc.	TOL	37.00	4.69	7.9	14.2	0.6	0.00	0.34	Consumer Cyclical	1349.8		

**Additions - 4/2/01**

Sunrise Assisted Living	SNRZ	19.69	1.89	10.4	20.8	0.5	0.00	0.43	Health Care	425.2
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**Deletions - 4/2/01**

AmeriSource Health Corp.	AAS	49.05	2.27	21.6	17.7	1.2	0.00	-0.03	Health Care	2579.0
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**MODEL PORTFOLIO**  
**4/2/01**

Company	Symbol	Price 3/30/01	# of Shares	Portfolio Value	% of Portfolio	P/E		Div (Ind.)	Beta	Sector	Mkt Cap (millions)
						Est Crnt FY	Est Crnt FY				
Anadarko Petroleum Corp.	APC	62.78	100.00	6278.00	6.79%	11.1	0.20	0.74	Energy	15676.9	
Applebee's Int'l, Inc.	APPB	35.69	100.00	3568.75	3.86%	13.1	0.11	0.53	Consumer Staples	864.3	
Arkansas Best Corporation	ABFS	15.75	200.00	3150.00	3.41%	5.6	0.00	0.83	Transportation	351.4	
Constellation Brands Inc.	STZ	71.75	100.00	7175.00	7.76%	13.8	0.00	0.88	Consumer Staples	1369.6	
Energen Corporation	EGN	35.30	200.00	7060.00	7.63%	15.3	0.68	0.26	Utilities	974.9	
Esterline Technologies	ESL	21.75	100.00	2175.00	2.35%	11.6	0.00	0.78	Capital Goods	407.9	
Fastenal Company	FAST	54.50	100.00	5450.00	5.89%	21.3	0.09	0.63	Basic Materials	2053.4	
Golden State Bancorp, Inc	GSB	27.88	100.00	2788.00	3.01%	10.4	0.40	0.91	Financial	3604.3	
Henry Schein, Inc.	HSIC	36.75	100.00	3675.00	3.97%	19.1	0.00	0.76	Health Care	1397.9	
Jones Apparel Group, Inc.	JNY	37.80	100.00	3780.00	4.09%	12.8	0.00	1.18	Consumer Cyclicals	4444.8	
Lincare Holdings Inc.	LNCR	52.94	100.00	5293.75	5.72%	19.8	0.00	0.29	Health Care	2767.4	
MBNA Corporation	KRB	33.10	200.00	6620.00	7.16%	17.9	0.36	1.61	Financial	25732.3	
Philip Morris Companies	MO	47.45	100.00	4745.00	5.13%	11.7	2.12	0.24	Consumer Staples	96501.2	
Phillips Petroleum Co.	P	55.05	100.00	5505.00	5.95%	8.5	1.36	0.67	Energy	13880.7	
Robert Mondavi Corp.	MOND	44.81	100.00	4481.25	4.85%	15.1	0.00	1.05	Consumer Staples	738.3	
Sollectron Corporation	SLR	19.01	200.00	3802.00	4.11%	21.1	0.00	1.98	Technology	13582.0	
Tellabs, Inc.	TLAB	40.69	100.00	4068.75	4.40%	19.4	0.00	1.95	Technology	18986.3	
Timberland Company	TBL	50.80	100.00	5080.00	5.49%	14.7	0.00	1.31	Consumer Cyclicals	2044.4	
Toll Brothers, Inc.	TOL	38.50	100.00	3850.00	4.16%	8.2	0.00	0.34	Consumer Cyclicals	1349.8	
<b>Total</b>				<b>92483.10</b>	<b>100.00%</b>						
<b>Additions - 4/2/01</b>											
Sunrise Assisted Living	SNRZ	19.69	200.00	3937.60	4.26%	10.4	0.00	0.43	Health Care	425.2	
<b>Deletions - 4/2/01</b>											
AmeriSource Health Corp.	AAS	49.05	100.00	n/a	n/a	n/a	n/a	n/a	Health Care	n/a	

## SECTOR ALLOCATION

March 22, 2001

Sector	% of S&P 1500 *	Portfolio Weight
Basic Materials	2.74%	Underweight
Capital Goods	8.78%	Neutral
Communication Services	5.60%	Underweight
Consumer Cyclicals	9.26%	Neutral
Consumer Staples	12.66%	Neutral
Energy	7.09%	Overweight
Financial	17.14%	Neutral
Health Care	12.76%	Overweight
Technology	18.76%	Neutral
Transportation	0.85%	Neutral
Utilities	4.37%	Neutral
Total S&P 1500	100.0%	

\* Data as of March 16, 2001

Our **sector allocation strategy** is based on a quantitative analysis of over 100 industries in the 11 economic sectors listed above.

Many years of experience has taught us that over the long-term, most investors should maintain some investment exposure to each of these 11 sectors. However, in the short-run, some sectors can be expected to perform better than others. Accordingly, the ratings of **Overweight**, **Neutral** and **Underweight** that we have assigned to each of the sectors above represent our assessment of the expected relative market performance of each of the sectors over the next year.

When constructing a portfolio, it is suggested that an investor invest in each of the

sectors, but *overweight* those sectors that have the best prospects and *underweight* those sectors that have the least favorable prospects.

It should be noted that these ratings are for broad sector groupings which are composed of many different industries and thousands of individual stocks. Therefore, a careful analysis should be made of such factors as valuation, financial strength and growth characteristics for each industry and individual stock in which the investor plans to invest. In other words, not every industry or stock in a chosen sector has the same expected attributes as the sector as a whole might have. It is important to be selective in choosing individual investments.

## THE ECONOMY - The Week In Review (Continued)

*(Continued from page 2)*

sumer confidence were up in the latest reported periods. Retail sales rose 0.8% (seasonally adjusted) in April; while the University of Michigan's consumer-sentiment index rose from 88.4 at the end of April to 92.6 in mid-May.

U.S. worker's productivity, as measured by the output per hour worked, fell 0.1% (seasonally adjusted) in the first quarter. This was the first drop in productivity in six years. However, the Fed said in its press release accompanying today's rate cut: "Although measured productivity growth stalled in the first quarter, the impressive underlying rate of increase that developed in recent years appears to be largely intact, supporting longer-term

prospects."

### Outlook

Two of our major concerns are the decline in corporate profitability and the declining investment in capital equipment. The uncertainty surrounding business conditions may continue to keep capital spending levels down.

While consumer spending has held up fairly well during this economic decline, any significant weakness in consumption expenditures would be very harmful to the economy. Today's Fed rate cut, combined with expected tax cuts, should help maintain consumer confidence and consumer spending. Rising unemployment, though, remains the concern here.

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## THE ECONOMY (Continued)

The Economic Forecasts table on page 2 shows our forecasts for a number of economic factors. We are maintaining our forecast of Real GDP growth of 1.9% in 2001 and 3.3% in 2002. We do not believe that it is likely there will be a recession in the foreseeable future.

*"We do not believe that it is likely there will be a recession in the foreseeable future."*

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## INVESTMENT STRATEGY (CONTINUED)

*(Continued from page 1)*

supply and demand relationship for stocks. This is important, as it is the law of supply and demand that is the most fundamental law of economics. Supply and demand governs everything in our daily lives, from the price of milk to the price of gas. It should not be too surprising, then, that the price of stocks is governed by supply and demand as well. But, people tend to forget that.

Point & figure analysis is not the only technical research tool used by Dorsey Wright & Associates. The firm uses tools such as relative strength calculations, the NYSE Bullish Percent, momentum, trading bands, and other tools. It is beyond the scope of this article to explain these various technical tools in detail. Many of Brookstreet's Members are already familiar with the tools that Dorsey Wright uses. For those that would like to

*(Continued on page 9)*



## INVESTMENT STRATEGY

(Continued from page 8)

learn more, the references at the end of this article should help.

There is one very important principal to keep in mind when using technical analysis. Technical analysis is intended to answer the question of “when” to buy a particular security. Fundamental analysis, which is concerned with such things as a company’s financial statements, quality of management, product and industry trends, etc., answers the other important question in investment analysis – “what” security should be bought.

### Organizing The Investment Process

Whether one uses technical research

tools, fundamental research tools, or some combination of the two, organizing the investment process often will lead to better investment results.

The Dorsey Wright Four Step Checklist is a “top-down approach”, so-called because it starts with an analysis of the stock market and progresses to an analysis of an individual security. The checklist has these main elements: (1) A technical review of the overall stock market; (2) a technical review of the sectors; (3) creating and maintaining an inventory of fundamentally sound stocks; and (4) a technical review of the individual stocks. Reviewing this four-step checklist occasionally is a valuable exercise, even for experienced practitioners of technical analysis, as it will help to keep the entire

## THE STEPS

investment process in perspective.

In the first step, the technical review of the overall stock market, various technical tools such as the NYSE Bullish Percent, High-Lows indicator, and positive trend indicators are employed to help investors determine whether they should be taking an offensive or defensive posture with respect to the market.

Next, a technical review of the various sectors is conducted to determine the ones that are the most desirable in which to invest. One of the most useful indicators in assessing sector desirability is the *relative strength* calculation. Relative strength measures how well a particular sector is performing relative to the S&P 500 or some other stock market index.

## CREATE & MAINTAIN A FUNDAMENTAL LIST

The third step is to create and maintain a fundamentally sound list of stocks. There are many sources that provide good fundamental research. At Brookstreet, we use Value Line, Argus Research and Brookstreet’s own proprietary research to develop our fundamental list. It is also important to keep up with changes to the fundamental list (earnings revisions, upgrades, downgrades, etc.).

Investors and brokers who are proficient market technicians sometimes ignore this third step of creating and maintaining a list of sound fundamental stocks. It should be remembered that technical analysis is only intended to provide the “when” to buy recommendation. The “what” to buy recommendation comes from fundamental analysis.

“It should be remembered that technical analysis is only intended to provide the ‘when’ to buy recommendation. The ‘what’ to buy recommendation comes from fundamental analysis.”

(Continued on page 10)

## INVESTMENT STRATEGY

*(Continued from page 9)*

The final step is to analyze the fundamental list of stocks from a technical perspective. In this step, you are looking for those stocks that have a high probability of rising in price based on the technical indicators employed. This is the stage where you are trying to answer the question of “when” to buy the stock.

Users of the Dorsey Wright research service have access to a screen entitled, “Evaluate This Stock”, which is found at the top of the individual stock chart. This useful screen gives a summary of the main technical indicators for the stock being studied, as well as for the overall stock market and the sector of which the stock is a part.

### STOCK EVALUATION CHECKLIST

The Stock Evaluation Checklist on page 11, which is provided courtesy of Dorsey Wright & Associates, uses a “weight of the evidence approach” in assessing the technical merits of a stock. The “weight of the evidence approach” determines which of the indicators are positive and which are negative; and then considers whether the indicators are on balance positive or negative. The decision of

### Conclusion

It should be noted that the fundamental analysis approach often uses a top-down approach that is similar to the process just described. In the fundamental analysis top-down approach, the process starts with an assessment of the overall economy and stock market; then looks at the various sectors and industries; and finally analyzes the individual security. Of course, the emphasis in the strictly fundamental approach is on analyzing the economy, the stock market, the sectors and industries, and the individual companies using mostly fundamental tools.

whether to purchase a security is based on the weight of the evidence (but also takes into account some of the critical indicators). You may wish to copy this form and use it in your own analysis of securities.

Maintaining an organized, top-down approach – whether it is a fundamental only approach or a fundamental/technical dis-

“The weight of the evidence approach determines which of the indicators are positive and which are negative...”

### MORE INFORMATION ON POINT & FIGURE ANALYSIS

cipline – can provide structure to the myriad and often confusing array of technical and fundamental research tools that we employ in our analysis and management of investments.

You may contact Dorsey Wright & Associates at 804-320-8511 or visit their website at [www.dorseywright.com](http://www.dorseywright.com) to learn more about Dorsey Wright & Associates and Point & Figure Analysis. Another excellent provider of information on Point

& Figure Analysis is Chartcraft, Inc., which may be contacted at 914-632-0422. Thomas J. Dorsey, President of Dorsey Wright & Associates, has written one of the classic books on Point & Figure Analysis entitled: “Point & Figure Charting: The Essential Application for Forecasting and Tracking Market Prices” (New York: John Wiley) which can be obtained at most bookstores.

# STOCK EVALUATION CHECKLIST - Pro's & Con's

Stock:	Date:		
	Positive	Negative	Comments
Market			
Sector			
Sector RS			
Trend			
Rel Str			
Peer RS			
Pattern			
Price Obj.			
Risk-Rewd			
Momentum			
Trading Bd			

Stock:	Date:		
	Positive	Negative	Comments
Market			
Sector			
Sector RS			
Trend			
Rel Str			
Peer RS			
Pattern			
Price Obj.			
Risk-Rewd			
Momentum			
Trading Bd			

Stock:	Date:		
	Positive	Negative	Comments
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Sector RS			
Trend			
Rel Str			
Peer RS			
Pattern			
Price Obj.			
Risk-Rewd			
Momentum			
Trading Bd			

Stock:	Date:		
	Positive	Negative	Comments
Market			
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Price Obj.			
Risk-Rewd			
Momentum			
Trading Bd			

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## BROOKSTREET TECHNICAL RESEARCH FOCUS LIST

The Brookstreet Research Services Department maintains a focus list based on technical research. We maintain this list as a portfolio with the Dorsey Wright Technical Research service. You can access the *Brookstreet Technical Research Focus List* by going to the Brookstreet web site and following the links to: Research, Dorsey Wright & Associ-

ates, View and Edit Portfolio, Brookstreet Technical Focus List.

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