"The Long and Short of It"

Quarterly Newsletter from

Robinson Wilkes, L.L.C.

First Quarter, 2000

In our last Quarterly Letter, we closed with the observation that we were seeing a return to a more rational pricing environment and that we were grateful for your patience, which would be rewarded. It is our belief that in the long run, value does matter. The First Quarter did not cooperate with this vision of the future. In the First Quarter, the Russell Value Index experienced a slight loss and the S&P 500 Index gained 2.3%. For the last 12 months the Russell Value Index returned 4.1% and the S&P 500 returned 17.9%.

Returns for periods ending March 31, 2000:				**Annualized Since Incept.**
Type of Investment	**YTD**	**1 Year**	**2 Year**	**12/31/97**
Russell 1000 Value Index	-0.2%	4.1%	3.5%	8.1%
S&P 500 Index	2.3%	17.9%	18.2%	22.1%

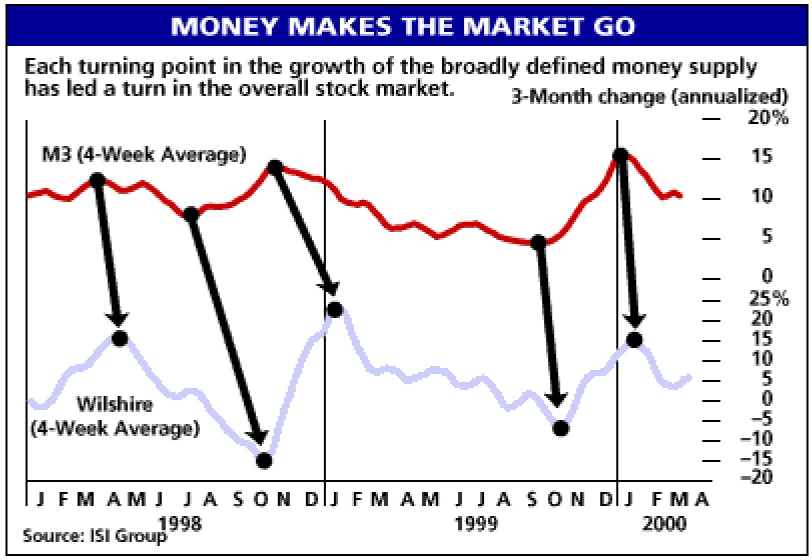
The Value Indices still lag the results of the S&P 500 Index since the inception of our firm. While it still has a long way to go to catch up, and there can be no assurance it will, we feel strongly that the market is beginning to see a return to more rational pricing.

The most obvious of these factors is the simplest – valuations. Many stocks (mostly from what are now called "New Economy" companies) remain priced for a decade of perfection while so called "Old Economy" companies remain at fair to attractive valuations. Although valuations can remain illogical for long periods of time, there are currently several factors that are acting as catalysts for rationality coming back into the market. These are 1) the reduction in liquidity due to a slowing growth in the money supply, 2) the growing supply of equity as insider stock from last year's initial public offerings (IPOs) come off of restriction from sale, and 3) the potential for panic selling heightened by the large increase in margin debt over the last six months.

Reduced Liquidity

During the 1970's, the broad underlying economic forces of a rapidly growing labor force, rising oil prices, falling productivity, etc., were all inflationary in nature. Any increase in the money supply went immediately into consumer spending as the Baby Boomers worked to complete the greatest period of household formation in history. Seeing an increase in money supply, investors would then move capital to non-productive assets like gold and antiques as more money supply meant more price inflation.

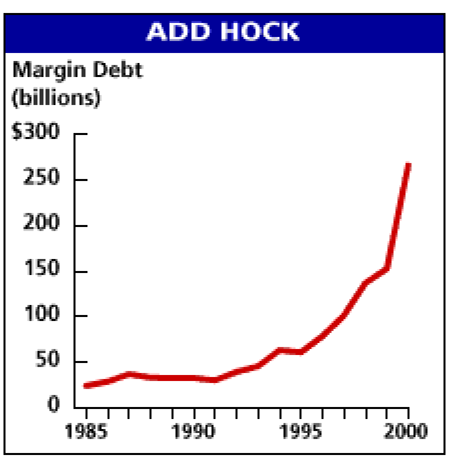
Today, in the middle of a technology revolution, with an aging, more productive labor force, the underlying economic forces are deflationary in nature. Most investors perceive that any increases in money supply currently will not create price inflation, but rather more money to be invested in productive assets. Investor's capital (including that created by money supply growth) thus feeds immediately into the productive capital found through the securities markets and creates asset price inflation. As a result, the stock market follows changes in money supply.



During the 1998 economic slowing in the Far East, there were numerous central bank interventions across the world, which increased money supply to avoid a global recession. As the chart shows, the equity markets responded with great enthusiasm. By the spring of 1999, with our economy hitting on all cylinders, the Federal Reserve began raising interest rates to temper the success of the earlier expansive policy. During the Fourth Quarter of 1999, with Y2K concerns mounting, money supply was again allowed to expand at a dramatic pace. The equity markets responded again with appropriate enthusiasm, but now have to contend with the morning after and Alan Greenspan's continued belt tightening.

Restrictions Removed

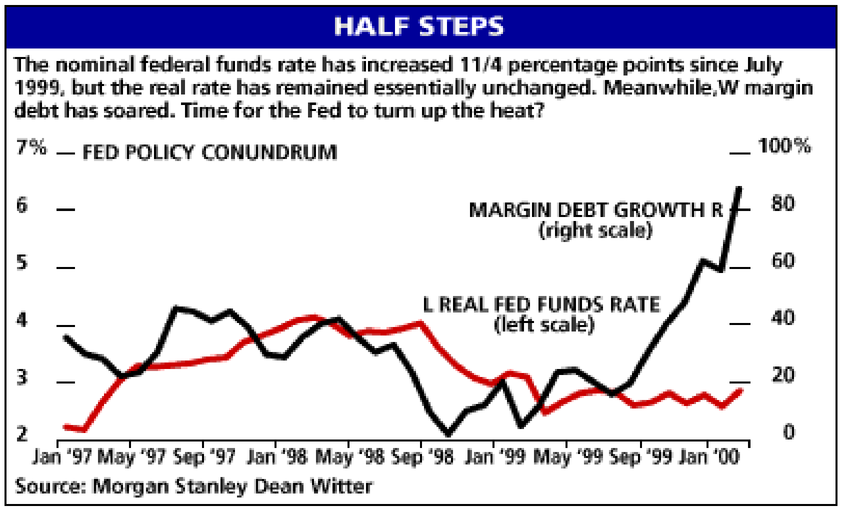
Another catalyst is that the 'Net companies' founders and early backers are eager to sell their shares as they come off of the restrictions from sale which typically last for one year after the IPO. They are even using secondary offerings to accomplish this goal. According to *Barron's*, "So far this year, 38 publicly traded Internet companies have tapped the markets for $16 billion in capital through secondary offerings. This represents a fivefold increase in the number of secondary offerings compared with the same period last year. In addition, this year a far larger number of second-round deals involved insiders unloading their shares on the public." Again from *Barron's*, "The evidence shows the race for the exits is especially pronounced among Internet companies. So far this year, in two-thirds of the secondary stock offerings by Internet companies, 25% or more of the shares were sold by insiders, according to CommScan."



Margin Debt

As the chart to the left from Ned Davis Research and *Barron's* illustrates, the market has been supported in large measure by borrowed money. Margin debt has swelled to an all-time peak and has hit a record high as a percentage of stock market value.

The latest round of speculation in the U.S. equity market was driven increasingly by heightened leverage. Ed Hyman, proprietor of ISI Group, reported that over the past four months, off-the-cuff buying of stocks increased at an astounding 200% annual rate -- far and away the fastest ever. Margin debt (see chart below) ballooned by 45% over the four months ending February 2000 and stood 87% above its year-earlier level -- literally three times the average growth pace over the 1997-99 period. This paints a worrisome picture. Investors have been going farther and farther out on the risk curve -- not just by upping the ante on overvalued technology stocks, but also by borrowing at an increasingly rapid rate to finance these plays. The footprints of speculative excess are now painfully obvious.



HALF STEPS

The nominal federal funds rate has increased 11/4 percentage points since July 1999, but the real rate has remained essentially unchanged. Meanwhile,W margin debt has soared. Time for the Fed to turn up the heat?

Source: Morgan Stanley Dean Witter

Extreme valuation levels are a sufficient reason to expect a correction, but predicting when it will occur is a much more challenging task. Tightening liquidity gives us a catalyst that might cause one to expect the correction sooner, but still in modest proportion. A large supply of stock hanging over the market introduces the possibility of a larger, more sustained correction if panic selling by insiders begins. Finally, enormous, unprecedented levels of margin debt in the midst of these other factors introduces a greater likelihood that some investors will panic, causing a rather severe correction.

No New Paradigm

During the last two years value managers have been caught in a vicious liquidity crunch. Investors have been fleeing value funds and pouring into growth funds. As reported in *Investor's Business Daily*, almost $30 billion was withdrawn from large-cap value funds last year, while $97 billion flowed into large-cap growth funds. As the managers sell their value priced stocks to meet redemptions, the performance of their funds suffer more, causing even more redemptions.

The logic for the move to growth has been not only that this is a new economy, but that the new economy brings with it a new valuation paradigm. We do not subscribe to the theory of a new paradigm and believe investment appraisals will revert to the mean. To justify current valuations, earnings must rise more rapidly than ever from here. P/E multiples have advanced far more than have earnings, and there is little chance of a lasting increase in earnings growth. The earnings change that we have seen has been very narrowly based. While the impact of the Internet on our economy cannot be dismissed, in the long run its role as an arbitrage mechanism will be to reduce prices, margins, and potentially profits.

Conformity is one of the biggest dangers in investing, and more and more investors have been conforming. One result is that the market has become less, rather than more efficient. Just when market timing has become totally unfashionable, it may have some merit. When more and more people have succumbed to the logic of indexation, they may be doing so at precisely the wrong time.

The Internet investing game has been kept alive in large part by a massive flow of money out of so called "Old Economy" stocks and into "New Economy" stocks. The current steep slide in the NASDAQ and stability of the Dow Jones Industrial Average may mark a reversal of this trend. As illustrated last week, once psychology changes, cash-poor Internet issues tend to fall farthest and fastest. However, a reduction in liquidity will likely hurt the broader market as well.

We welcome a return to a more rational pricing environment by nearly any means. We own companies with solid businesses and proven track records of sustained profitability; and we own them at historically low multiples. In the long run, the profits will come – as they did over the last year. As usual, we continue to search for low risk opportunities to grow wealth in the equity markets and will not compromise our disciplines, which have stood the test of time.