

Impressions

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Idealism, money, moving and change

I'm an idealist. I don't know where I'm going but I'm on my way

Carl Sandburg

Idealism is what precedes experience, cynicism is what follows

David T. Wolfe

An idealist is one who, on noticing that a rose smells better than a cabbage, concludes that it will also make better soup.

H.L. Mencken

Cynics regarded everybody as equally corrupt... Idealists regarded everybody as equally corrupt except themselves.

Robert Anton Wilson

For those who do not live in Washington I need to explain a bit about the state to provide context for the remarks which follow.

Washington entered the Union in 1889. Prior to the 1840's it was largely the purview of Indians, mountain men and French and English fur trappers. A great number of famous Americans were associated with Washington history, the major pass through the Cascade Mountains was discovered by George B. McClellan later a General in the Civil War. George Pickett of Pickett's

Charge fame fathered a child by an Indian woman here and US Grant first got into trouble with liquor while stationed in the territory. In fact the famous Oregon Trail actually ended in what is now a golf course near Tacoma.

The state is one of unsurpassed physical beauty with conifer forests of unimaginable size, deep lakes, ocean shore, desert and majestic mountain peaks. I have seen sunsets in

the



Caribbean sunrise following a typhoon but none of those compares to the tints and shadows of a Cascade sunrise such as this one over Mt. St Helens. The state contains the largest concrete structure in the world and the remains of a prehistoric waterfall that made Niagara look like a leaky tap.

The state was settled by populists with an independent bent, and in the last few years has become a state with two different populations depending whether one lives on the east side of the Cascades or the west. The population has always had a respect for the

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land and its bounty and understood the richness of their locale.

Until the 1980's Washington and Oregon were the northern bumpkins to the flash and dash of California and the Silicon Valley. In fact as late as 1990 you had to wait to mid day to get the Wall Street Journal in Seattle.

The state is divided into 39 counties and some of those in Eastern Washington have very small populations while the big five, King (Seattle/Bellevue), Pierce (Tacoma), Snohomish (Everett), Thurston (Olympia) and Kitsap (Bremerton) contain a majority of the population.

I live in King County in a town called Redmond the home of Microsoft we have 47,000 permanent residents but during the working day we have close to 90,000 as people commute into town for jobs.

The reason for all this rambling is that in the past few years we have seen the fall of icons in both business and government and while the pundits are still scratching their heads about cause and effect what is happening here in Washington is an object lesson in how such messes are created.

In common with other areas experiencing a surge in population Washington is straining the edges of its infrastructure, particularly in the big five counties, and increasing spending is difficult due to the fact that one of the legacies of our populist founders is no state income tax. So as a substitute we have a high sales tax and high fees for everything else that a fee can be levied on. For example we have what is called a B&O (Business and Occupations) tax figured on gross revenue, that's right **gross** revenue not net so if you are in business whether profitable or not you get taxed.

The spending needs are not to be minimized; the city of Seattle needs to replace two

highways and a seawall for a combined total of a cool 24 billion dollars. Lake Washington divides the eastside of King County from Seattle and the West and is spanned by two bridges which float for part of the span. The most northern of the two needs to be replaced but on both ends are communities with some of the most expensive housing in the world and naturally they have no interest in an expanded highway in their neighborhoods. You would think that given this existing need and the increasing cost of doing nothing everyone in a leadership position would be looking to future ways to solve the problem, but sadly that is not the case.

In late 2004 the King County Council (our answer to the 7 dwarfs except they used to be 13 of them) passed what is called a Critical Areas Ordinance (CAO) severely limiting the ability of rural property owners to develop their property. The eastern part of King County is largely rural the majority of the county's population living within 20 miles of the littoral of Puget Sound.

The idea for the CAO originated with a citizens group called A Thousand Friends of Washington (ATFW), and was aided in its misguided way by the King County Executive Ron Sims (our equivalent to Kofi Anan). Ron is so politically correct that even though he is an ordained Baptist Minister he banned the words Merry Christmas from the County Admin building out of concern that someone would be offended, but I digress.

Ron was running for governor, a Democrat sinecure if there ever was one, and needed a method to differentiate himself from the front runner and eventual thief of the election, the attorney general, so he ran as an unabashed liberal favoring a state income tax, massive increases in state spending and of course environmental protection.

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ATFW with the instincts of the Green River Killer leapt into the fray and pushed forward the CAO knowing that Ron would not and could not resist if he was to cement the disturbingly powerful, obstructionist greens in the western part of the state. The result was the passage of what has to be the most restrictive land use ordinance in the entire country; the only lands with more restrictions are nuclear waste dumps, minefields and Falljua.

The passage of the CAO has been accompanied by the printing of colorful brochures with smiling, happy, healthy people standing beside rushing rivers with pristine mountains as backdrop and filled with the most unconscionable lies I have ever seen.

For example the CAO states in its text that any land currently not developed (that term is defined later in the text) must maintain 65% of its land area in a natural state, yet the publications state "Critical areas legislation in most cases does not effect what you build but may guide how you build it."

In Washington maintaining land in native growth means allowing blackberry tendrils to grow to a thickness and length at which they begin to capture family pets and small children for sustenance.

Then further on the propaganda says that if a land owner completes a stewardship plan they are eligible for tax breaks. So let me ask a question. Who thinks that when government offers tax breaks is it because it has a sudden sense of largesse or is it because its actions have made it difficult to justify the current tax rate?

But the ex post facto lies are not the real point here. The State and the County have entered on a path to destruction motivated by out of control idealism which views any

opposing point of view cynical and corrupt all the while demonstrating the corruption which comes with the feeling that there is no political risk to enacting destructive legislation. This is the course on which California embarked in the 1990's and which several eastern states such as Massachusetts have traveled in the past. Here is what happens.

King County has the largest population in Washington and therefore most of the critical infrastructure needs are there. Property tax rates are at levels where rebellions break out and it fact if it were not for a Supreme Court profoundly distrustful of citizen action there would already be a cap on property taxes.

Incremental taxes are going to have to come largely from the conversion of rural land to higher uses. Local communities generate a good portion of their revenue from sales taxes on construction materials. The CAO effectively puts a limit on incremental taxes. In the absence of incremental taxes, taxes in already developed areas are going to have to rise and not a little bit.

The flow down effect will be that existing communities in rural areas will be trapped in the current level of services, and communities in developed areas will see skyrocketing taxes. Spineless political hacks will first attempt to find the necessary revenues by taxing business so their voters will not be inconvenienced enough to vote them out of office. Business will then seek lower costs locales and tax receipts will decline further and the vicious cycle with start.

Washington has had fair warning when Boeing, a company founded here, departed for Chicago. Boeing said that since the merger with McDonald Douglas it needed a more central location for its headquarters. If that is a real issue then I guess we will see Wal

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Mart moving out of Bentonville Arkansas soon. The cold hard fact of life is that Boeing moved out of Seattle because it was attractive to leave. It did it in the gentlest way by only moving its corporate headquarters but the clear message is that if the business climate in Washington does not get better the rest of the company will follow. This pattern has been repeated endlessly in history, the textile mills of the northeast, the steel industry, automobiles, televisions, video recorders, and personal computers but still government will not learn.

However, the most serious side effect will be to intensify the State's declining position in educational attainment further destroying the business climate.

The state constitution mandates the first duty is to provide education and about 50% of state funding goes directly to the education establishment. I am not a believer that money alone is the answer to educational underachievement. If it was New York City and Washington DC with the highest spending per student would be turning out an unbroken stream of Nobel Prize winners but money is important if the antiquated educational system is to be changed.

There is no economic prescription indicating a state can attain high levels of business activity with an illiterate workforce. The kind of jobs which depended on a strong back and a weak or at least untrained mind are few and far between and their numbers will decline further in the next few years. Business will not make investments where its capital is treated badly and the prospect of sub par infrastructure, constantly increasing taxes, a poorly trained workforce and idealistic but unfocused government equates to treating capital badly.

There is a lesson here for investors. Investment is more than just buying some stock,

watching it rise then selling, investment refers also to the environment surrounding the stocks one picks. It is really hard to make money in commodity related stocks if world wide economic growth is slowing and inflation low for example.

One of the cycles of American History has been the movement back and forth between the primacy of social concerns and business focus. In recent years the two sides have become antagonistic with social reformers or as they like to call themselves progressives castigating business for lack of concern for anything except the bottom line. Business on the other hand characterize the progressives as melodious voiced, wire rimmed glass wearing, Birkenstock clad, drug addicted dreamers who have never had a real job. Like all stereotypes there is truth in both charges.

Business types, if we are to believe Adam Smith, will be led by an invisible hand to pursue their own best interests which will necessarily be the best interests of all, the social progressives believe that the rational impulse of each person to maximize their own position must be controlled because infinite aggrandizement cannot exist in the finite world they believe exists. In this case business is the more optimistic party but progressives have a case to make also as it is based in human nature and thus the conflict.

The two should not be antithetical as one accomplishes the other but politics being what is they have become enemies of each other and like the Capulet and Montague no longer understand why they fight.

Social concerns are never far from any ethical person's mind the question is how to address those issues and the contention between the two sides is what causes misguided activity like the CAO to occur.

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As Menken says in his devastating quote at the beginning of the article those pushing socially progressive ideas believe that because rushing streams and trees gently nodding their heads with the winds are prettier that houses the soup is better if the trees are preserved. What in fact such thinking has done is to condemn those targeted for help to receive less than what they might get otherwise. In other words progressive social policies have detrimental effects on the business climate and cause the general level of prosperity in the commonweal to decline. This is the ultimate cynicism of idealism and also its irony.

Progressive, anti business activity takes only seconds in time to enact but decades to dismantle. When the course of the river starts to run in the direction of social improvement the numbers of initiatives promising the end of homelessness, child poverty or lack of health insurance proliferate. These types of initiatives are long tail meaning that the full effects are hardly ever forecastable and as spending tends to increase with time groups begin to feel entitled to the benefits of the plan.

While the quest for social justice is a noble and moral aim the need to have a viable business structure to underlie the social system is also paramount. Neither naked capitalism nor naked socialism is the answer but the tale of the CAO in King County is a cautionary one for investors as we move from a period of excess into the unknown. We must remember the sage advice of Chance the Gardener in the movie "Being There" "In the garden if the roots are good in the spring there will be growth". Misplaced idealism can be bad for your economic health.

The Book

As some of you know five years ago I entered on one of the most interesting adventures of my life, I decided to write a book. One client on hearing the news fired us because in his view we would be spending more time on the book than on his needs. The fact that I did not is why it took me 5 years to complete the work.

Writing a book is a nightmare of organization and the more research intensive the work the more nightmarish the task. I discovered the truism of the remark by Dave Barry that writers spend a lot of time looking out the window.

But the book is at last a completed manuscript and after some initial interest from the University of Oklahoma we submitted it to University of Arizona Press for potential publication. We selected an academic press because the subject of the book is the economic development of American Indian Reservations. Hardly type of work that will feature a beefy male model holding a buxom beauty on the cover. It is not a scholarly work but a practical explanation and description of the incentives and benefits which can flow from business locating on reservation land. It is a hard eyed look at the issue of both the tribes who have been their own worst enemy in this endeavor and business who have been asleep at the switch.

I have no idea if Arizona will publish it but at least I have one more achievement in life I am a widely unpublished author.

CHANGE

My wife and I recently made a big lifestyle change. With our daughter's marriage in 2004 we were empty nesters and since our son had managed to boomerang on us several times we decided to move our residence so first there would be no forwarding ad-

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dress and second to a house too small to accommodate the children. Just kidding about the forwarding address.

So we sold our three car garage, 4 bedroom, 3.5 bath, and 3,700 square foot house on 2 acres and moved to a community where one person has to be over 55 (that would be me), I call it the old folks home. This is the place where Cialis Creek flows over Viagra Falls into Lake Levitra.

It is really interesting to see the difference. The community will eventually be 3,000 homes and they are selling like hot cakes and not because they are cheap either.

There is a golf course here so all the homes have one garage space that is deeper than the other, so you can park a car and a golf cart there. There is even a special vehicle license allowing you to drive your golf cart on the public streets.

The community is largely populated by retirees and the first question asked when you meet someone new is "are you still working?" The only problem is that it is perched four miles out on the end of a road at the top of a hill and the traffic on the road is a nightmare.

When a person particularly men are younger there is a concept called penis envy, which later matures into car envy then to tool envy here all that is behind us we have instead screen envy over who has the biggest TV screen, I am sort of on the outs because mine is only 42 inches.

The other thing has been the effect on our friends. We have always had a group of younger friends but as soon as we moved to Trilogy it was like everyone had the same thought, okay they are officially old now and I don't want to be around old people

they make me feel old and remind me of my mortality.

But the success of Trilogy got me thinking about big changes. We all know of the huge bolus of baby boomers who will be retiring and we have heard of the enormous money to devolve from the remaining members of the Greatest Generation but the subtle effects of these changes are most interesting.

The first is the coming gentrification of cities. Older folks with no concern for schooling and tired of driving are increasingly moving into high rise condos and co-ops in central cities to be nearer those things they find interesting. In the suburban areas we are finding an increased density of housing preferential to the large house on large acreage.

Newer homes are more energy and environmentally efficient, clustered and dense housing offers the opportunity for provision and delivery of services in closer proximity and people in central cities offers some hope of less need to drive and therefore less energy usage. We have already seen the effect of changed focus in the movement of stocks like Whole Foods and the other organic markets.

Demographic trends are hard to predict and even harder to play in the investment world but they are fascinating to observe and intellectually stimulating to think about.

ENERGY

I would say that in the last 18 months I get asked about 3 times a day if I think energy prices will stay up here and are the energy stocks still good investments. I have an answer to both questions: no and some are.

The SP 500 is divided into various industry groups and the energy complex is one. Over

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the nearly 80 years of the 500 index the groups have taken on greater or lesser weights depending on the fancy of Wall Street or changes in the world, but they are all cyclical and the cycles are long.

In the early 1980's energy made up about 24% of the SP 500 by weight and financials about 10% in the intervening years they switched places. The same was true of consumer discretionary and capital goods.

The weight of the consumer, financial and technology stocks got to the nosebleed area and industrials, capital goods and energy reached the nadir. When extremes are realized in the investment markets the stage is set to make money.

The answer is that energy stocks have quite a way to go before they get to their median weight and further still to over weight. Some the stocks are still capable of providing double digit returns from here. One group to watch out for however are the coal stocks particularly the eastern miners who have very large retiree health and pension obligations which as we have seen from GM can leave you with a pension fund running a company.

The price of the commodity will fluctuate as they all do, so the prices might go higher and they will surely go lower at some point but that is not the issue. The real story is that there has been a fundamental change in the way energy is used and how energy companies operate which have made them better companies. This is one of the effects of being in the penalty box for a long time. Companies who reside in the penalty box are forced to rationalize their business, evaluate the asset allocation and capital allocation decisions and make decisions about the business with a different view and time line. All of this leads to improved returns on

assets (always critical for asset based companies), capital and equity. This in turn attracts the interest of value investors who have the patience and time frame to allow the story to mature. Then the investment focus shifts to closet indexers and growth funds and finally finishes with the fast money crowd and then it is over.

There are a lot of people whose only connection with gas is after a visit to a Mexican restaurant and for whom oil means Oil of Olay ass over apple cart invested in oil and gas. So it is probably time for a vicious correction to wash out the sissies. The secular trend is still intact and will reassert itself. Of course the one thing we have not heard, yet, is our honorable solons demanding their pound of flesh in the form of an excess profits tax, but I have faith that will come.

BUSINESS EVOLUTION

A few years ago as Sweetwater stagnated during the recent bull market I was advised by a coach for financial service firms to re-evaluate the nature of my business to determine what type of customer I could best serve and in what business areas.

Introspective self evaluation is always difficult and to some extent threatening to those with big egos because we think we have all the answers and we are running so hard maintaining the existing business that we have no time to do the introspection. But I decided to make the time.

What I found was quite surprising, the adjective that was most applied to me by associates, co workers, clients, and vendors and even competitors was trust, the second was constancy and third mindfulness. The other thing that surprised me was the women made up over 50% of my client base. This last was particularly amazing since I have

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never thought of myself particularly attractive to women and I have done nothing to market specifically to female clients and certainly I am no Tom Cruise or Antonio Banderas but there is was as a fact. One of my female friends told me the reason I was attractive to female clients was that I treated them with respect and that I was unafraid to tell them their nest was okay, that they could accomplish their goals.

The other thing that eventually reasserted itself was that I had grey hair around my temples (it has to be there since there is no hair anywhere else) and that experience would cycle back and forth in importance and that educated clients would always go with experience.

During the late 1990's when every snotted kid was a genius and I had internet analysts telling me I was an idiot in search of a village no one needed me and my 30 years of lessons learned but come the fall suddenly everyone needed me it seemed.

In any case all of this has led me to two new business initiatives which are not far from what I have been doing. The first is providing people in divorce situations with unbiased non legal financial advice to help them come out the end of that meat grinder in better shape. Lawyers do a terrible job at this part of divorce work and there is a real need for this work. Women are more ready to accept and seek out the advice and more willing to follow the suggestions, men so far seem to be tied up in their egos and revenge.

The side effect of all this work with women is that I have what has to be the most beautiful client base in the world.

The second new venture is exit planning and this goes back to the comments above demographic changes. A good deal of wealth is tied up in closely held business and

there are a limited number of options available for business owners to realize value.

Whichever avenue the owner uses there is a need to bring together a number of disciplines to help the parties realize their dreams and to form a plan for the succession, this is a relatively new area of work and it is really fascinating to be either part of a team or the coordinator of the work.

So if you are going through a divorce and need a ferocious advocate or would like some help in planning for the succession of your business we are ready and equipped to help you with our usually skill, dedication and steadfastness.

Good Luck and Good Hunting

Dennis