Improving a Well-Diversified Portfolio

Combining a Stock Selection Guide Analysis with PERT

Repair Shop
by Ralph L. Seger, Jr., CFA

Club and personal portfolios may be submitted for review in *BI's* Repair Shop. Portfolios are selected on the basis of information submitted that can be used to prepare an article of general interest and usefulness to readers. Additional information needed includes investment objectives, an up-to-date valuation statement, costs, dates of purchase, human interest background and the opportunity to provide a learning experience with successful, long-term investing based on NAIC principles.

As a seven-year-old venture, the Bluebonnet Investment Club of San Antonio, Texas is asking for an objective opinion about its stock selections, quality and portfolio diversification. The club's primary objectives are to master the NAIC stock study tools and to invest for the benefit of the partners.

The club has taken full advantage of five years of an excellent bull market. The NAIC Club Accounting software members use reports a 19.3 percent annual rate of return, far above the 15 percent target NAIC recommends long-term investors strive for. Another way to look at the attractiveness of such a return is to compare it to the middle single-digit returns from fixed income investments such as CDs, saving accounts, U.S. Treasuries and other ultra-conservative techniques which emphasize safety and conservation of the nominal value of principal. There is always a trade-off of risk versus potential return. Stocks are characterized by greater risk in that they are more volatile in price and have the danger of declining in value.

Trying to suggest how the Bluebonnet Investment Club may do better is like preaching to the choir. In this business of investing, if you are right 80 percent of the time, you will do very well, and these members certainly have their share of

Bluebonnet Investment Club of San Antonio, Texas

Company	No. Shares*	Cost	January 7, 2000 Price	January 7, 2000 Value	Gain/ (Loss)	% Gain/ (Loss)	Quality Rating	% Growth Estimate**	Percent of Portfolio
Analysts International Corp.	100	$1,375	11.688	$1,169	($206)	(15.0%)	1	?	1.4%
The Boeing Company	30	2,294	46.025	1,381	(913)	(39.8)	2	?	1.7
Computer Associates Int'l.	100	3,745	56.500	5,650	1,905	50.9	3	17%	6.8
The Walt Disney Company	150	2,110	31.188	4,678	2,568	121.7	2	?	5.7
Intel Corporation	25*	1,596	82.000	2,015	419	26.3	2	16	2.4
Lucent Technologies	200	7,358	53.875	10,775	3,417	46.4	3	10	13.0
Merck & Co., Inc.	129*	4,754	74.938	9,675	4,921	103.5	1	17	11.7
Methode Electronics "A"	300	4,361	29.688	8,906	4,545	104.2	3	15	10.8
Microsoft Corporation	20	1,963	111.688	2,234	271	13.8	2	18	2.7
Nautica Enterprises, Inc.	100	1,400	12.938	1,294	(106)	(7.6)	3	20	1.6
PepsiCo, Inc.	110*	2,129	38.250	4,193	2,064	96.9	2	9	5.1
SBC Communications, Inc.	78*	3,630	44.000	3,443	(187)	(5.2)	2	12	4.2
Sara Lee Corporation	200	3,032	20.750	4,150	1,118	36.9	1	5	5.0
Simpson Industries	146*	1,680	10.625	1,547	(133)	(7.9)	3	10	1.9
Transocean Offshore	100	2,714	34.188	3,419	705	26.0	3	13	4.1
Tricon Global Restaurants	10	144	35.625	356	212	147.2	4	8	0.4
Wal-Mart Stores, Inc.	200	2,689	68.625	13,725	11,036	410.4	1	13	16.6
Cash	—	4,032	—	4,032	—	—	—	—	4.9
Total		$51,006		$82,642	$31,636	62.0%			100.0%

* Rounded to the nearest full share. ** Author's estimate of future growth.

Repair Shop continued from page 59

winners, with such excellent choices as Computer Associates, Intel, Lucent Technologies, Merck, Microsoft, SBC Communications and Wal-Mart Stores. But let's focus on what might be learned by examining some of the stock selections and portfolio management decisions that led to results, or may lead to results, that are less than satisfactory. Here are some examples.

The Walt Disney Company

Walt Disney was purchased in December, 1993 when revenues and earnings were growing at 20 percent a year. If you used PERT to help you manage your portfolio, you would have noticed that beginning with the June quarter of 1997, revenue growth changed from a handsome double-digit level to a very modest single-digit figure. EPS growth didn't start dropping until one year later when pre-tax profit margins sank and pre-tax profit growth declined to single-digit and negative figures. The accompanying PERT Worksheet A and PERT Worksheet A Graph from Investor's Toolkit *(see below)* documents this demise of profits.

The important thing to note is that the premise of 20 percent growth that probably led the club to buy Disney doesn't seem to be holding true. That's one of the reasons for selling a stock — when the investment characteristics that persuaded you to buy a stock no longer are true, it is time to reexamine the situation. Find out what has changed, and why. Is the situation temporary or is it chronic? What are management's plans to correct the situation and how successfully are they being implemented?

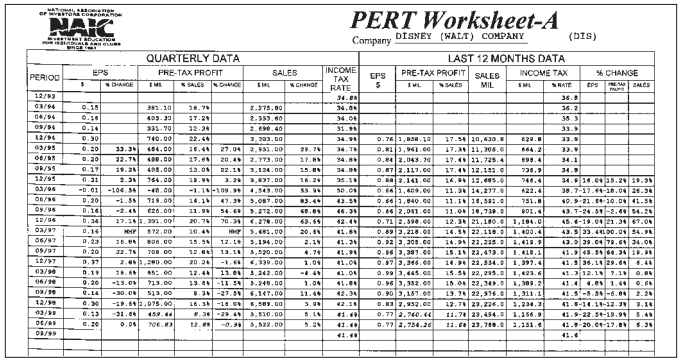
The Boeing Company

Boeing was purchased in June, 1998 after earnings growth had dramatically recovered from a sharp decline in 1997. The news of problems was widely spread in the media. Production lines for civilian aircraft had to be shut down for months to sort out a confused situation, which was preventing Boeing from delivering a big backlog of orders. Sales growth of the company has returned from the disappointing years of 1989 to 1995.

The late George Nicholson taught me that management is one of the most important elements in selecting a successful investment. It is my personal opinion that a company that has to shut down its production line during a boom in incoming sales orders is not displaying a capability that shareholders like to see. Combine that with the unfavorable terms of the labor union contract negotiated in 1999, and I come to the conclusion that a switch to a better investment opportunity should be considered.

Sara Lee Corporation

A quick check of sales, earnings and market price in the Visual Analysis section of a Stock Selection Guide (SSG) on Sara Lee *(see below)* shows sales growth has stalled since 1997. Combine that factor with the corporate decision to sell off its factories and contract with others to supply its products and I wonder about the future. Certainly, the sale of production facilities will free up capital and should eventually result in an enhanced return on equity capital. The question that investors have to deal with, is whether this business plan is going to produce overall good results for shareholders, employees, customers and the communities where Sara Lee operates. Personally, I have my doubts.

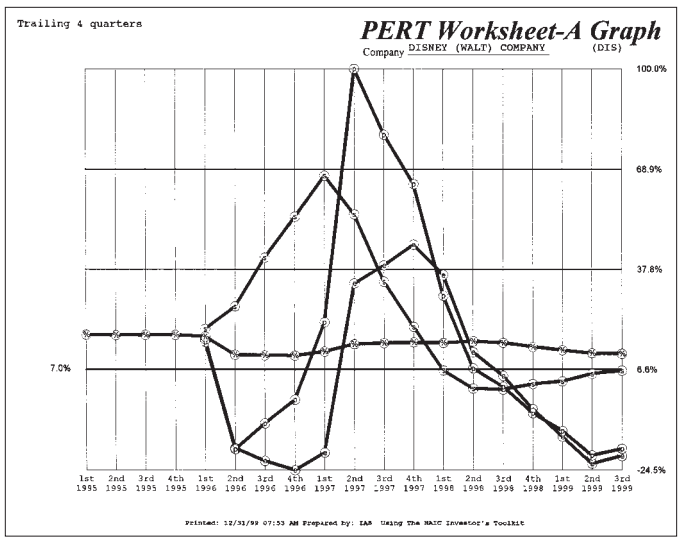


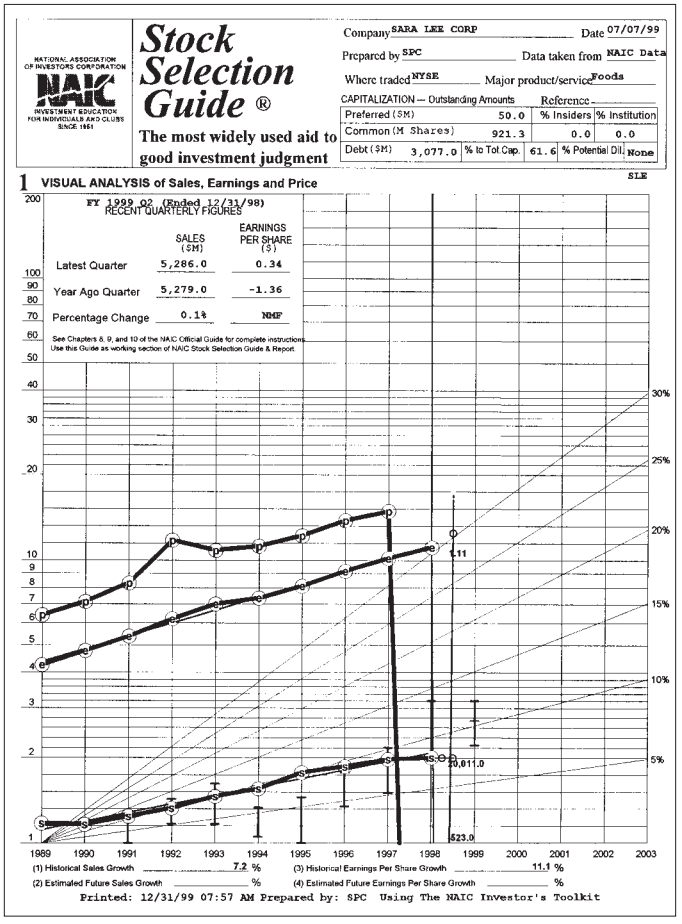
NATIONAL ASSOCIATION OF INVESTORS CORPORATION — NAIC — INVESTMENT EDUCATION FOR INDIVIDUALS AND CLUBS SINCE 1951

PERT Worksheet-A

Company DISNEY (WALT) COMPANY (DIS)

PERIOD	QUARTERLY DATA: EPS $	EPS % CHANGE	PRE-TAX PROFIT $ML	PRE-TAX PROFIT % SALES	PRE-TAX PROFIT % CHANGE	SALES $ML	SALES % CHANGE	INCOME TAX RATE	LAST 12 MONTHS DATA: EPS $	PRE-TAX PROFIT $ML	PRE-TAX PROFIT % SALES	SALES MIL	INCOME TAX $ML	INCOME TAX % RATE	% CHANGE EPS	% CHANGE PRE-TAX PROFIT	% CHANGE SALES
12/93								34.8%						36.8			
03/94	0.15		381.10	16.7%		2,275.80		34.0%						36.2			
06/94	0.16		403.30	17.2%		2,353.60		34.0%						35.3			
09/94	0.14		331.70	12.3%		2,698.40		31.9%						33.9			
12/94	0.30		740.00	22.4%		3,303.00		34.9%	0.76	1,858.10	17.5%	10,630.8	629.8	33.9			
03/95	0.20	33.3%	484.00	16.4%	27.0%	2,951.00	29.7%	34.7%	0.81	1,961.00	17.3%	11,306.0	664.2	33.9			
06/95	0.20	22.7%	488.00	17.6%	20.4%	2,773.00	17.8%	34.8%	0.86	2,043.70	17.4%	11,725.4	698.4	34.1			
09/95	0.17	19.3%	405.00	13.0%	22.1%	3,134.00	15.8%	34.8%	0.87	2,117.00	17.4%	12,151.0	736.9	34.8			
12/95	0.31	3.2%	764.00	19.9%	3.3%	3,837.00	16.2%	35.1%	0.88	2,141.00	16.9%	12,685.0	746.9	34.9	16.0%	18.2%	19.3%
03/96	-0.01	-106.5%	-40.00	-1.1%	-109.9%	4,543.00	53.9%	50.0%	0.66	1,609.00	11.3%	14,277.0	622.4	38.7	-17.4%	-18.0%	26.3%
06/96	0.20	-1.5%	719.00	14.1%	47.3%	5,087.00	83.4%	43.5%	0.66	1,840.00	11.1%	16,581.0	731.8	40.9	-21.8%	-10.0%	41.3%
09/96	0.16	-2.4%	626.00	11.9%	54.4%	5,272.00	68.8%	46.3%	0.66	2,081.00	11.0%	18,738.0	801.4	43.7	-24.3%	-2.4%	54.2%
12/96	0.36	17.1%	1,391.00	20.7%	70.3%	6,278.00	63.6%	42.4%	0.71	2,598.00	12.3%	21,180.0	1,184.0	45.6	-19.0%	21.3%	67.0%
03/97	0.16	NMF	572.00	10.4%	NMF	5,481.00	20.6%	41.8%	0.69	2,218.00	14.5%	22,118.0	1,402.4	43.5	33.4%	90.0%	54.8%
06/97	0.23	16.8%	808.00	15.5%	12.1%	5,194.00	2.1%	41.3%	0.92	3,303.00	14.9%	22,235.0	1,419.9	43.0	39.6%	79.6%	24.0%
09/97	0.20	22.7%	708.00	12.8%	13.1%	5,520.00	4.7%	41.9%	0.96	3,387.00	15.1%	22,473.0	1,418.1	41.9	45.5%	84.3%	19.8%
12/97	0.37	2.8%	1,280.00	20.2%	-1.6%	6,339.00	1.0%	41.0%	0.97	3,266.00	14.9%	22,534.0	1,397.4	41.5	36.1%	29.6%	6.4%
03/98	0.19	18.6%	651.00	12.4%	13.8%	5,242.00	-4.4%	41.0%	0.99	3,445.00	15.5%	22,295.0	1,423.6	41.3	12.1%	7.1%	0.8%
06/98	0.20	-13.0%	719.00	13.8%	-11.3%	5,248.00	1.0%	41.8%	0.96	3,352.00	15.0%	22,349.0	1,389.2	41.4	4.8%	1.4%	0.6%
09/98	0.14	-30.0%	513.00	9.3%	-27.5%	5,547.00	11.6%	42.3%	0.90	3,157.00	13.7%	22,976.0	1,311.1	41.5	-5.5%	-6.6%	2.2%
12/98	0.30	-19.5%	1,075.00	16.3%	-16.0%	6,589.00	3.9%	42.1%	0.83	2,952.00	12.7%	23,226.0	1,234.3	41.8	-14.1%	-12.3%	3.1%
03/99	0.13	-31.6%	459.44	8.3%	-29.4%	5,510.00	5.1%	41.4%	0.77	2,760.44	11.7%	23,434.0	1,156.9	41.9	-22.5%	-13.9%	5.4%
06/99	0.20	0.0%	706.83	12.8%	-0.3%	5,522.00	5.2%	42.4%	0.77	2,724.26	11.6%	23,788.0	1,121.6	41.9	-20.0%	-17.8%	6.3%
09/99								41.4%						41.6			





Simpson Industries

An examination of the SSG chart on Simpson Industries *(see below)* shows the price of the stock has been in a narrow range since 1992. In the meantime, sales have grown at about a 12 percent annual pace. As a supplier of auto parts, the company is subject to pricing pressures from automotive companies. Its customers are in a mature, highly competitive industry, each one seeking market share in a market where worldwide capacity exceeds sales.

Why has the five-year average price-earnings ratio (P/E) dropped from 18.8 in 1993 to 14.2 in 1998 during a period when P/E ratios in much of the stock market have been rising? *(See PERT Worksheet B below.)* Could it be because EPS reached $0.80 in 1994 and $0.81 in 1998 after peaking out at $0.97 in 1996? It is difficult for good management to produce superior results when it produces and sells machined parts and assemblies for original equipment manufactures of autos, trucks, diesel engines and farm equipment.

These are some of the things investors should consider and reach conclusions about as they manage their portfolios. With almost 9,000 stocks traded in the public markets each day, it may be possible to find investments with more compelling attributes.

Analysts International

Analysts International provides contract programming and related services to users and manufacturers of computers and software developers. The stock was purchased early in March, 1999 at a price of about 13 3/4, down from the 36-36 1/2 level at the end of 1997 and beginning of 1998. It certainly looked like a bargain. Sales and EPS had been growing at 17 percent a year. Almost immediately, beginning with the December, 1998 quarter, sales

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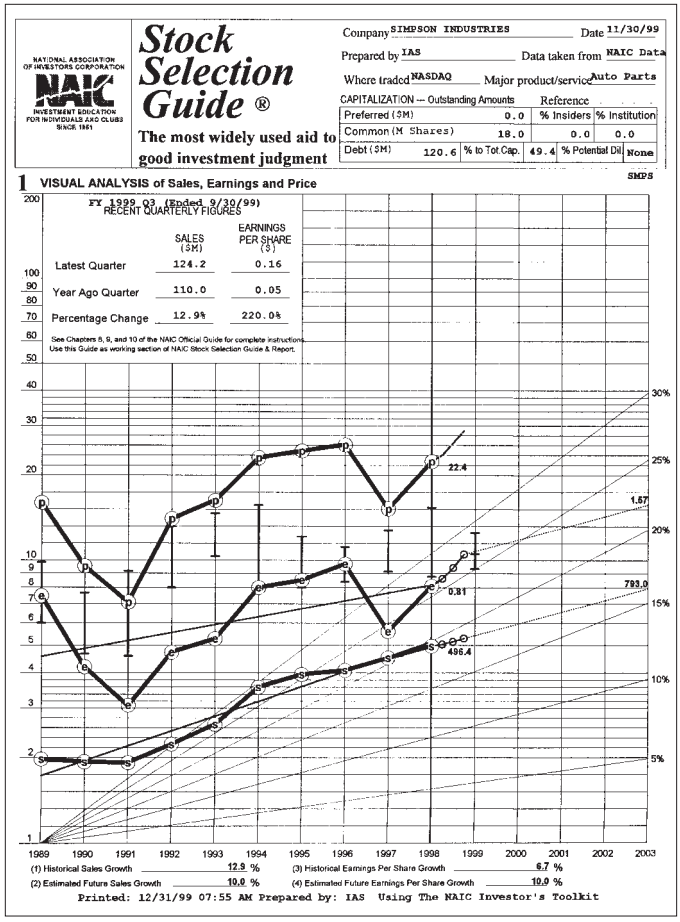
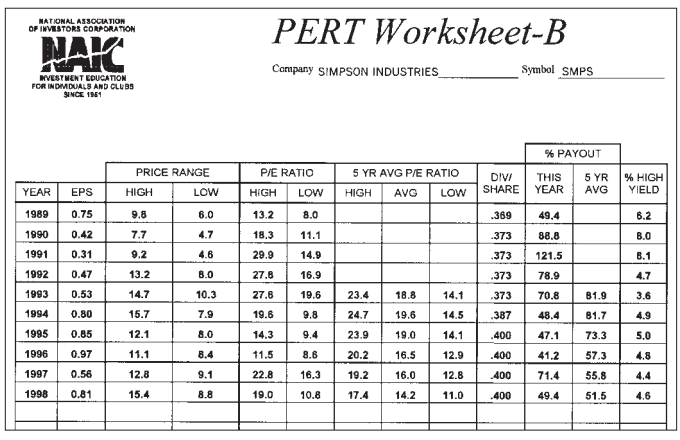


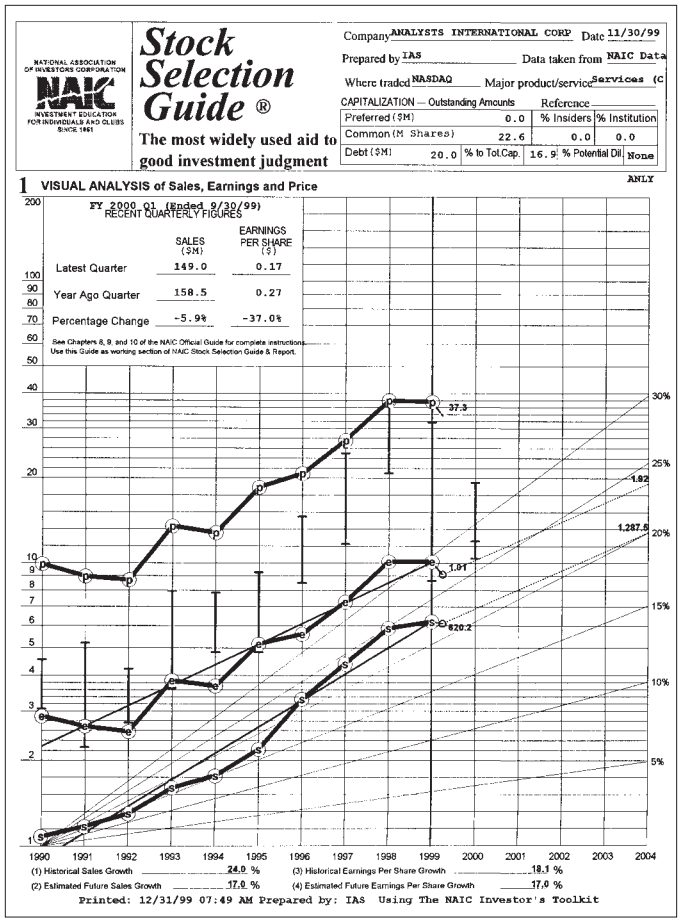


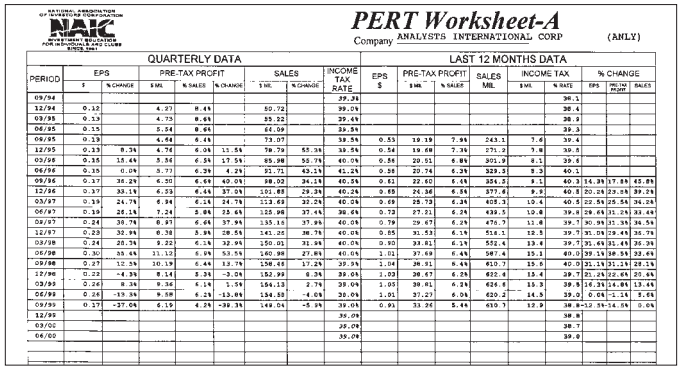
NATIONAL ASSOCIATION OF INVESTORS CORPORATION NAIC INVESTMENT EDUCATION FOR INDIVIDUALS AND CLUBS SINCE 1951

PERT Worksheet-B

Company SIMPSON INDUSTRIES Symbol SMPS

		PRICE RANGE		P/E RATIO		5 YR AVG P/E RATIO			DIV/ SHARE	% PAYOUT THIS YEAR	% PAYOUT 5 YR AVG	% HIGH YIELD
YEAR	EPS	HIGH	LOW	HIGH	LOW	HIGH	AVG	LOW				
1989	0.75	9.8	6.0	13.2	8.0				.369	49.4		6.2
1990	0.42	7.7	4.7	18.3	11.1				.373	88.8		8.0
1991	0.31	9.2	4.6	29.9	14.9				.373	121.5		8.1
1992	0.47	13.2	8.0	27.8	16.9				.373	78.9		4.7
1993	0.53	14.7	10.3	27.6	19.6	23.4	18.8	14.1	.373	70.8	81.9	3.6
1994	0.80	15.7	7.9	19.6	9.8	24.7	19.6	14.5	.387	48.4	81.7	4.9
1995	0.85	12.1	8.0	14.3	9.4	23.9	19.0	14.1	.400	47.1	73.3	5.0
1996	0.97	11.1	8.4	11.5	8.6	20.2	16.5	12.9	.400	41.2	57.3	4.8
1997	0.56	12.8	9.1	22.8	16.3	19.2	16.0	12.8	.400	71.4	55.8	4.4
1998	0.81	15.4	8.8	19.0	10.8	17.4	14.2	11.0	.400	49.4	51.5	4.6





NATIONAL ASSOCIATION OF INVESTORS CORPORATION NAIC INVESTMENT EDUCATION FOR INDIVIDUALS AND CLUBS SINCE 1951

PERT Worksheet-A

Company ANALYSTS INTERNATIONAL CORP (ANLY)

	QUARTERLY DATA									LAST 12 MONTHS DATA							
PERIOD	EPS		PRE-TAX PROFIT		SALES		INCOME TAX RATE	EPS	PRE-TAX PROFIT		SALES	INCOME TAX		% CHANGE		
	$	% CHANGE	$ MIL	% SALES	$ MIL	% CHANGE		$	$ MIL	% SALES	MIL	$ MIL	% RATE	EPS	PRE-TAX PROFIT	SALES
09/94							39.3%						38.1			
12/94	0.12		4.37	8.4%		50.72	39.0%						38.4			
03/95	0.13		4.73	8.6%		55.22	39.4%						38.9			
06/95	0.15		5.54	8.6%		64.09	39.5%						39.3			
09/95	0.19		4.64	6.4%		73.07	39.5%	0.53	19.19	7.9%	243.1	7.6	39.4			
12/95	0.19	8.3%	4.74	6.0%	11.5%	78.79	55.3%	0.54	19.68	7.3%	271.2	7.8	39.5			
03/96	0.15	15.4%	5.36	6.5%	17.5%	85.98	52.7%	0.56	20.51	6.8%	301.9	8.1	39.6			
06/96	0.15	0.0%	5.77	6.3%	4.2%	91.71	43.1%	0.58	20.74	6.3%	329.3	8.3	40.1			
09/96	0.17	38.2%	6.50	6.6%	40.0%	98.02	34.1%	0.61	22.60	6.6%	354.3	8.1	40.3	14.3%	17.8%	45.8%
12/96	0.17	30.1%	6.23	6.4%	37.5%	101.88	29.3%	0.68	24.34	6.8%	377.6	8.2	40.5	20.2%	23.6%	39.2%
03/97	0.19	24.7%	6.94	6.1%	24.7%	113.63	32.2%	0.69	25.73	6.3%	405.3	10.4	40.5	22.5%	25.5%	34.2%
06/97	0.19	26.1%	7.24	5.8%	23.6%	125.98	37.4%	0.72	27.21	6.2%	439.5	10.8	39.8	29.6%	31.2%	33.4%
09/97	0.24	39.7%	8.37	6.6%	37.9%	135.16	37.9%	0.79	29.67	6.2%	476.7	11.8	39.7	50.9%	31.3%	34.5%
12/97	0.23	32.9%	8.38	5.9%	28.5%	141.26	38.7%	0.85	31.53	6.1%	514.1	12.5	39.7	51.0%	29.4%	35.7%
03/98	0.24	20.5%	9.22	6.1%	32.9%	150.01	31.9%	0.90	33.81	6.1%	552.4	13.4	39.7	31.6%	31.4%	36.3%
06/98	0.30	30.4%	11.12	6.9%	53.5%	160.98	27.8%	1.01	37.69	6.4%	587.4	15.1	40.0	39.1%	38.5%	32.6%
09/98	0.27	12.3%	10.19	6.4%	13.7%	158.65	17.2%	1.04	38.91	6.4%	610.7	15.6	40.0	21.1%	31.1%	28.1%
12/98	0.22	-4.3%	8.14	5.3%	-3.0%	152.99	8.3%	1.03	38.67	6.3%	622.4	15.4	39.7	21.2%	22.6%	20.4%
03/99	0.26	8.3%	9.36	6.1%	1.5%	154.13	2.7%	1.05	38.81	6.2%	626.6	15.3	39.5	16.2%	14.8%	13.4%
06/99	0.26	-13.5%	9.58	6.2%	-13.0%	154.53	-4.0%	1.01	37.27	6.0%	620.2	14.5	39.0	0.0%	-1.1%	3.6%
09/99	0.17	-37.0%	6.19	4.2%	-39.3%	149.04	-5.3%	0.91	33.26	5.4%	610.7	12.9	38.8	-12.5%	-14.5%	0.0%
12/99							35.0%						38.8			
03/00							35.0%						38.7			
06/00							35.0%						39.0			

Repair Shop continued from page 61

growth slowed. The March, June and September quarters of 1999 were tough as sales growth dropped to single digits and then negative. EPS growth turned negative in the December, 1998 quarter and continued to deteriorate. Profit margins held up, but top line growth (sales) disappeared. As a result, bottom line growth of EPS melted away. I gleaned this information using NAIC S&P Datafiles and ToolKit's SSG and PERT Worksheet A *(see charts, last page)*. They help explain why the price was not necessarily a bargain.

In August, 1999, a new president and chief operating officer for Analysts International was named. The chief executive office remained.

The computer software business is tough. A company that has an advantage can lose it to a competitor who develops a product more appealing and useful to users. Unlike the pharmaceutical business where the barriers to entry are tough because of a high level of research and development expense plus the Food and Drug Administration's stringent approval process, the software industry responds to brains and innovation. Very few reach the dominance of a Microsoft or a Sun Microsystems. Just look at what happened to Digital Equipment (DEC) when it stood still too long with its product line.

If you go through a similar process of evaluation of PepsiCo, you are likely to find a record of growth that has faltered. Like Coca-Cola, PepsiCo has resorted to sharp rises in the prices of its soft drink syrup to restore profit growth. In a competitive environment, such strategies have the potential of backfiring. I think there are better choices out there than PepsiCo or Coca-Cola.

The Bluebonnets have a reasonably well-diversified portfolio. Overweighting in Merck, Lucent Technologies and Wal-Mart Stores has developed from excellent investment performance. A nice problem to face! The challenge is to continue building. The combination of the Stock Selection Guide and PERT analysis can be a big help. BI

Ralph Seger is chairman of the investment management and consulting firm of Seger-Elvekrog, Inc., Birmingham, Mich., president of the NAIC Investor Advisory Service and a member of Better Investing's Securities Review Committee.