

Investment Outlook

Time to Hang Tough

Well over a year ago we anticipated the current economic slowdown and decided the best strategy was to invest in financially strong companies and ride it out. With the stock market on a downward path since last November, our resolve is now being put to the test. We find the best cure for stock market worries is to go back and check the fundamentals underlying our investments.

Our largest investment group is our REIT's (Real Estate Investment Trusts). With an average dividend yield of 6.85%, we are being well paid while we wait for REIT stock prices to recover. In the residential sector, home foreclosures are keeping rental demand strong. On the commercial side, the longer leases are giving the REIT's some buffer from their tenant's problems. We have deliberately sought out REIT's with fixed rate debt. Although a sustained economic downturn will hurt real estate, we believe inflation will increase real estate values and enable owners to pay their debts with cheaper dollars.

Our second largest group is oil and gas, and we are concentrated in the drilling area. Exploration and production capability was severely diminished

during twenty years of cheap plentiful oil. When prices finally began to lift in 2004, the remaining skilled labor and equipment was in short supply. We believe it will take several more years for supply to catch up with demand, and are surprised that companies such as Nobel Energy and Helix are selling at modest PE ratios around ten, when their earnings are growing over 30% annually. We note that oil and gas prices need not remain at current lofty levels in order for exploration and production demand to remain strong. Even if prices drop 50%, they will still be at levels where it will pay to drill, and the oil and gas companies are flush with cash.

Our third largest area is medical. Medical is considered somewhat insulated from the economy; it is not a discretionary expenditure and most healthcare is funded by insurance.



Arthrocare makes a minimally invasive surgical wand used in sports medicine, spinal/neurological and ear/nose/throat. Their PE is a lofty 28, but justified in

our opinion by earnings growth in excess of 35%.



Crucell develops and markets vaccines. Its production technology uses a human cell line to manufacture vaccines more quickly, cheaply, and with fewer allergy problems. Crucell licensed their technology to many major pharma companies and is cash flow positive. Increased air travel and drug resistance are increasing the risk of infectious disease and consequent need for vaccines.

We believe Crucell, with a market cap around \$1 billion, is undervalued based on its eight marketed vaccines, eleven products under development, and royalty potential from licensing.



Teva is the largest maker of generic drugs. The non-GAAP PE ratio is about 17. Our outlook for generics is bright, and given Teva's long term growth rate, the stock seems very cheap. Teva is headquartered in Israel, which may soon be in armed conflict with Iran. For this reason we have been temporarily removing Teva from some client portfolios.

REIT's, Oil & Gas, and Medical make up the majority of most client portfolios. We hope we have given you some comfort that the business fundamentals underlying these investments are strong, despite a weak economy and weak stock market.

Robert Balopole, CFA

Disclaimer:

This newsletter is informational only, and does not constitute investment advice or a solicitation. BIMC is invested in all the stocks mentioned in this newsletter at the time of publication. Certain investments may not be suitable for a particular investor. Investments can result in losses.