

# Smith Barney Mutual Funds

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### MANAGER HERSH COHEN LOOKS BACK AT 2000 AND WHAT MAY LIE AHEAD FOR 2001

#### Hersh Cohen, Managing Director

Smith Barney Asset  
Management

Hersh Cohen has more than 31 years of securities business experience. He has been featured in industry publications such as *The Wall Street Journal* and *Barrons*.

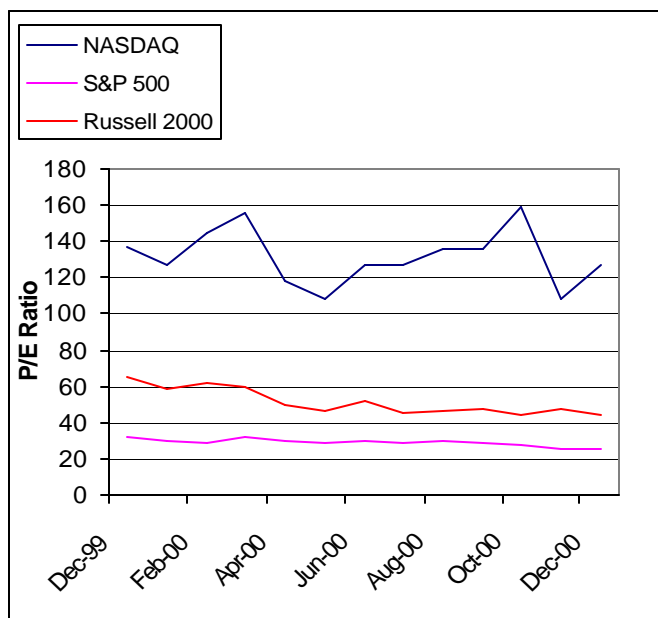
Education: BA from Case Western Reserve University. Ph.D. in Psychology from Tufts University.

#### WHAT HERSH SAID IN DECEMBER 1999

*"We are reluctant to accept the risks that come with buying stocks selling for extraordinarily high price-to-earnings ratios..."*

#### 1999 P/E Ratios For Three Major Stock Indices

Many stocks across the board became less expensive, as defined by their P/E multiples:



The price-to-earnings ("P/E") ratio is the price of a stock divided by its earnings per share. The Nasdaq Composite Index is a market value-weighted index that measures all domestic and non-U.S. based securities listed on the NASDAQ stock market. The Standard & Poor's 500 Index ("S&P 500") is a market capitalization-weighted measure of 500 widely held common stocks. The Russell 2000 Index ("Russell Index"/"Russell 2000") measures the performance of the 2,000 smallest companies in the Russell 3000 Index, which represents approximately 8% of the total market capitalization of the Russell 3000 Index. An investor cannot invest directly in these indices, which are widely recognized as indicators of stock market performance and include the reinvestment of dividends. Keep in mind, stock prices are subject to market fluctuation. The indices presented above are unmanaged, cannot be purchased directly by investors, and are not subject to the same management and trading expenses as a mutual fund.

**ACCORDING TO HERSH, THE STOCK MARKET IN 2000 CAN BE  
SUMMED UP IN ONE WORD: OVERVALUATION**

By just about any measure, 2000 was an exceptionally difficult year for the stock market, with the S&P 500 declining 9.1% and the NASDAQ Composite Index declining 39.3%. Volumes can be written about the "whys" of 2000, but we can sum up the net results in one word: Overvaluation. For all the explanations that may emanate, the most compelling is of the mania of late 1999 that carried into February 2000, which left the stock market vulnerable to a resounding drop.

**FOR HERSH IT WAS A MATTER OF WHEN, NOT IF THE TECH STOCK BUBBLE WOULD BURST.**

Given the overvaluation of the technology sector, the outcome for the stock market depended on whether the drop in tech stocks would spread to other sectors, causing a massive bear market, or whether money might then flow into other better-valued stocks.

The jury was still out as we moved into the fourth quarter. Many basic industry stocks had taken a beating, and the financial services sector had also been neglected. Finally, as the complacency surrounding technology began to dissipate, money did indeed begin to flow into some previously neglected stocks. So while the popular market averages were all down for the year, an overall bear market did not develop.

**IF YOU HAD INVESTED \$10,000 IN THE STOCKS THAT COMPRISE THE DOW JONES INTERNET  
COMPOSITE INDEX<sup>1</sup> ON DECEMBER 31, 1999, YOUR INVESTMENT WOULD HAVE BEEN WORTH  
\$3,388 ON DECEMBER 31, 2000.**

**WILL 2001 BE LIKE 1930?**

Unlike previous market downturns such as in the 1930s and early 1970s, when speculative excesses led to large withdrawals of investor participation and the collapse of entire markets, thus far, investors have stayed with stocks. Though the NASDAQ suffered a devastating collapse, people who placed their faith in stocks over the past several years have either ridden out the decline in technology or have switched to more conservative holdings.

**SOME LESSONS LEARNED**

According to Hersh, among the lessons that investors either learned or were reminded of during 2000 were:

- Diversification can be better than betting the ranch on any one kind of investment;
- Cash is not always trash;
- Valuations do matter; and
- Most importantly, the belief that "this time is different" is still the most dangerous phrase in stock market lingo.

**"THE KEY TO SUCCESSFUL INVESTING IS TO OWN QUALITY COMPANIES, STAY DIVERSIFIED,  
REMAIN PATIENT AND MAINTAIN A LONG-TERM PERSPECTIVE." HERSH COHEN**

In my opinion, the major determinant for the market in the coming year may be whether the economy slips into a recession—defined as two quarters of declines in Gross Domestic Product ("GDP")<sup>2</sup>—or whether a "soft landing" (i.e., slower growth but no recession) is the outcome. Unfortunately, the odds of a recession have increased in the past two months, as the positive wealth effect from the 1999 stock market has turned negative. This has affected many areas of the economy that have great multiplier effects, such as housing, autos and consumer spending. In addition, high energy costs have begun to act like a tax increase, and investor confidence has declined. It remains to be seen whether further monetary easing by the Federal Reserve Board ("Fed") will be enough to overcome the negative investor sentiment that has set in.

In my view, hammered technology stocks should have a relief rally early in the year, although valuations are still high. Industrial stocks—so inexpensive just a few months ago—have rallied nicely, and are now at a point where they need evidence of a soft landing in the economy in order to advance farther. Many financial stocks have also lifted, based on expectations of lower interest rates. Healthcare stocks have rallied vigorously as the threat of price controls has evaporated. In the energy sector, where skepticism abounds about the sustainability of high oil prices, we believe many stocks have upside potential.

We believe 2001 could turn out to be a far better year than its predecessor if the economy merely slows, instead of declining, giving earnings room to advance. The second half of 2001 may provide a more hospitable environment for the stock market, because it is only when stocks have been heavily liquidated that bargains become available.

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<sup>1</sup>The Dow Jones Internet Composite Index ("DJICI") is a price-weighted average of actively traded internet stocks. Figures for the DJICI include reinvestment of dividends.

<sup>2</sup>GDP is the market value of the goods and services produced by labor and property in the U.S. GDP is comprised of consumer and government purchases, private domestic investments and net exports of goods and services.