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The Crummer SunTrust Investment Portfolio 1999

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The

CRUMMER

GRADUATE SCHOOL OF BUSINESS

ROLLINS COLLEGE

SUNTRUST

Investment Portfolio

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#2

Objective:

To provide scholarships to future Crummer students by investing donated funds into an aggressive, well-diversified portfolio. To provide existing Crummer students with hands on experience of designing and implementing a real portfolio.

Assumptions:

- Anticipated 6% draw based on three-year moving average.
- Moderate-to-high risk tolerance. With the three-year moving average distribution of six percent and with minimal dependence on cash flow, Crummer can afford to take on higher risk in order to generate additional returns.
- Passive investment strategy. Crummer will not actively manage the portfolio. The only time the portfolio composition will be altered is when the new class makes adjustments or when the board of overseers feels that certain adjustments need to be made.
- Limited diversification potential. Since the portfolio is initially only $100,000, diversification potential is somewhat limited due to substantially higher trading costs on the percentage basis when only few shares of a particular stock are purchased.
- Dividends and interest will be held in money-market account. Since dividends and interest will represent a relatively small sum of money reinvesting it is not feasible. Therefore dividends and interest will be held in a money-market account and will be first-use funds in paying out the draw.

Goals:

- Annual average return of 15% over the long-term. It is the goal of this portfolio to earn above average returns by intelligently assuming additional risk. Ample diversification will eliminate a significant amount of risk. However, it is still expected that the portfolio will have higher risk than the market.
- We will focus our diversification efforts on diversifying the portfolio between asset classes and across different industries.

Portfolio Composition:

- 10% Bonds – 90% Equity. We will invest approximately 10% of our portfolio in bonds for diversification purposes with the remaining amount to be invested in equities.
- Bond portion of the portfolio will be invested in US Treasuries. US Treasuries provide maximum security and provide returns only slightly below other highly rated bonds.
- Equity will be allocated according to the following formula:

Technology	25%
Financials	17%
Pharmaceuticals	15%
Retail	11%
Conglomerates	4%
Energy (Oil)	4%
Transportation	4%
International	10%
Total	**90%**

Reasoning:

- 10% was allocated to bonds because bond portion will significantly improve stability over time and will provide better risk-adjusted rate of return over time.
- Equity was allocated between the industries using combination of bottom-up and top-down approaches. First all industries were evaluated and those with the greatest return potential and largest diversification effect were identified. Next, universe of all highly liquid mature stocks was evaluated and a limited universe of strong stocks was selected by consensus. Finally, the two approaches were combined and equity allocation percentages were derived.
- International portion was included to further improve diversification and because of buying opportunities in relatively depressed markets.

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Actual Portfolio:

STOCKS	TARGET WEIGHT	BETA	APPROIXMATE # SHARES	APROXIMATE PRICE / SHARE	TOTAL DOLLAR AMOUNT
HomeDepot	4%	0.93	65	61.56	4,000
General Electric	4%	1.14	36	111.63	4,000
Staples	7%	1.45	196	33.56	7,000
BP Amoco	4%	0.54	42	95.81	4,000
Delta Air Lines	4%	0.87	58	68.63	4,000
American Express	6%	1.32	53	121.00	6,000
Wells Fargo & Company	4%	1.12	109	36.69	4,000
Charles Schwab Corporation	7%	2.12	74	94.25	7,000
IBM	5%	1.20	28	177.00	5,000
Compaq	4%	1.36	127	31.56	4,000
EGGS	~~7%~~ 9%	2.76	393	17.81	7,000
Novel	9%	1.66	355	25.38	9,000
Johnson & Johnson	4%	0.91	42	94.13	4,000
Warner Lambert	4%	0.85	61	66.00	4,000
Pfizer	7%	0.97	50	139.00	7,000
T. Rowe Price Global Stock Fund	10%	0.82	659	15.18	10,000
Treasury Bond	10%	0.17			10,000
Total	100%	1.207	2,348		$ 100,000

Methodology for Allocation:

- We began by allocating 25% to technology, 15% to pharmaceuticals, 15% to financials, 10% to retail, 5% to transportation, 5% to oil, 5% to conglomerates and 10% to international funds.
- Next we picked the best stocks within each industry and came up with preliminary allocation of approximately 5% for each stock.
- Then we researched weekly returns for each stock for the last 12 months, and compared the returns next to each other. Given the weighting and the returns we were able to come up with the historic beta for the portfolio. We were also able to come up with the historic return.
- Solver was used next in order to find the optimal portfolio (maximum return) given a constrained beta.
- We first constrained the total equity allocation to be 90% and constrained each equity allocation to be above 0 in order to avoid short sales situations. We have also constrained beta to be 1 for the whole portfolio. Given these constraints we have maximized return to find a point on the efficient frontier. After running this scenario we came up with allocation of 61% to Novell and 29% to Staples. Given this scenario we came up with the historical return of 114%.
- Since allocating all of equity to just two stocks would severely hamper diversification we next constrained each individual equity allocation to be with 3% and 7% except for IBM and Egghead.com which constraints were set to be 5% to 9% and the International fund that was set to be 10% to 15%. After running this scenario we have come up with representation of all equities which gave us better diversification and got the historical return of 72%.
- We next went further on and attempted to increase the allocation made to each individual equity by increasing the minimum allocation to 4%. Given this scenario we have came up with the historical return of 68%.
- After considering all of the scenarios we have decided to use the scenario where minimum allocation was constrained at 3%.

Financial Services Industry

The Financial Services Industry can be divided into five primary categories: Depository Institutions (banks, credit unions), Insurance Companies, Securities and Brokerage Exchanges, Nondepository Institutions (credit institutions and mortgage companies), and Real Estate. The industry has been faced with many changes over the past decade and this trend is expected to continue as issues such as deregulation of the industry and technological changes force competitors to reevaluate their business strategies.

The deregulation in the industry has been brought about by the relaxation of the Glass Steagall Act. Banks are now allowed to offer insurance products and investments under certain limitations. Insurance companies are now allowed to offer banking services.

Though the financial services industry is facing many changes in the coming years, we believe that it is a good investment for the Crummer portfolio. The players in the industry have harnessed the available technology and are making use of it for the benefit of their customers as well as themselves.

- The commercial banking sector has seen numerous mergers over the last few years because large national banks have realized that they cannot effectively compete in this new marketplace with their limited resources.
- These mergers are having a tremendous impact on the industry as shown by the fact that in 1996, the 300 top banks, which represent only 5% of the total US banking entities, controlled 70.5% of the total US deposits of $3.1 trillion.
- This trend is expected to increase over the next few years, resulting in the top 300 banks controlling 85% of the total US deposits.
- It is expected that commercial banks will form into several distinct niches, based on the products they can offer to their customers.
- The large national banks such as J.P. Morgan, the Bank of New York, and Banker's Trust are shifting their focus toward investment banking services, which they afford to offer because of their size and resources.

- Larger regional banks are focusing on consumers for the bulk of their customer base. They have the ability to offer the latest technology to consumers more effectively than smaller banks and they appeal to consumers because of the wide availability of branches and ATMs.
- The small community banks will most likely end up with the bulk of the small business loan segment of the market. They have the ability and background to develop relationships with small businesses within their communities, which is quite difficult for national and even some regional banks.
- Securities and Brokerage firms are another part of the industry that has seen many changes ,due to deregulation and technological changes. Firms have been forced to compete not only with other investment banks, but with commercial banks as well.
- Consumers are becoming more aware of the need to contribute to their retirement, thus the popularity of 401(k) plans has increased, leading to an influx of money into the capital markets.
- With the increased usage of the Internet, online brokerages have become popular. Between 1996 and 1998, the number of online brokerage accounts increased from 1.5 million to over 5 million and is expected to continue to increase to 14 million by 2002.
- During 1998, an estimated 27% of all stock trades were placed by online investors with the average commission for a trade placed online being $16.

American Express

- American Express provides travel-related services, financial advisory services, and international banking services.
- The travel related services segment is the world's largest issuer of charge cards and traveler checks.
- American Express Financial Corporation and its marketing subsidiary, American Express Financial Advisors, sell life insurance, annuities, investment funds, and financial advisory services.
- In 1994, they spun off their investment-banking segment as Lehman Brothers.
- American Express' current strategy is to focus on its credit card and corporate traveler business segments.
- Spending per cardholder is increasing due to an increase in reward programs and an expansion of merchants.
- Net income increased to $2.14 billion in 1998, up 7.5% from 1997.

- ROE was 24% in 1998, up from 1997.
- American Express has long term targets of:
  - 12-15% EPS growth
  - At least an 8% growth in revenues
  - ROE of 18-20%
- Warren Buffett owns an estimated 10% of the company.

Wells Fargo & Company

- Wells Fargo has six primary business lines: retail and business banking, investment services, real estate lending, consumer finance, mortgage banking, and international trade financing.
- They are the 7th largest bank holding company in the US.
- In November of 1998, they completed a merger with Norwest Financial Corporation, making the new entity the #1 mortgage banking company in the US.
- They operate 2,800 branches and 4,350 ATMs in 10 Western states
- In 1998, revenues increased 112% to $20.48 billion, and net income rose 44.3% to $1.95 billion.
- Wells Fargo is on the edge of technology as far as bringing new products to their customers. They offer online banking and bill paying, credit sweep accounts for businesses, and online payment services for merchants.

Charles Schwab Corporation

- Charles Schwab has shifted from a discount broker to a more service oriented strategy. They now offer advice and research to customers who are willing to pay extra for it. But the primary business is still discount brokerage.
- They offer automated phone and online investing, futures and commodity trading, IPO access, and investor education materials.
- Half of Schwab's new accounts come from online investors.
- Schwab has 52% of the online brokerage market share.
- The online brokerage market is expected to increase from about 5 million current customers to 14 million by 2002.
- In 1998, revenues were $2.74 billion, up 19% from 1997. Net income was $348.5 million, up 28.9% from 1997.

Oil Industry

In a commodity industry, we do not expect any company in the oil industry to gain sustainable competitive advantage by product differentiation or market focus in the US. However, we do foresee several opportunities worldwide as new markets undergo privatization that will provide us with a respectable return.

Traditionally, stocks of oil companies follow the demand and the supply of oil instead of the overall market. For example, the declining demand in Asia has hurt the oil price to about $10 a barrel in 1998, which was lower than the real price of oil in 1973. Since then, the oil has recovered to $13 a barrel, which is a 30% increase in price. As a result, the S&P Oil Composite outperform the S&P 500 in the same period. We expect the price of oil to remain around the $13 to $15 ranges, so we do foresee additional stock appreciation in our oil company. For the long-term, we expect the price of oil to remain soft at its current level, and expect the earning growth came from efficiency operation and economy of scale.

The downside to this investment would be a low oil price of $10 a barrel. However, we do not expect the oil price to drop significantly than its current level as Asian economies recovered. First, if the oil price continues to drop below the $10 a barrel level, then the supply of oil will also reduce, as many oil producers will not be able to profit due to their higher drilling cost. In Russia, North Sea and North America, the production of oil cost is as high as $10 to $14 a barrel. As we have seen in 1998, the low oil price has shut down wells that used to generate 500,000 barrel a day production. Therefore, the natural balance of demand and supply should help to maintain the current price of oil. Second, many oil companies are cutting exploration budgets by 40% this year, which should reduce the future supply of oil. In addition, the latest OPEC attempt to reduce oil production by 2.1 million barrels a day may help oil to maintain at its current price.

Certainly, the historic performance of oil is less than desirable. Between 1993 to 1997, the risk-adjusted returns were the second lowest of all of the major sectors of the S&P 500. In fact, the energy sector on average generated two percentage points less than the cost of capital for every dollar invested over the period. However, we believe that the worst is over for some of the oil companies that have undergone consolidations. Therefore, we designated a low proportion of our portfolio in the oil stock. Moreover, this oil stock should diversify the risk of our transportation stock.

- Through consolidations, newly merged oil companies have gained synergy in the reduction of operating expenses and increased market shares that should lead to superior return in coming years.
- Oil price has appeared to be ending their 13-month-long slide. Since bottoming out in December, oil prices have risen 30% to $13 a barrel. In the last 2 months, there has been a strong rebound of oil stocks in the S&P oil composite, which had a ten percent return higher than the S&P 500 composite.
- Asia demand is no longer failing and has started to recover slowly. The demand from Asia in not likely to increase quickly, but should recover slowly.
- The current market surplus is estimated to be around 1 million barrels a day. The recent proposal from OPEC is expected to cut over 2.1 million barrels a day. A 50% compliance level to year-end should take out excess supply by year-end. However, the price of oil can not maintain the rising price without high participation.

BP-Amoco

- High earnings growth in 1999, the consolidation included cost cutting synergy that is estimated at $1.5 to $2 billion after tax savings.
- Strong historical earnings growth and price appreciation in spite of low oil price. Between January 2, 1998 to March 1999, the return was 34%.
- The stock prices is expected to increase at annual rate of 18% over 1998 – 2001
- Cash flow is expected to grow at a weaker 9% annual over 1998 – 2001.
- The merger of BP-Amoco would provide the company with experience management skill and strong financial resources for larger projects.
- In chemicals, BP-Amoco has become the third-largest seller of petrochemicals in the world. While results are expected to be depressed cyclically through 2000, returns are set to improve markedly during next upcycle.

Airline Industry

The business of transporting paying passengers and freight by air started in 1912. The industry grew from severing a few thousands in 1930s to over 460 million passengers by the top ten airlines in the US alone in 1998. It has become very competitive after the airline deregulation act of 1978. Since then, airlines were allowed to set their own routes and set their own fares. The cutthroat competition has forced many airlines into bankruptcies since the deregulation. However, the top ten US carriers have solidified their financial strength and market share in the last few years. This industry typically has stable earnings growth and a low PE ratio.

The airline industry is expected to grow as worldwide economic development, population growth, and international trade increases. Moreover, new technology has also allowed airlines to be more efficient and effective in their operations. As a result, the FAA has predicted the number of passengers using air transportation is expected to grow 67% by year 2008. The only concern would be the current buildup of capacity that may hurt the profit margin in the short-term. Therefore, we were very selective in choosing our transport company. The following are some of the industry trends.

- The major airline carriers continue to dominate flights in their hub, since they are able to better server their customers with better schedules and pricing.
- The aviation industry is experiencing remarkable expansion. The FAA has forecasted an increase of 303.5 million domestic passengers between 1997-2008, and a doubling of international passengers in the same period. The aircraft fleet among major carriers is expected to increase from 4,774 in 1996 to 7,226 in 2008. The FAA simply expects more people flying more often in the coming years.
- Continued alliances among major players are expected to fuel growth. The alliances included code-sharing, marketing pacts and flight alliances. This would allow airlines to extend their routes, and increasing load factors on their aircraft without taking on additional costs, such as depreciation expenses, added fixed assets and additional staff.
- There is a concern that the revolution of telecommunication will shrink the business travel market and leave airlines more dependent on low-paying leisure travelers. However, fax machines, e-mail, and videophones can't duplicate the personal relationships or the physical presence. The key is the price.
- The international markets hold the greatest potential for growth, in part because of the expansion of the increasing world trade and the rapid economic growth occurring in many foreign countries. The economic recoveries around the world have provided the time and money needed for international travel.

- The use of world-wide-web and other new technologies has allowed airlines to reduce operational costs. The direct interactions with customers have by-passed the middlemen, travel agents, and reduced the historical commission costs. The ticket-less travel would also reduce the cost of issuing tickets.
- The US carriers plan to increase capacity by 5.6% in 1999, and are expected to be around 5% in 2000. This is much faster than the 1.5% in 1998 and 3.1% growth rate in 1997. However, the growth in demand is estimated to be around 3%. Therefore, there is an over-capacity buildup concern.
- Regional carriers are in direct competition with the major carriers for revenue due to their niche market, lower airfare, and direct flights. However, only one of the 58 startups launched between 1978 to 1990 has survived the rigorous competition.

Delta Airlines

- Stable demand increase of 5% a year for the next ten years.
- Low PE ratio (10).
- The management shakeup two years ago has improved employee moral, financial strength, on-time schedule and lower baggage complains. Additionally, management has aimed to reduce redundancies and unnecessary activities to reduce cost, but to increase customer service.
- It is in the process of improving its fixed-to-variable cost mix. It is aggressively looking to minimize its fixed costs and avoid staffing for peak seasons. Other than US Airways, Delta has the lowest operating expense with the quarter ending in December 1998.
- Airline of the Year by Air Transport World magazine
- The world's most flown airline. More than 105 million passengers in 1998, which is responsible for 23% of all passengers in the US. The code-alliances have allowed Delta to serve a majority of the US market without adding additional assets.
- Delta has the most conservative capacity build up in 1999. It estimated to grow at a mere 3.5% growth, the second lowest in the top ten carriers. In addition, it has focused growth in the Latin America, Asia and European locations, where the growth are expected to occur. In case of a domestic economy downturn, Delta would be affected the least.
- Delta has several equity investments in other successful regional air carriers, such as Comair, ASA, Skywest, Business Express Airlines, and Trans States Airlines. Comair in particular had one of the highest ROE in the industry.

- The company has plans in place to reduce the total aircraft types to three, which also would reduce the cost of maintenance.

Specialty Retailers

As an industry, Specialty Retailers are one of this portfolio management team's top picks for the future. Considered to include stores such as Best Buy Co., Barnes & Noble Inc., and Linens & Things, Specialty Retailers have returned an average of 21.6% over the past 10 years, 20.9% over the past 5 years, and an amazing 71.9%* in the past year (*this number is skewed by the mind-boggling 966.4% return on Amazon.com, which is also included in this industry).

The Home Depot

The Home Depot is a pioneer in the home improvement retail industry. Founded in 1978, in Atlanta, Georgia, The Home Depot is the world's largest home improvement retailer currently operating 742 stores, including 691 Home Depot stores and 7 EXPO Design Centers in the United States. They also possess an international presence with 41 stores in five Canadian provinces, 1 store in Puerto Rico and 2 stores in Chile. The company employs approximately 155,000 people. The Home Depot is credited as being the leading innovator in the home improvement retail industry by combining the economies of scale inherent in a warehouse format with a level of customer service unprecedented among warehouse-style retailers. Each Home Depot store stocks approximately 40,000 to 50,000 different kinds of building materials, home improvement supplies and lawn and garden products. Home Depot expects to be operating over 1,600 stores in the Americas by the end of the year 2002. For five consecutive years, the company has been ranked by Fortune magazine as America's Most Admired Retailer.

- The company reported net sales for fiscal 1998 of $30.2 billion. This figure is up 25.1% over 1997.
- Net income for Home Depot in 1998 was $1.6 billion, up 39.1% over 1997
- Comparable store sales for fiscal 1998 rose 7% from the previous year
- Annualized inventory turnover for fiscal 1998 improved to 5.44 from 5.35 in fiscal 1997
- During the fourth quarter of fiscal 1998, The Home Depot opened a net of 44 stores

Staples

The fast-growing Westborough, Massachusetts-based retailer pioneered selling low-cost office supplies in warehouse stores to companies of any size. They focused on small businesses and consumers. The #2 US office products superstore chain (behind Office Depot) operates about 800 office supply stores (primarily under the Staples and Staples Express names), most of which are in the US and Canada.

Generally located in suburbs and offering about 8,000 office products (business machines, computers, office furniture, and supplies) and services (printing, photocopying) at guaranteed low prices, the Staples superstores generate most of the company's sales and profits. Other businesses include catalog and contract stationery operations, as well as ventures in Germany and the UK.

Staples continues to focus on customer service and aggressive store openings, which have transformed it from a regional player into a national chain. The company has begun emphasizing smaller markets with its smaller Staples Express stores.

The company agreed to buy Office Depot, its biggest competitor, in 1996, but the FTC rejected the $4.3 billion deal on antitrust grounds. Hurt the most by the FTC's rejection of the merger was Office Depot, which had slowed advertising and renovations during the six-month negotiation. Following a failed attempt to buy Office Depot, Staples has ordered up an increase in its catalog business with its purchase of the catalog and contract business Quill Corporation and is investing heavily in its online sales operation. Staples opened about 160 stores during 1998 (one-fifth of them in Europe), with 150 planned for 1999.

- 1999 diluted earnings per share of $0.53, a 33% increase compared with the $0.40 earned in the prior year
- Company to repurchase up to $200 million of its common stock over the next 12 months
- Total sales for the year rose to $7.1 billion compared with $5.7 billion in the prior year, a 24% increase
- Comparable sales in stores open for more than one year increased 11% for the year, the highest in the office superstore industry
- Net income for the full year increased to $238 million from $171 million in 1997, a 39% increase year over year

Conglomerates

In a competitive marketplace where timing is critical, speed and agility in decision making and change implementation are the lifeblood of business, conventional wisdom would lead you to believe smaller is better. However, in an increasingly volatile marketplace, we felt adding a large conglomerate to the portfolio would add to the diversity of the portfolio, and provide stability as well. For these reasons, we chose General Electric to add to our portfolio.

With a peer group containing such names as Textron Inc, Allegheny Teledyne Inc, and Berkshire Hathaway, conglomerates such as General Electric have provided shareholders with amazingly consistent performance over the long haul. Ten-year returns in this industry average 23.3%, up 0.5% over their 5-year returns of 22.8%, and down only 1.2% to their 1-year returns of 24.5%.

General Electric operations include aircraft engines, capital services, lighting, NBC, power systems, appliances, industrial systems, medical systems, plastics, and transportation systems. Owning General Electric is like owning a diversified portfolio of businesses in one security.

GE is a diversified services, technology, and manufacturing company with a commitment to achieving worldwide leadership in each of its businesses. GE operates in more than 100 countries around the world. It employs 293,000 people worldwide, including 163,000 in the United States. In 1998, GE was named Fortune magazine's "Most Admired Company in America" and "The World's Most Respected Company" by a worldwide business audience in the Financial Times.

- In 1998, GE's revenues rose to $100.5 billion, up 11% from 1997.
- Earnings increased 13% to $9.3 billion, and earnings per share grew 14% to $2.80.
- Operating margin rose to a record 16.7%, up a full point from the record 15.7% of 1997
- Working capital turns rose sharply to 9.2, up from 1997's record of 7.4.
- $10 billion in free cash flow in 1998, allowing GE to raise dividends by 17% and to further increase share owner value by repurchasing an additional $3.6 billion in GE stock.
- AAA debt rating

Computer Industry

Computer Industry is an extremely diverse sector that includes anything from hardware to Internet and from mainframes to handheld devices. The Industry has exploded since the 1960's and has been the main driver of the stock market and the economies around the world. It is expected that the technology industry will continue to grow at above average pace for the foreseeable future.

- Tremendous growth potential – Computers and computer-related products have a virtually unlimited growth potential since they clearly enhance productivity of the users and therefore creates true value to users and stakeholders.
- The industry has a number of exciting segments that allow for diversification within the industry.
- Computers and computer-related products have become an absolute necessity in the lives of businesses and individuals.
- The industry is expected to grow at 20% annually.
- The need for computer hardware is expected to increase as the PC become more affordable. The downward pressure on prices has typically been accompanied by a decrease in manufacturing and distributing costs.
- The software segment continues to rapidly evolve. The Government's lawsuit against Microsoft is likely to produce increased competition and therefore lead to greater growth potential for the industry as a whole.
- Internet segment is by far the most exciting. Internet has created a new paradigm and is only in the beginning stages of development. One negative aspect of this is that the lottery effect has been created where investors are willing to pay premiums on Internet stocks in hopes that the stock they bet on will eventually pay off.

IBM

- The company has been able to derive significant returns (78%) from profitable services and software segments. This has decreased cyclicality and improved growth potential.
- EPS are expected to grow at about 15%.
- Non-hardware revenues that are responsible for a major share of profits are recurring.
- PC business should rebound from poor 1998 figures.

- IBM should be able to decrease their expense ratio in the near future and therefore improve their operating margins

Compaq

- Compaq is the leader in the PC segment
- Compaq still has room to improve its operating efficiency as compared with its competitors
- Great opportunity to follow Dell's model of build-to-order systems
- Presence in more than 150 countries
- Strong revenue growth
- Strong brand equity

Novell

- Novell's stock suffers from potential and perceived threat from Microsoft. A cloud of uncertainty is expected to lift in the near future as company gains credibility with investors and government's suit against Microsoft shakes out.
- Novell is starting to experience strong new product cycle and has several award winning products to offer to its customers.
- The company has positioned itself to be a leading participant in the high-growth markets
- driven in part by the surge in corporate deployment of Intranets and extranets.
- Novell has undergone a significant change in top management in 1997. New management has refocused the company and restored stability to traditional networking business.
- Industry leader in the rapidly emerging market for directory-enabled network services.
- Services and consulting business are another great opportunity.

Egghead.com

- 14-year retail history that leads to strong brand recognition and retailing expertise.
- Egghead closed all of its retail stores and operates solely on Internet.
- Egghead.com is one of the top ten e-commerce sites.
- Egghead has a great opportunity to enter new markets such as office products under the existing business model.

- As computer industry continues to grow computer retailing will follow.
- Online retail categories in which Egghead.com participates are expected to grow at double-digit rate.
- US market for personal computer products and software is expected to grow from $145 billion in 1997 to $215 billion in 2001.
- Egghead.com is well established in the less competitive off-price segment.
- Relative to the peer group egghead.com is trading at a discount.

Pharmaceutical Industry

The pharmaceutical industry was because of its outstanding performance and strong standing as the century comes to a close. The typical over-65 patient uses three times as many prescription medicines as a younger patient. With the over-65 group expected to expand by 17% over the next 12 years, the industry should grow as U.S. expenditures on health products climbs past its present $111 billion. Worldwide drug sales are rising at a rate of 8%-10% a year. Warner Lambert, Johnson & Johnson, and Pfizer are all large companies in prime position to capitalize on the promising trends in the industry.

Warner Lambert

Warner Lambert has a wide range of consumer products and pharmaceuticals. They offer a diversified line of products including Certs, Listerine, Schick razors, Dentyne, agents for diabetes, and cholesterol treatments. The company gets almost half of its sales from the U.S. and has operations in 34 countries.

- In 1998 their sales grew by 25% while their net income grew by an astounding 44%
- Net Income has grown 19.25% over the past 3 years annualized
- Earnings per share grew 43% last year

Johnson & Johnson

One of the world's largest and most diversified health care product makers. They operate in three sectors: consumer products (Tylenol, Band-Aid, Reach toothbrushes), professional products (surgical instruments, joint replacements), and pharmaceuticals (cancer treatment, antihistamines). The company expands through acquisitions. They have made more than 30 acquisitions this decade. The smaller firms provide the technology while Johnson & Johnson provides the marketing.

- The stock has consistently appreciated over the past five years
- Revenue has increased over 50% in last five years
- Net Income has grown 18.08% over the past 3 years annualized

Pfizer

Pfizer is a leading US maker of prescription drugs and is one of the world's top producers of veterinary medicine for domestic animals. The company makes consumer health products, such as BenGay muscle rub, Visine eyedrops, and Bain de Soleil sunscreens. Pfizer's drugs include Norvasic (its leading product) for cardiovascular disease, antidepressant Zoloft, antibiotic Zithromax, and Lipitor, a cholesterol-lowering drug co-marketed with its developer, Warner-Lambert Co. Pfizer is jointly developing an insulin inhalant with Hoechst Marion Roussel, and also makes implants and drug-delivery systems. Its health care products account for 85% of sales.

- EPS grew 50% last year
- ROE and ROA have grown consistently over the past four years

International Exposure

International exposure is essential to a well-diversified portfolio. With the U.S. market looking pricey and most foreign markets outside of Europe looking rather cheap, it's is a good time to add some international exposure to our portfolio. We felt that in order to get adequate international exposure we should find a mutual fund. Historically, foreign stock funds have not moved in sync with U.S. stocks over long time periods. We feel that investing a portion of the portfolio in such a fund will enhance diversification while providing the opportunity to boost long-term returns.

The T. Rowe Price Global Stock Fund was selected for this portfolio. The fund's objective is long-term growth of capital through investments primarily in well established foreign and U.S.

companies. The fund invests in well-established companies in a variety of industries in developed, newly industrialized, and emerging markets throughout the world. The fund has achieved an average annual return of 18.52% since its inception on December 29, 1995. The fund has also exceeded the performance of the Lipper Global Funds Average, an applicable benchmark.

The expense ratio of the typical diversified U.S. equity offering is 1.41%, the average expense ratios for the various international-stock categories range from 1.79% to 2.23%, with the foreign-stock group enjoying the lowest ratio and the diversified Pacific/Asia group sporting the highest. Of course, there are some good reasons for the high costs of international funds--such as the fact that it takes more resources to research stocks from all over the world--but that doesn't lessen their negative impact on investors' pocketbooks. The T. Rowe Price Global Stock Fund has an expense ratio of 1.2%. This ratio is significantly lower than comparable funds. The Fund has a category rating of a 5 and the manager responsible for the past success remains in place.

As mentioned earlier, the fund does invest globally and has some holdings in well-established U.S. companies. The 25 largest holdings are:

National Westminster Bank	United Kingdom	1.5%
Wolters Kluwer	Netherlands	1.2
SmithKline Beecham	United Kingdom	1.2
MCI WorldCom	United States	1.2
Nestle	Switzerland	1.2
Freddie Mac	United States	1.1
Glaxo Wellcome	United Kingdom	1.1
Microsoft	United States	1.0
GE	United States	1.0
Vivendi	France	0.9
ING Groep	Netherlands	0.9
Tyco International	United States	0.9
Kingfisher	United Kingdom	0.9
Novartis	Switzerland	0.8
Network Associates	United States	0.8
Diageo	United Kingdom	0.8

Shell Transport & Trading	United Kingdom	0.8
Wells Fargo	United States	0.7
Citigroup	United States	0.7
Telecom Italia	Italy	0.7
Safeway	United States	0.7
Intel	United States	0.7
Danaher	United States	0.7
Bristol-Myers Squibb	United States	0.7
KBC Bancassurance Holding	Belgium	0.6

The fund currently has the following asset allocation:

Common Stocks	95.7%
Reserves	2.9
Preferred Stocks	0.7
Warrants & Rights	0.7

Fixed Income

In conjunction with the overall philosophy of the portfolio, 10% of the portfolio funds are to be allocated to U.S. treasury securities. Treasury securities provide some of the necessary cash flows for the portfolio and provide diversification and stability to the portfolio.