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Thanks RJA!

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posted: Sat Jan 15, 2000 12:32:43 AM
author: RJA <b.auffenberg@att.net>
subject: Denny's Pearls III

Until Denny returns we will have to rehash some of the insights he has shared with us. The following is the third installment and represents his most recent "pearls."

rja (Bob)

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1. There will be no gorillas in the storage business because there is no "open, proprietary, storage architecture." Storage, both on disk and on chips, is a commodity business. EMC and NTAP might be kings but not gorillas. I am long SSTI and loving it, another nugget-king! As of two days ago it became my best performing stock on an annualized basis.

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2. If you wait until the Telecosmic infrastructure is, say 80%, built, QCOM and JDSU will have "normal," "logical," "historic" valuations. They will be selling at 30 to 40 times earnings. Of course, by then, you will also have missed the boat.

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3. If they had said that GBLX has a positive story that they like, I would have no objections. But to arrive at a solid $80 figure, you need a solid time frame, a solid cash flow or at least, a solid earnings stream, all of which is lacking in the report.

I also think that they are way off base (with due apologies to GG). QCOM, JDSU, ARMHY, MUSE, RFMD and SSTI are all better medium term prospects than GBLX. My thinking is that after the Telecosm infrastructure is built out, then we should move our money from chips to service providers—to the cash cows. But that is not now, maybe in 5 years time.

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4. How can you tell if what is currently happening is a bubble or a reasonable bull market? My tape measure is earnings growth.

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5. Everyone with a grill and ground meat competes with MacDonald. Everyone with a store competes with WalMart. What keeps MacDonald and WalMart on top of the heap? Customer satisfaction. Micromuse must insure that they have the most efficient and universal solution in their chosen area. Once they become king of the hill, it is very difficult for others to dislodge them unless they (MUSE) slack off.

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6. Time is money. We all say that we are buy and hold investors but this does not mean that we hold everything that we held 10 years ago. As a matter of fact, we do a lot of trading in our quest to find the "holds." For the time being, the center of interest focuses on the infrastructure build out. Once the infrastructure is 80% or so complete, the focus will probably shift to the conduit cash cows like GBLX, GSRTF and others. A few years after that the focus will shift to some new paradigm that we cannot even think of now. I confess to having a short term bias in the buy and hold strategy. I want to invest now in whatever is most profitable now, not 5 or 10 years from now. I think the low rate of turnover of my portfolio will qualify me as a buy and holder but for me this is not the be all and end all of investing. The object of investing is not to be right. The object of investing is making the most amount of money at an acceptable rate of risk.

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7. RFMD is more focused, is growing faster and has more risk while CNXT is more diversified, is growing slower and has less risk. I own them both!

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8. I agree with GG that storage will grow like crazy. But I don't see anyone making a heap of money from it. Quantum has excellent products, when I buy disk drives I specify Quantum when possible. But this is a commodity business. The model you should use when investing in this market is Dell, WalMart and EMC. Execution, execution and execution will be the three primary stock price drivers in storage.

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9. I am a baseball manager. I have 18 players. Roger has hit 30 home runs this season while the average player seldom gets to 15. There is no way this guy is going to hit any more this year, he must be plain tired! I think I'll put Roger on the bench for a while so he can rest up and I'll field Sam who only has 3 home runs this season which makes it much more likely that he will get a lot because he too must come near the average of 15 a year.

This is what I call a very prudent balancing of my team! I really don't know why we don't win the pennant more often with this scientific team management. Do you?

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10. From March through September 1998 my portfolio lost 20% of its value. The question is, next time this happens (and it will), what will you do about it. My experience tells me that buy and hold is the right thing to do for me. Every time I have tried to trade my way out of a dip I have not done well. But buy and hold only works with stocks that have healthy revenue and earnings growth. I find that a lot of the stocks touted on the forum are long term speculations and these fare badly in dips even though, they too eventually bounce back. It is a question of how much pressure you, the investor, can take.

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11. First off, you must like the story, then the company should be growing sales rapidly and the first or second quarter with positive earnings is, in my opinon, the right time to get in.

I love the JDSU story and it is growing revenues at a 104% clip year over year and it is growing earnings at a 121% clip year over year (pro forma to exclude the accounting fictions like good will).

Can it get better than this?

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12. It's not current prices that matter but future prices relative to current prices! :)

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13. Also, the S&P 500 and Dow-Jones are totally irrelevant to the Gilder stocks. As Louis Navellier said recently, a correction can be triggered at any time and the stocks with good earnings will bounce back like tennis balls while speculative stocks with no earnings will bounce like rocks.

Review your portfolio by all means but look for revenue growth, earnings and, specially, earnings growth. The stocks that have these things will bounce like tennis balls in a correction. The speculative stocks with no earnings you might want to trade in for stocks with earnings. This is the type of rotation that I do all the time, not just when others worry about corrections.

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14. I have spoken to a lot of friends about the incredible returns you can get from the stock

market. Some have invested and others have not.

The ones that did not invest claim that the market is too risky or that they don't have the time and patience. The market is not too risky but you do need to have the time and the patience. And then you need to study and, most difficult, you must ignore the incredible amount of hype and misinformation flying around. Money attracts scum just like garbage attracts flies and you need to ignore the scum and their vile tales. Caveat Investor!

Not all the ones who did invest made good. The ones who did not find a methodical system and instead listened to each latest and greatest idea never did well. For a while I listened to Louis Navellier and did very well. Then I tried to outsmart Navellier using his own recommendations and I did less well. There are many thing that work and you have to find one that suits your style. For the while I have settled on what I call the Telecosmic Value Plays. I listen to GG for technological advice and read a lot of books about the technology and then I pick those technology stocks that also meet sound investment criteria like revenue growth and earnings growth. It is a winning combination with relatively little risk.

It has taken me nine years of active study and hard work to get to the point I am at now. It is not easy but the rewards are sweet. Never did I dream that too much wealth would be a problem I would have to deal with.

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15. When you trade stocks you have three trading costs that a buy and hold philosophy does not have.

1. Broker commissions
2. Spread
3. Family (Uncle Sam)

When you buy and hold stock of excellent companies you are in effect reinvesting yearly with no trading costs using tax free dollars. Buy and hold only works well for growing companies, it won't work for cyclicals.

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16. My top 10 turned into 25!

I already have 15 of these and being a buy and holder, I have to believe in them, don't I? The new ones include storage, Gigabyte Ethernet switches and optical switches. They will place in this order in 2000!

1	JDSU Best bet of the next 5 years
2	GSTRF The market will catch on (fire)
3	MUSE Only software play in infrastructure
4	QCOM Cellular giant
5	ARMHY "ARM inside" everything mobile and intelligent
6	SCMR Only optical switch I could find
7	FDRY Gigabyte Ethernet switches
8	EXTR Gigabyte Ethernet switches
9	JNPR Gigabyte Ethernet switches
10	NTAP Topologically correct storage place
11	SSTI Flash memories are made of this
12	AMCC Chips are US
13	PMCS Chips are US
14	CNXT Modems, modems everywhere
15	RFMD RF in everything mobile
16	NXLK Last and next to last mile
17	NT NT is reinventing NT
18	ATML Chips are US
19	POWI Power management
20	PWAV RF in everything fixed
21	XLNX Chips are US
22	EMC Old gorillas never die, they trash chips
23	CSCO Old gorillas never die, they trash chips
24	GBLX Still has to spend a lot of cash for build out
25	NOVL Not convinced that the market is ready for this

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17. Modern Portfolio Theory (MPT) has some kind of asset allocation model that supposedly reduces risk. While I was using Navellier's MPT Review, I would rebalance the portfolio according to the report. I have to tell you that I left a lot of money on the table by doing that because, in effect, you sell the winners to reach the balance (recently Navellier sold some RFMD because it had grown too much!). With hindsight, this is kind'a stupid!

The Gorilla Game takes a totally different view of asset allocation. It suggests that, instead of diversifying, you should concentrate on the winners because they will be the best performers.

You can see that this is the opposite of what MPT preaches. I am now using the method suggested by The Gorilla Game. I continually check for losers and when I find one, I sell it (I was recently accused of being trigger happy :) and move the cash to a better performer. Some stocks perform so well that they grow to be a very large part of the portfolio (QCOM, JDSU and ARMHY now make up 50%). Since I don't want to overdo things, the cash gets reinvested in good but not the best performers. (QCOM gave me a BIG problem in December :) but JDSU seems to be coming to the rescue :).

This being a bull market, I am 100 to 110% invested (margin). If some money becomes available and I have several new candidates, I usually split the money in near equal amounts amongst them unless one or more of them is some kind of a "dip my toe" test in which case it gets less than its equal share. Then, over time, each stock sort of decides where it wants to be.

But non of these rules are fixed, I play it by ear within this framework

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18. I have recently adopted a fairly strict rule: I only buy companies that are showing earnings. I am no longer buying hopes and promises. This is a very frothy bull market and it is due for a correction at any time. I took to heart Navellier's suggestion that stocks with excellent earnings will bounce back like tennis balls while the ones without earnings will bounce like rocks.

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19. My first take was that storage is a commodity business and therefore dangerous to your wealth. Now I have changed my position a bit, disk drives are a commodity and a danger to your wealth. So, no Quantum in my portfolio.

When I did my "baggerness" piece I discovered, very much to my surprise, that EMC out bagged Microsoft's Bill (robber hacker) Gates, Dell's Michael (just in time) Dell and Intel's Andy (paranoid) Grove. EMC did not just out bag Intel, EMC beat Intel by a 7 to 1 baggerness margin!!!!!

How could you possibly have a portfolio without EMC when GG says that storage will eat up 75¢ of each dollar spent on computer hardware? After reading "The Holy Grail..." it seems to me that Network Appliance has the leading edge in NAS storage even if EMC's market share is growing faster. I will be doing the same as you, if NTAP falters, bye-bye NTAP!

One of the wonderful aspects of this forum is that it makes you do research in areas where you previously had decided who the winners and losers will be. This new research, which unclogs the brain of old and wrong ideas, more than pays for the time spent on the forum.

Next surprise: Cisco Crisco out bagged EMC by 29%!!!! Guess who will be added to my portfolio when I finally figure out the Ethernet and optical switching business?

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20. Moral? I think investing and morality are not related, at least, I don't see a connection.

Productive? I think shorting is just plain stupid because the risk/reward ratio is much less than going long.

- Shorts: The maximum you can lose has no limit (everything) The maximum you can win, if the stock goes to zero, is the amount you invested If the lender wants his stock back, you MUST sell!
- Longs: The maximum you can lose is the amount you invested The maximum you can win has no limit You sell if and when you want

Investing is a question of resource allocation. Short can never equal long in potential appreciation of capital. Simple!