

# J.L. BAINBRIDGE & COMPANY, INC.

◆ PROFESSIONAL MONEY MANAGEMENT ◆

## 2001 ANNUAL REPORT

### INVESTMENT RESULTS

For 2001, J. L. Bainbridge & Company, Inc. achieved a -3.3% rate of return on all money managed. In conjunction with 1994, 1995, 1996, 1997, 1998, 1999 and 2000 returns of 10.2%, 38.4% 20.3%, 23.2%, 29.9% 5.6% and 16.9% respectively, a January 1, 1994 investment of \$100,000 has grown to a December 31, 2001 value of \$350,533 which equates to an increase of 250% over the past eight years. The annually compounded return over the past eight years is 17%. These results assume reinvestment of dividends and are after transaction costs and our management fee.

### INVESTMENT REVIEW

Our 2001 return of -3.3% and our total return over the past three years of 19.4% are well above the market which witnessed declines of -11.9% and -5.4% in the S&P 500 and declines of -21.1% and -11.1% in the NASDAQ Composite over the past year and three years respectively. While both our 2001 results and total return over the past three years exceeds by a wide margin the overall market, we are not pleased with these results because they are well below our 15% annually compounded objective. However we are pleased that our clients weathered this disastrous decline intact and therefore our clients are well

positioned to see their portfolios grow to new heights as we catch-up to our 15% objective.

The market decline over the past two years is the most severe in the past twenty eight years which means the majority of today's investors have never before experienced such a severe loss. These investors have never learned the important lesson of preserving the value of their investment portfolio during a market decline. Our investment philosophy and principles, which focus on reducing risk are directly aimed at protecting clients from a devastating drop in their net worth. Those that threw caution to the wind and embraced the speculative fever that swept through the markets in 1999 and early 2000 have suffered a terrifying decline in their wealth. Unfortunately this faith has not been limited to just young investors. We have met with many prospective clients over the past year that are retired and have seen half or more of their hard earned retirement assets disappear. This is why we pledge to our clients that we will never speculate with their money and will always own only the highest quality growth companies that have stood the test of time. A key to long-term investment success is to prevent the loss of ones money in bad markets and therefore retain the wherewithal to fully participate in the inevitable recovery.

## INVESTMENT STRATEGY

Today investors are nervous and skeptical about the future, and consequently this year's report will focus on our outlook. Ironically when the market is strong, investors become increasingly optimistic, and when the markets are weak investors become increasingly pessimistic. Hence today the mood is glum. However pure logic dictates that as markets reach high levels, risk increases and the probability of additional strong gains diminish and vice versa market declines mean lower risk and enhanced opportunity for strong gains. Accordingly we are very optimistic that the next two years will produce returns well in excess of 15% compounded annually.

This view is based on the following:

- First and foremost the companies carefully selected for investment continue to produce impressive earnings growth and are very reasonably priced.
- The amount of cash held by households is at record levels.
- The massive build-up of retirement assets by the next generation continues.
- The lowest interest rates in forty years coupled with stimulative government spending will bring about an economic recovery.

In aggregate the companies in our portfolio have increased earnings more than 50% over the past three years while their stock price has increased less than 20%. Obviously the current stock market evaluation of these extraordinary companies is much less than three years earlier. An excellent example is Pfizer. Since April, 2000 when Pfizer completed the acquisition of Warner-Lambert, earnings have grown 59% while the stock price has declined 6%. Mathematically this

equates to investors evaluating Pfizer at a 41% lower rate even though its earning growth has accelerated during a period when the vast majority of companies experienced a decline in earnings. Granted two years ago the market stood at a much higher evaluation, and in order to account for the fact the market in the future will not reach such a lofty level, we have lowered our evaluation model by 20%. But even with this lowered expectation, which may not be justified given Pfizer's earnings strength versus other companies, its price appreciation over the next one and two years is 82% and 123% respectively. This is why we are so excited about the prospects for superior investment returns over the next several years.

Due to the concern arising from the devastating market decline over the past two years, American households are holding a record amount of cash. The current value of household savings accounts, money market funds and certificates of deposits is a staggering \$4.3 trillion dollars. This represents slightly more than 20% of the total value of the American stock market. The previous record of holdings as a percent of total stock market value was just below 20% in 1981, which marked the beginning of the most powerful and long lasting bull market in history. In 1981 cash was earning double-digit interest versus the current interest rate of less than 3%. Therefore holding cash today yields almost nothing, and as the next bull market gains momentum a large portion of this cash will flow back into stocks. Given the recent lessons learned from the losses incurred in high risk investments, this money will likely be invested more cautiously into quality growth stocks which bodes well for our investment program.

When the markets were moving higher throughout the past decade market analysts repeatedly stressed the most important factor driving the rise in stock prices was the aging population and the associated

large and consistent build-up of money for the retirement of the “baby boom” generation. This vast amount of money was the reason for optimism, but in today’s downbeat environment this train of thought is seldom heard. However the demand for investments from the significant and unprecedented accumulation of retirement assets for the next generation of retirees will continue for the next twenty years. This constant source of investment funds will provide an underpinning of the stock market and will translate into strong long term investment results.

Since the economy is not facing any major long term problems such as the high inflation and high interest rates of the 1970’s or the large government deficits of the 1980’s, the economy is well positioned to rebound in 2002 as a result of the aggressive interest cuts in 2001 and the current increased government spending. However due to the excessive capital investment and subsequent over manufacturing and service capacity in the technology and telecommunications industries that occurred over the past five years, the recovery will be modest. In addition the recovery will be hampered by sluggish growth in Europe and economic problems in Japan.

Historically during the early phase of an economic recovery, the stocks of economically sensitive companies such as automobiles, machinery, paper, technology, etc. out perform both the market in general and traditional growth stocks in particular. In the past month these groups have appreciated more than our growth stocks, and if history is a good guide this trend may continue for awhile. Intel is a perfect example of the risk associated with a dive back into technology. Without a doubt Intel is a great company, but its stock is not cheap and its return to high profitability uncertain. Over the past two years sales have declined 26% and competition in its markets has increased dramatically. Thus a return to the level

of sales in 1999 may bring lower profit margins because competition will dictate continued price discounting. Today Intel’s PE on projected 2002 earnings is 57. Any negative news on the earnings outlook would cause the stock to drop precipitously. The same risk is inherent in the above referenced cyclical industries. A slow economic recovery will produce little profit growth, which will inevitably lead to investment funds flowing aggressively into the few great growth companies posting consistent double digit earnings increases.

## CONCLUSION

Achieving a 15% return over the five year period 1999 through 2003 will require returns of almost 30% in each of the next two years. To be perfectly honest getting back to a 15% trend from 1999 forward may take more than two years, but the good news is it is achievable in two years in that our portfolio has the potential to appreciate 52% and 74% over the next one year and two years respectively. Whether the goal is met by the end of 2003 time will tell. But let us assure you we are committed to our objective and totally confident our risk adverse growth investment program together with the favorable investment outlook described in this report will bring us in line with 15% annually compounded growth within the next few years.

In accordance with SEC regulation, a current copy of our SEC registration form ADV Part II is available upon request free of charge.

PRIVACY POLICY: J. L. Bainbridge & Company, Inc. policy is client information is private and is not shared with any individual, organization or firm.

# ENHANCING CLIENTS' LIVES

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At J.L. Bainbridge & Company, Inc. our business is dedicated to “enhancing clients’ lives” by providing long term professional money management service totally focused on helping clients finance their children’s education, build and preserve the resources for an enhanced retirement and achieve a meaningful higher standard of living.

The foundation of J.L. Bainbridge & Company, Inc.’s business philosophy is based on the full understanding that our future and success is completely dependent on client satisfaction and delivering to clients a consistent long term investment service of the highest level of quality, competence and integrity.

Our commitment to “enhancing clients’ lives” is a guiding light that governs our professional daily activities and demands every decision and action be assessed as to exposure to investment risk as well as the long term benefit to clients.

**J.L. BAINBRIDGE**  

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**& COMPANY, INC.**

Managing more than \$150 million for over 600 clients nationwide.  
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