



Chapman, Spira & Carson, LLC

Securities

How to Make It in the Stock Market

(or the Theory of the Inferior Person strategy)

Edited by William Noe

Since the most recent stock market implosion began, I have been approached by many of my friends and associates and asked this question: what the secret is to my consistency of getting into and out of the stock market at just the right time? As we saw in the most recent 10-year run up, selling too early could be disastrous for most people, especially money managers.

Being wide of the mark is not too hard to live with if you are a financial commentator who is paid to look appealing, talk logically and say things that sound like they make sense in spite of the fact that they are usually *non-sequiturs* or worse. In the media game, no one keeps score of the results, and the only thing that is in question is the show's ratings. If the networks had hired well-groomed mongoloids who drew high ratings, no one would care one way or the other that these people did not have a clue as to what they were talking about. In addition, no one would care about whether these dolts ever picked a winner because there wouldn't be a scorekeeper within shooting distance. in sight.

However, with the mutual funds, hedge funds and money management advisers, it's quite different. Any blood being spilt is readily apparent and the record of their winners and losers is firmly etched on the great scorecard in the "Journal" – and there is no possible refuting their record, in spite of a highly proficient cadre of artful public relations people engaged to make the results take on a brighter hew.

This transparency triggers certain problems, of course, the foremost one being the fact that as the identities of the superior stock-pickers become unambiguous, money seem to gravitate towards those people like a magnet in a body shop. in that direction. However, the more funds that a manager has under management, the less flexibility he has, no matter how much he argues that the contrary is true. Moreover, sizeable positions often cannot be completely accumulated before reporting periods come due, and when it is announced that so and so, a highly successful money manager, has been buying a particular stock, everyone wants to jump aboard at the same time. The stock runs up, and the manager is forced to go back to his research department to find something else to buy. Sadly, this often comes to pass only after substantial investigation into micro and macro economic factors have already been thoroughly examined, which takes a substantial amount of time and effort. When this happens, the cat may well have gotten out of the bag far too early, and another investment direction will have to be sought.

Moreover, another problem for investors and managers is the determination of when a “bull” market has risen too high. Historical patterns are often excellent guides in predicting what may take place in the future, but some of the smartest people on earth have wound up in bankruptcy court using this tried and true prescription for financial success. James Leeson, the young man who brought down Bearings, the oldest bank in England, was only following historic patterns when he went down in flames speculating in the Japanese stock market. However, there was no transparency in Leeson’s positions, as he was overseeing himself by also running the “back-office” while placing mind-bending securities bets in Singapore. Had others been monitoring his positions, it is more than likely that he would have been stopped in his tracks and Bearings would be with us today instead.

Another sterling example of an entire firm failing by the historical numbers is Long Term Credit. In spite of the fact that this hedge fund employed an accumulation of brains, the likes of which in the investment business had never been seen before (at least on this planet), their management bet so disastrously wrong that they almost collapsed the entire global economy, quite a trick to accomplish. If it were not for super-fast action by the New York Federal Reserve and many of the large Wall Street Firms who realized the scope of the catastrophe, this country would probably now be mired in a depression because of the fallout.

So, it appears that even if you put the world’s smartest people together and they follow historically successful investing patterns, stock market success can still be elusive to say the least. How can you, someone with far less resources, possibly be assured of stock market success when the elite can’t seem to always get it right? The answer to that question is not as challenging as it may appear at first glance, but then we would be getting ahead of our story and that is certainly something that we don’t want to do until other possibilities have been explored.

Smart people are smart because they occasionally do very smart things, and that is what sets them apart from the rest of us. However, there are also smart people who do make errors in judgment, perhaps even only one time, however, once may be more than enough and if it is, they are instantaneously relegated to the Hell of the Mistaken. Only a select few of the market’s most savvy players were able to get out of their positions before the Crash of ’29. What set them apart from those who were equally canny, but somehow lost everything? Let’s examine a case history.

One of the lucky/skillful few was John D. Rockefeller, and when he was requested to put his reasoning into perspective, he put his efforts into perspective. He said that he was getting his regular shine in front of the Exchange on a pleasant enough day in September of 1929 when his regular shoe shine boy looked up at him and said that the “pool” was going to move RCA up fourteen points that day (or words to that effect). Rockefeller listened carefully without uttering a word, scrutinized the market’s action that day and when he saw that amazingly, the shoe shine boy had indeed been correct, Rockefeller immediately liquidated every stock in his investment portfolio. He pointed out that the day when the chap that shined his shoes knew more about what was going to occur in the stock market than he did, it was certainly time to get out and do so in a hurry.

There is little issue that following Rockefeller’s moves that day would have been a capital idea in more ways than one, but you also could have easily kept an eye on a raft of other equally well-known speculators and had your head handed to you during that period as most of those that got creamed, hung on till the bitter end believing the market would come back. As in the case of all market crashes, substantially more people were wrong about what was going to happen than were right, and the odds would have been heavily stacked against you. Keep in mind two issues, the fact that the stock market can often cause a recession by going down because of the enormous amounts of money that are taken out of circulation. Most people tend to count stock market profits as money in the bank even though the stocks have not been sold. In 1929, this was not much of a push as price-earnings on stocks were unreasonably high, people thought that the market was going to go up forever and margin loans often ran 95% of equity.

Those that hold themselves out as experts usually have an axe to grind and following them can often be suicidal. During this period, the president of Chase Bank shorted enormous amounts of his own stock while telling the world what a great buy it

was. However, during that period, his falsehoods were the exception not the rule. However, in earlier days, following the likes of stock market experts/conmen such as Fisk, Gould and Vanderbilt would have turned into a disaster. Great fortunes soon became inconsequential ones after the dirty trio had finished weaving their magic. They were great at making money for themselves, but fundamentally they were for the most part in the printing business and would churn out new shares for one of their companies as fast as their printing presses would operate. At the time, no one was keeping track and the government didn't seem to care. In addition, the SEC didn't come into existence until the 1930s.

These robber barons were really in the business of printing the equivalent of money (freely tradable securities), and the more they printed the less each certificate was worth. (There were no registration statements required on new corporate offerings and there was no holding period requirements) Thus they were in the business of making investors poor instead of rich and they did it with aplomb. In order to be truly wealthy, one must be totally paranoid and have a disinclination to share any portion of your wealth. It is a given that you should never count on wealthy people to throw you any kind of a bone no matter how diminimus unless there is something substantial in it for them. Giving away something for nothing is diametrically opposed to how these people achieved their wealth in the first place.

Anecdotally, there are other stories that support the theory of what you see is not necessarily what you get. Let's take a cautious look at the chronicle of the English Rothschild family's greatest *coup* when searching for a prime example of financial *legerdemain*. The legend has it that Wellington, The Iron Duke, was just about to engage Napoleon and his armies at Waterloo. Moreover, it was an acknowledged fact among the English gentry that if the Duke was vanquished or even bloodied, England would be set back a number of centuries in terms of progress and their stock market would wind up in *shambles* or worse.

However, conversely if Wellington won, the economic state of affairs for England would have turned spectacular to say the least. Their was no question in Rothschild's mind that this uncertainty offered the prospect of his making a humongous killing and he armed one of his observers with his trusty, family trained homing-pigeon and bought him a first-class ticket to the battle as an observer. When it became evident to Rothschild's agent that the Duke of Wellington had been victorious, he released the pigeon carrying the intelligence of England's victory back to England and the Rothschild's literally weeks before anyone else would receive the intelligence that the battle had even commenced.

While that is a pretty good start, that isn't the whole story by any means. As we know, Rothschild was extremely shrewd and knew that if he immediately started to purchase stocks, everyone else, seeing what he was doing, would follow his lead, thinking correctly that he had inside information on the battle's outcome and that Wellington had been victorious. After some thought, the Baron came up with a brilliant alternative strategy, he instructed his brokers to start unloading everything in sight. When people caught wind of the Rothschild family's heavy selling, a panic ensued and prices soon collapsed. When the dust had cleared, Baron Rothschild not only had covered his shorts at bargain basement prices, but also accumulated an immense long position, and no one yet was any the wiser.

Both the Rockefeller and Rothschild stories make two critical points, the first being that one should believe only some of what one sees and none of what one hears. The first is probably more important: as the is not much question that you can bet your last nickel that ultimately the public (meaning the majority of the investment community) will be wrong, so if you are always following the experts, you will be most certainly be doomed to a life no better than an average subsistence. Thus, it is most important that one must keep one's own counsel if you want to stand apart from the herd. Others will only attempt to send you down paths that will lead you to anguish and worse. P. T.. Barnum summed up this philosophy to a tee with his statement that there is a sucker born every minute. Barnum took it as his God-Given mission to fleece every single one of these people. We are very lucky that Barnum never discovered the opportunities available in the financial markets for a man with a great story.

Not only do we always run the risk of being deceived by those that we believe are friends but extraneous events can even offer more pitfalls. Moreover, Having said all of that, we must admit the global investing world has become infinitely more complex and there are too many undecipherable factors to reflect upon when attempting to evaluate which way the stock market is going to go. Even such factors as wars breaking out can not always be interpreted without running into substantial

complexities. Large wars cause resource reallocations, price controls and increased taxes but small wars offer opportunities for economic growth. Thus, if one can be certain that a war will last for a while and stay constrained within reasonable boundaries, much money can be made. Nevertheless, as occurred in Europe in 1914, small wars often unexpectedly become large ones and whole countries can get chewed up in the process.

The old rules just don't seem to apply in the new economy, and the new economy becomes somehow ever newer almost daily. By the time we have figured out what will happen under one technological scenario, that technology usually becomes as hackneyed as yesterday's news or the investing in tulips during the period of that craze in Holland. For investors it has become important to carefully consider that both economic theory and market psychology evolve briskly, and the path they follow is often circular and follows no clearly discernable path.

A sterling example of this would be the circular investment theory that evolved shortly after World War II. It held that inflation and common stocks were synergistic and therefore were natural allies. At the time, there was certainly a lot of logic in this approach, moreover, the study of economic dynamics had not yet reached the heady environment that it has attained today. The theory held that as inflation amplified, underlying assets cost substantially more to replace, which certainly made sense at that time.

In addition, everyone seemed to accept that inflation caused prices to rise which in turn allowed margins to increase. In theory, earnings would rise, margins would improve and assets would grow; an excellent case for solid stock market performance. Many economists at that time stated that the more inflation the country experienced, the healthier things would be for the stock market. At the time, common stocks were literally christened, an insurance policy to protect one's assets against inflation, and investments in them was a requisite not a choice. The ultimate disproof of this hapless theory occurred during the misguided Carter administration when interest rates hit 20% or more, loans defaulted, businesses could neither borrow money or afford it if it was available and the stock market tanked.

Moreover, as time passed, this country's reliance on heavy industry waned and service industries became relatively more important. American manufacturing increasingly was done offshore, and a company's assets became a less critical balance sheet item when money managers examined a corporate balance sheet. All of the capital expenditures that had been made in the industries such as steel making and telephony had to be written off. The new wave of management practices had become one of examining the potential of company's ability to increase its productivity and bring increased earnings to the bottom line as opposed to endlessly building fixed assets. The job of squeezing more and more out of less and less developed into the newest economic rage and whenever the market perceived that a bloated company was bringing in highly regarded new management that were perceived as being capable of cutting fat, investors gravitated to the stock like hogs after garbage. Billed as such a person was Chainsaw Al Dunlap who epitomized this ability in the public's eyes. He and those like him became viewed as corporate saviors.

This was a man that had gained a serious reputation for cutting costs to the bone, however in retrospect it appears that he did it through the help of a series of inconceivable fabrications that he created that no one ever bothered to check out. Someone should have gotten the message when the news came out that Dunlap had left a good portion of his estate to his dogs. When the smoke had finally cleared, Dunlap became rich while in the process firing workers, bringing in products that didn't work and posing for the financial journals and talking about his success while running Sunbeam. Dunlap had unduly enriched himself at Sunbeam's expense, totally destroyed what was left of the company, fired most of its workers, destroyed its product image, buried its investors so deep that they could no longer see the sun come in the morning and burnt the banks that lent him money. He disrupted so many people that he became afraid for his life and in order to protect himself he purchased a heavily gated and guarded estate in Florida. Chainsaw Al had accomplished all of this faster than you can get a "go to jail card" in a game of Monopoly. When the government is finished with this financial pervert, it is no stretch to believe that Al will be spending a good portion of his remaining years behind bars, however, when it was announced that he was going to run Sunbeam, investors flocked to the shearing pens by the thousands. These folks will be cheering when they lock Dunlap up, but they will be doing it from the local poorhouse.

Seeing that the tried and true investment theories were not working, corporations turned to recent “B” school graduates (disaffected medical school students who thought they could do better in the corporate world) who were placed in responsible corporate positions, soon incorporated enhanced inventory controls, which required substantially reduced the strain on corporate treasuries and while this played havoc with the corporation’s gross assets, it was groovy when it came time for earnings to be reported. This was copied directly from the Japanese who had developed a theory of “just in time inventory” which they said was the reason that they were going to be able to conquer the world in an economic sense. During that period they were buying most of the golf courses and commercial building in the United States along with making substantial purchases of art, jewelry and small nations.

Those of us in the United States soon came to believe that the Japanese indeed had accomplished in economic war what they had lost in battle. In our minds we became a second class country. American industry started to copy the Japanese theory of inventory management. However, Japan was a country where there were never any worker’s strikes as this was considered an act against both god and country to go up against ones “employer for life”. This made the theory work in Japan, however, when the same experiment was attempted here, it was soon found that when the people that were supplying Ajax valves in Pomona went on strike, General Motors was forced to close their plants in Detroit. We soon became a country where \$3 parts were deterring whether our gross domestic product would rise or fall. This minor miscalculation caused the loss of enormous amounts of money in both the stock market and in industry.

However, the “B” school prepubescents had done so well with cutting down on inventory that they next turned to the task of eliminating people from the workplace, a thankless task at best. They concentrated on the area they called telecommunications and soon the number of Human beings answering telephones declined as they were replaced by wonderful machines. These machines asked an endless series of choppy questions that seemed to go on endlessly before totally cutting the customer off. This did not make any friends and people deserted the products in droves. Another ploy was attempted which consisted of having service calls answered in exotic locations such as India, Cambodia, Vietnam and Pakistan. These people were paid only a fraction of what the American’s had earned in the job but were conversational disasters. While the jury is still out on this amazing concept, there is no question that the people that were thrown out of work will not have the money to buy American products and the age old workable theory which has to do with the recycling of money will eventually be the demise of a substantial part our industry.

In spite of people being fazed out whenever possible, flexibility replaced sloth-like imbedded management, and electronic advances allowed hands-on management to work on a global basis. Michael Milkan was among the new bred that gravitated to “The Street” looking for riches and soon thereafter, thanks to his superior investment theories, the Savings and Loan industry collapsed in a heap taking both Wall Street and the entire American real estate market down with it. The bail out that ensued required billions of dollars and created a raft of new legislation to prevent this from ever happening again and Milkan wound up in jail.

However, Milliken was only a flash in the pan when it came to leading investors astray. Corporations discovered that by managing their earnings, Wall Street would pay a higher price for their shares, financings would be easier to do and management could extract substantially more money in salary and benefits than had ever been conceived before in history. However, the managing of earnings is against the law and there were always the accountants that had to be dealt with. The general feeling was that the bigger the accounting firm, the greater their integrity. However, the accounting firms were caught in the earnings spiral as well and had added consulting services to their quiver as another source of revenue. Before very long, this adjunct in many cases was bringing in more cash than were the ordinary accounting services. In many cases, there seemed to be a direct correlation between the non-accounting services that were purchased and how well the accounting firms were able to create solid earnings growth, from year to year.

Eventually, so many frauds were uncovered that the SEC stepped in and demanded that the consulting firms be spun off and that accounting practices be tightened. During this period, the accounting firms paid out billions of dollars to investors that had been misled by their aggressive misrepresentations. Besieged by accounting fraud, technological changes, and investors lawsuits, the stock market became a battlefield. Anyone who wasn’t totally awake during this period did not see the end of massive meat packing plants, steel manufacturing complexes and endless production lines. The United States had

quietly gone from being the world's largest producer of goods into the world's largest producer of services and it happened in a very short period of time. The stocks that made up the Dow Jones Averages started being replaced because they were no longer representative of either the economy or the stock market. In essence, slimmer more efficient companies replaced the behemoths of the early post-war years. The fast afoot were able to make money during this period but some of the old guard, not wanting to accept the fact that their way of life had disappeared along with the Doo Doo Bird, were sent out to pasture with a few less chips than they had before.

So the theory of "keep your money in blue chips and everything will be alright" also went by the boards, as heavy industry crumpled into a heap. The philosophy that you should keep your money in blue chips was all well and good, but who was to say what a blue chip was at any given time. In an environment that was changing faster than Clark Kent in a phone booth, the Xerox's and Polaroid's of the investment world, star performers of another generation became unwieldy dinosaurs in spite of the fact that they represented the second generation blue chips. These companies had led the evolution of thinking from low tech to high tech, but the pendulum continued to swing ever faster as well and their managements were not up to the task

Foreign competition, which had never represented a serious factor in an America which had primarily been isolationist since World War I, now had become a factor to be reckoned with in our economy. Xerox became a philosophy, rather than a company, and the Japanese had them for lunch. Polaroid lost their fearless leader when the fabled inventor of the self-developing camera retired, and then shortly thereafter died.

At about the same time, securities analysts determined that the hitherto exciting investment philosophy of investing in what they considered to be "one decision" companies were not as great a theory as they had been touted to be. Analysts had been espousing the unusual premise that the more simplistic a company's product line, the lesser the number of decisions managements would have to formulate. This in turn would lead to less surprises for investors and far fewer things that could go wrong. However, the investment community failed to take into consideration the fact that when you are dealing with a one product company, or even a one industry company such as Xerox was at the time, you were increasingly betting the store on a narrowly based house of cards. Eventually, the premise of less decisions being the superior way to go was revisited and found substantially wanting.

This theory of less being more was soon replaced with a portable form of centralized management. Investors applauded the fact that recent substantive technical advances have made it possible for chief executives to now oversee their domains from anywhere on the planet. Investors were overjoyed to know that this allowed top management to stay in touch with division heads on a consistent basis, and the financial world gravitated toward name brand chief executive officers who prowled the globe looking for transactions.

The new world of making deals now consisted of finding a country run by a despot, paying him off, employing the people at coolie wages, providing them with no benefits and paying the country no taxes. Soon there was a conga line of corporate jets flying hither and yon, attempting to coral dictators and hopping to bring them into their corporate family. As it turned out this was hardly a difficult thing to accomplish. Despots who had never been invited to dinner were now regulars on the social circuit as multi-national executives attempted to get into their pants. Suharto or Indonesia, Mobutu of the Congo and Erap in the Philippines were able to garner very substantial amounts of their country's gross domestic product and find offshore banks that were pleased to accept that illegally gotten gains.

This marked the inauguration of the "era of conglomeration". Once again, big became better and heroic management types formed monoliths such as International Telephone & Telegraph, Teledyne and Gulf & Western. The investment community was truly whelmed to say the least. For a time this inherently flawed type of investment theory was somewhat successful, with the market obligingly putting a high multiple on this type of global leadership. Senior officers of these companies started to become rated by the number of miles that they were able to chalk up to their frequent flyer accounts. Thus, these companies with stocks selling at prodigious price earnings ratios were able to take over companies that were trading at a

much more reasonable levels, making the theory of bigness and bulkiness a self fulfilling prophecy and a winning stock market strategy. This was a theory somewhat akin to the more recent rollup philosophy which is a story all to itself. We will digress.

This new found vehicle succeeded conglomeration as the way to go. The companies that were rolling up an industry (rollers) were always on the lookout for private companies that they could buy (rolled) at prices substantially below their own price earning ratio. The public thought that this was the greatest idea since sliced bread. However, as with all fads, it soon became apparent that the rolled were basically folks that owned small businesses in their own communities and who had no exit program available. Getting stock from these large companies was like getting manna from heaven. They couldn't wait to get out the door and retire to the good life in Florida. The rollers soon found that these businesses which had been doing so well previously were now floundering without local management. Marvelous sounding ventures such as Four Seasons Nursing Homes and International Funeral Parlors soon collapsed in a heap, the stocks collapsed and a number of Wall Street types were given free room and board by the Federal Government for their troubles.

Meanwhile, back at the ranch. However, too many companies picked up the conglomerate cudgel, and soon everyone worth anything had been conglomerated. The barrel of potential acquisition candidates had been abruptly drained, and the conglomerates were left with only the internal pruning, zapping their sales and cutting their expenses in order to show more consistent growth. Even if the managers of these conglomerates had been superb administrators (which they really weren't), this theory of helter-skelter investing did not lend itself accepted good management theories, if only because it turned out that everyone involved in every company that was acquired had their own sweetheart deal with the parent. More often than not, the high paying jobs-for-life contracts which were glibly entered into did not give management much flexibility in critical cost saving strategies. Left with little flexibility and expenses that could not be pared, it did not take long before conglomerates became a bad word, one which hardly anyone even uses today.

The conglomerate nomenclature has more recently been replaced by what we now call "multinationals." Before we begin our multinational tirade, in all fairness we must state that there is a degree of unfairness in this one-size-fits-all approach to defining an industry. Many of today's multinationals have learned how to stick to their own knitting and have been successful on a continuing basis, one such example being Nike. Sure, their earnings rise and fall like the tide, and they sometimes get bad publicity for using slave labor. This success however is based on these companies continued abilities to find overseas hosts that will allow their wage costs to remain "rock bottom," the environmental concerns invisible and their taxes in the host country to be non-existent or less (actually, taxes are paid in the form of payoffs to critically important people as we have covered before).

However, this group of companies will soon be sorely tested by China, which is taking a much more proprietary role relative to its industry. China is globally unique having the lowest wages around (i.e., slave labor) and is not a dictatorship in the normal sense of the term. Even Japan, whose companies historically have manufactured products in plants owned and run by their citizens in Japan have succumbed to China's deadly but economically sensible short term solutions. For the first time in its industrial history, Japan is now having proprietary products made in China, using Japanese name branding, with little or no Japanese presence in the process at all. As China enlarges its reach, no one can possibly predict what the equation will be when the smoke clears.

Other multinationals look amazingly like their tarnished forerunners and on the surface appear to be a hodge-podge of unwieldy companies tied together by so much mucilage. General Electric and Cisco are interesting illustrations of this. Cisco issued its stock in exchange for that of promising concept companies like it was going out of style. They announced that they had paid prodigious prices for the acquisitions but in the ensuing stock market collapse, many who thought they had become instant billionaires were relegated to becoming hopelessly confused centa-millionaires instead. Cisco bought excellent technology for highly inflated paper and if business recovers, should be able to capitalize on their good fortune. However, a rush for the exits occurred when the stock market collapsed by all investors and acquirees alike and when the smoke had cleared, investors had lost billions. In addition, a company that had for a short time become the most valuable in the world had its mere survival questioned and its flurry of acquisitions came to an abrupt and screeching halt. Billions of

dollars had been lost in a matter of only a few months and there is still a question of whether this company which was considered one of the best managed one earth will be able to regain its composure.

General Electric fell into another sort of trap. Its CEO, Jack Welch, a man often spoken of in hushed tones as the greatest corporate manager that ever lived was about to retire. He determined that as a fond farewell to his investors he would make one of the largest acquisitions in corporate history. Welch should have left well enough alone and retired on the top. Strangely, Welch learned that in this modern day economy there are a lot of extraneous folks that have to approve acquisitions. Some of these people live in Europe and make up what is now known as the European Union.

These supposedly unrelated people determined that while the deal made a lot of sense in the United States, it was anticompetitive in Europe and threatened General Electric with all types of counterattacks should they go ahead with the proposal. General Electric tried their best to reason with the people whose bacon we had pulled out of the fire in two World Wars but to no avail. Jack had been hoisted by the European petard, a truly amazing turn of events. Honeywell investors lost millions and it is possible that the company will not survive this turn of events and Jack Welch's retirement party has been totally ruined. In the old days, we would have gone to war before caving in on something of this nature but were are living in a different sort of world today And stranger things are going to happen.

Historically, the economies of other countries has had only limited effect on the financial system of the United States because this country was capable of producing almost everything necessary for its own needs and we had the natural resources available to back up that isolationist philosophy. This was proven in exacting detail when during World War II, this country's sources of rubber, sugar and copper were severely restricted. However, it did not take very long before substitutes were created that worked almost as well the natural stuff.

When the war ended, a different story started to unfold. We had began to believe that our natural resources were unlimited and that substitutes were just, that, substitutes and Americans were entitled to the real thing and plenty of it. With this type of thinking, it didn't take very long until America's energy needs outstripped its production abilities. In recent years, the United States has gone from being a natural resource and manufacturing powerhouse to a nation of limited resources and outmoded factories. We call ourselves a service economy and as long as things continue the way they have been, this may be alright, however, keep in mind that there is a substantial risk to putting ourselves totally at the mercy of those that could become our enemies under different circumstances. It is difficult fighting a war only with telecommunications and computers and will be most difficult to use logs to heat our homes.

America has become particularly dependent upon outside sources for raw materials, low cost skilled labor and high quality manufactured products. In many circumstances, such as shipbuilding and mass production, the U.S. is no longer a factor. If it were not for "made in America" regulations relative to government purchases, many industries would have ceased to exist altogether. Should economic or political upheaval effect America's foreign sources, there could be substantial dislocations within the economy.

An excellent illustration of this is the recent resurrection of a seemingly dead but not buried OPEC which has sent oil prices screechingly higher. When this volatile organization is able to fully pull itself together, it is just about capable of controlling the price the world pays for gasoline at the pump. Luckily for us, these folks that make up the membership of OPEC are not always the best of friends, and the economists guiding them are often misguided at best. Thus, their decisions have for the most been bungled, and they are consistently misjudging economic truths.

For this reason, the situation here is extremely dangerous, because any major misjudgments on OPEC's part can cause a global recession such as the one that we now find ourselves in. If you can remember back to 1973 when the Arabs last

played the “oil card” you will recall that the world was sent into a recession, long lines extended in front of gas stations, the stock market collapsed and interest rates soared. Obviously even a slight deceleration of oil spigot’s flow and thereby increasing its price can throw international economies into recessions, substantially bringing down the use of oil and making economical, alternative fuel usage, perhaps even causing the resurrection of nuclear power and other alternative methods of extracting energy. However, this is always the talk when we are squeezed by the Arabs and we always start passing laws, giving incentives and running around in circles while doing strange things. Windmills have made their reappearance during these periods and other crackpot ideas will rise their ugly heads once again. Certainly, we will continue to subsidize the turning of corn into energy in spite of the fact that it is economically not a logical long term solution. Temporarily, certain industries will prosper that should have been left for dead, but many investors will buy into them and will be the worse for it.

However, the literally limitless tar sands available in Canada, Venezuela and in the Western United States are now an economically viable source of energy because of oil’s price increases. The point is that sudden moves in economic strategy by cartels throughout the world are now able to throw into a cocked hat any projections that American economists have made for corporate earnings and indigenous growth. The airlines which were performing admirably and flying high with a greater percentage of occupancy than at any time in their history have seen their bottom lines turn blood red from the increased oil price. Stockholders of the airlines have taken the gas pipe while those holding shares in the big oil companies have profited mightily. More importantly, not knowing what is coming next always causes a high degree of uncertainty and this indeed is the ultimate negative that sticks in the stock market’s craw. Keep in mind that the market can take good news and bad news but it can’t handle uncertainty. A strange quirk but a real one.

However in spite of all the extraneous influences that have the potential to play havoc with our economic well being, we are geographically blessed to live within boundaries which are to a large degree, sacrosanct. Your day to day investment philosophy could well become highly different let us say if your neighbors were Iran, Iraq, Ukraine, Pakistan, Afghanistan and Yugoslavia as would be the case if you lived in Turkey. A strong stock market wouldn’t be the number one order of importance, it would be a very healthy standing army. In a geopolitical sense, it is critically important for investors to realize that this country has more than acceptable relations with its neighbors, which in the long run frees up a lot of resources that can be earmarked for extended growth. Canada’s relationship with the United States has always been first class, but recently their currency has gone to hell in a hand basket causing substantial dislocations both there and here. This in turn has caused a significant amount of goods being purchased from that country that would have been otherwise manufactured here. If the population of Canada was substantially larger, the effect would have been catastrophic, but luckily this is not the case.

Mexico’s population, however, is a different story. Its people are underfed, underpaid and restless. We have a history of paying their government both early and often to keep the country from disintegrating altogether. This condition has caused an influx of their people looking to find various points of egress across our borders in order to garner the advantages of a better way of life. When first addressed, about a decade ago, there was substantial concern that with all of these Hispanics illegally coming through our porous borders literally at will, they would eventually overwhelm our continuing ability to absorb them without having our country developing economic problems. However, recently, a 180-degree turn was taken when U.S. Government officials became seriously concerned about where the labor supply would come from to support America’s newly service-based economy which seemed to be growing exponentially. The exodus of workers from Mexico which had previously been perceived as a problem is now being viewed as a necessity, and taken along with Mexico’s improved political climate, our South of the Border neighbor could eventually become a true economic partner.

Mexico y probably effects America’s delicate economic balance more sharply than any other country and for this reason, the U.S. has poured substantial dollars into the Mexican economy whenever events seemed to be going the least bit wrong (which sadly has been more often than not). These folks were constantly finding their economy in the dumpster and historically, and we have been bailing them out with a religious fervor. However, much of our gratuitous gifts have wound up in the hands of Mexican political leaders and therefore granted little overall benefit to their population at large. Many of the previous stock market collapses in the U.S. have been a direct result of Mexican collapses because of the effect that they would have on our banking system. Should the situation straighten out, there would be a lessened risk of investment uncertainty. Unfortunately, Mexico has a long way to go and the jury will be out for quite some time.

The rest of South and Central American is also critically important as it, along with the Caribbean Basin, provides a bulwark against overseas cartels or other types of mysterious and unusual alignments. The problem with these coalitions is that in spite of much political cultivation by the United States, South American politics is a tad like a game of Russian Roulette and one never knows who is going to be left standing when the game has ended. These countries, for the most part, are economic cripples and their government officials are readily available to the highest bidder. Eventually, a more solid relationships will have to be fashioned and their governments will have to be transformed in order to ward off the eventual strength of unity of a eventually strong European Community and the numerous other alliances that have sprung up in the Pacific Rim.

The world is full of strange bedfellows and cartels have been created to control nearly every substance on earth. Those that have platinum, palladium and oil have formed groups to jack up their prices to obscene levels. Even the relationship between Russia, Belarus and Ukraine could become a serious world economic player, should oil prices stay at higher levels and if these folks eventually get their acts together. In addition, many other of the former Russian satellite countries find that they are now awash with in oil because the West has brought them new extraction technology. Even they could become important players in the international scene by helping the cartels play the black gold card. For the moment they need Western financing, but once they are cash flow positive, more likely than not, we will be seeing an increase in the number of countries making up OPEC.

The stock market is also affected by numerous non-economic realities. We call these strange anomalies, politics. This is a strange phenomenon where pompous individuals give bizarre speeches promoting themselves and in turn those that amble on the most are elected to what is called "office." This is a place where people continue to pontificate and do not work. After years of doing this they are eventually given a pension and told to get lost. For the most part, they do not leave and are heard from consistently until they die which is a problem. However, which party in the United States controls the White House or controls Congress has been extremely important to the stock market over the years.

For some reason or other, market professionals have believed that one group of politicians is somehow better than another. This must be true because for the most part, when the financiers favorite party wins, the market generally goes down and when the other party controls things, it goes up. Financial people are very knowledgeable and therefore we are certain that there is some logic in this thinking. However, as the face of these parties seems to have blurred, this happenstance has become increasingly less important and both parties are equally derided by Wall Street executives. However, in spite of uttering nasty words about their competence, much money is sent to help them continue on in their jobs. While politics in this country has become surreal, elsewhere it is a matter of life or death. More important to our sensitivities would probably be the rise of the Fundamentalist Muslims, who are spreading their own brand of gospel throughout the world. Although the Fundamentalists have not made much progress to date, but they are certainly not going to go away and the world would be a whole less fun if we had to play by their rules.

Take a look at Afghanistan which has become a problem for everyone, and Pakistan seems to be rapidly following suit. Egypt has been placed in a constant state of flux by these people and has been forced to make numerous concessions to this group in order to keep the peace, never a good move. The danger to the world's stability caused by a Fundamentalist Egypt is potentially substantial, because this would pose an even greater threat to Israel, Sudan or Libya. In the case of Israel, a Fundamentalized Egypt would more likely than not bring the area to the brink of atomic war. However, this same type of scenario could erupt in the ongoing war battle of the borders between Pakistan and India, but this would probably have less substantial economic consequences as the world's oil supply would not be of issue. Any of these events would case a substantial decline in the securities markets globally.

As if we didn't have enough to worry about, North Korea has replaced Libya as the world's leading natural agitator and is now supplying sophisticated and highly accurate, long-range missiles to countries that under normal circumstances should not be allowed rubber duckies to play with in the bathtub. Moreover, North Korea has become probably the most unstable country on earth today and is thinking deep thoughts about using the Japanese homeland its missile range. While this did not please Japanese sensitivities, there is not much that they can do about it because they gave up weapons of aggression long ago.

The Japanese had cooperated with North Korea's dubious ambitions to blow them to smithereens by rewriting their own history books in such a way as to anger not only the North Koreans, but just about everyone else in the region. The Japanese historians felt that their countrymen were feeling too much guilt about what happened during World War II and so they proceeded to rewrite history, something that was logical under the circumstances but which did get them any accolades from their neighbors who had been sodomized, tortured, murdered and enslaved during the war. Japan's new history books give proof positive that these events never took place.

I would seem that Japan under its newly installed government has once again become a nation of wannabe Kamikazes. The only thing that seems to be missing in the scenario is the ritual Sakhii ceremony before a flying immolation. If it can be believed, it seems that the Chinese and the South Koreans are even more displeased with Japan than are the North Koreans. Any war that breaks out among people with serious weaponry will cause global uncertainty to say the least and lead to substantial stock market declines. Worse yet, the radiation may even surpass the market's decline in spreading unpleasantness.

Of concern, but not nearly as capable of causing the potential degree of fallout as just discussed, is the rapidly unfolding scenario in the fourth most populated country on earth, Indonesia. Two-Hundred and ten million Indonesians are among the most unhappy people on earth. They have gone from a modicum of semi-prosperity under a thieving despot to an anarchical society that may soon come totally apart at the seams. Because of the uncertainties in Indonesia, many are trying to physically escape the economic and political problems inherent in the country. This migration is dramatically effecting countries in the region such as Malaysia and Singapore which are going through bad times themselves. Supporting unwanted refugees can become a tremendous economic burden to emerging societies, and hence, severe measures to combat this influx are now being used, which could cause lasting problems. For the most part, as in Indonesia, the Chinese segments of these populations represent the wealth of most of the countries. For this reason, there has been considerable jealousy leading to severe ethnic problems. Riots, killings and the destruction of property have become commonplace in the region and the Chinese Government has issued several statements that if it continues, they will not take it lying down. This scenario does not even contemplate what could happen with Taiwan, should the Chinese invade and the United States joins forces with the islanders.

Moreover, the same refugee problem exists in Europe, as displaced people from the former Soviet Union, Yugoslavia and the Middle East swarm ashore onto fortress Europe looking for an improved way of life. These realities are more controllable but with Europe already suffering massive unemployment, tough times are ahead. Italy has been almost like a sieve in terms of how many of these people have entered the continent through that country. Many in the EC are already talking about the fact that Italy is not doing enough to stop this torrent of people. Naturally this is easy for them to say. Moreover, the peace between Greece and Turkey is always boiling slightly below the surface and it wouldn't take a lot to these countries at each other's throats.

What we are saying here is that no one can possibly really know what is ahead for our global community from either a political or economic point of view. There are just too many wild cards, and the odds that nothing is going to break loose from its moorings has to be given a very small order of magnitude. In other words, from a purely statistical point of view, the odds of a major dislocation occurring somewhere in the world that could have a dramatic effect upon life in the United States is almost a sure thing. We have not even considered the possibility of natural disasters, like long-term global warming and the ever increasing ozone problem causing dislocations. Other nasty lay-ups include the continuing and increasing potential of famines as the world's population grows, but its cultivatable area diminishes. Flooding as topsoil continues to be drained away, smog as more people gravitate to the larger cities and their environment systems cannot accommodate them, waste which can no longer be carted away as quickly as it is created, weapons falling in the hands of bad guys and the proliferation of new and strange diseases creating scientific challenges that cannot be addressed such as HIV.

Finally, we have not discussed the problem of internally generated migration. China alone currently has a migratory population of over a hundred million people wondering around the country looking for work seasonal work. How long that

country's government is going to be able to keep this group under control is anybody's guess and they are already becoming more than a nuisance. .

The Internet has allowed the poor to visibly observe how the rich live, and this has speeded up the nomadic bent as people move from the rural to the urban areas looking for a better way of life. Wars are becoming more likely and may come upon us at any time in order to put down disorders caused by hungry nomads with nowhere to go. Cartels may withhold products that are necessary for us to continue to live in the style to which we have become accustomed. The world has become an interlocked community where most of us sneeze when anyone else catches a cold. We have little or no control over most of these eventualities and can only sit back hope for the best.

Those that read stock market tea leaves have proven to be no better than a monkey taking a random shot into a dart board. In the meantime, earnings growth is becoming more difficult to judge as competition increases. While some full-time investment managers may have performed a tad better, there is no unique formula for investing success. Even the great George Soros got his head handed to him and has lost not only money but some of his employees as well. The only thing we can say for sure is that some people are less wrong than others. As the potential of unpredictable events increases geometrically, economic predictability will drop like a lead balloon in a vacuum.

In spite of this fact, I have followed my own theory of investing which is capable of dispensing with economic variables and unpredictable natural events. In spite of not having a large staff and fancy computers, this strategy has proven extremely successful, at least for me, and I thought I would pass it along as something as close to a sure thing as you are ever going to hear. However, what I call the "Inferior Person Theory" requires a great deal of social reflection and a serious commitment to its practice.

First, let me show you how to get started.

Remember the guy in your class in your first grade whose name you couldn't remember and who always just managed to get by. Although he wanted to be part of things, he was always on the fringe of the in-group and his ideas were never taken seriously by anyone. However, he hung in there and had a high degree of tenacity, and tenacity is a critically important element in my equation. In spite of the fact that he had a crass personality and a less than hefty IQ, he constantly just got by. He finished high school, went on to college where he managed to graduate by running errands for the teachers. After graduating he found himself ensconced in a growing industry, but he was always the low man on the totem poll. However, he did have enough sense to realize that he better be at the right place and at the right time if he wanted anything good to happen in his life. Luckily for me we had one of these people in our grammar school class whose name was Feltner Carvel. Somehow or other, our paths continued to cross over the years, and most recently I have become a more affluent person because of it.

I had known Feltner for years but did not realize his latently immense value, nor did I pay more than passing attention to him until I noticed this strange anomaly. Every once in a while, in spite of all the odds against it, Feltner would become extremely successful for a short period of time. It was almost as though Feltner had hit the lottery and could only keep the money until the people from the IRS showed up. However, on those occasions he would always run out and buy a new sports car, flashy clothes and would be seen for a time at all of the best places with the most magnificent looking women. This anomaly however would last for only a matter of weeks when the nation's economy would totally collapse and once again, Feltner would be the first out of work and he would be back driving his jalopy and eating and drinking stale bread cocktails at home alone.

The first several times this strange incongruity occurred, I really didn't pay much attention to the seemingly coincidental nature of the incident and was unaware of its dramatic economic significance. However, this happenstance took place time after time, and eventually it dawned on me that although there was no way to determine what stocks to buy by following Feltner's ups and downs, he was certainly predictive of the market tops and bottoms, something equally as important. I could not believe my accidental good fortune.

I began to stick to Feltner like glue so that I could keep tabs on his progress or lack thereof. When I saw him about six months ago riding around in a brand new bright red Mercedes 600 convertible with a beautiful girl sitting so close to him that I thought they were glued together I knew that bad things were about to happen. I literally jumped for joy at the opportunity. This was an unequivocal sign that the market was about to collapse, and I sold a substantial percentage of my portfolio the next morning while shorting a few stocks in the bargain.

True to form, NASDAQ soon unraveled, and stock markets around the world tanked. However things are not all that rosy. Although he is no longer driving the bright red Mercedes, Feltner still eats at some of the better Wall Street restaurants; so it is apparent we have not yet hit the bottom of the cycle. I reflected on the past and recalled that the last time he bought a car like this one, I sold most of my positions, and soon thereafter, Thailand collapsed along with the rest of the Pacific Rim.

It would seem that there are a group of people out there that are what could be called economically late cycle achievers. Put another way, I guess you could call them, early cycle underachievers as well. The odds are in favor of your having one of these people in your own neighborhood. For the most part they look just like you and I and are therefore fairly hard to isolate. If you uncover one of these gifted people and keep them under rigid surveillance while being disciplined enough to carefully adjust to the signals that they inevitably give off, you too could soon be fabulously rich. Usually, when they are laid off, you can be almost certain that the country is starting to mend while a sure way to investment prosperity is to sell out when this poor soul does well and to buy in when he asks you for a loan.

Why am I offering this free advice? Obviously, if everyone followed my advice I would not be able to continue to do nearly so well in the market, simply because of the law of diminishing returns. The reason for my generosity is that through careful and painstaking research I have been able to develop a data bank of highly "inferior people." I probably have identified at least one "inferior person" available in your own neighborhood. My extraordinary database is available to you, but at a stiff price. I will sell the rights to no more than one "inferior person" per zip code, and the responsibility of ingratiating yourself to this poor soul to maximize his benefits to you are not my responsibility. However, we do guarantee our work and are available for consultations relative to the meanings of various signs that you person may be giving off.

Keep in mind, please, that I will guarantee results of the person designated and will even warrant that this person will be able to predict economic disasters brought about by natural causes, a truly mind-boggling talent.

Yours for better investing in these trying times, Robert A. Spira

Having Said All of That, Let's Talk About the Creation of a Security. What Then Are The Elements?

SECTION 1

Corporation- must apply for a charter "Articles of Incorporation." Or "Certificate of Incorporation."

a. State which incorporated

- b. Name of corporation
- c. Number of shares of stock that may be issued
- d. amount of indebtedness corporation may incur
- e. statement of duties of officers
- f. names and addresses of original directors.

Board of Directors

Elected by stockholders

Capitalization

Total of all securities a corporation issues known as its corporate structure.

Stocks are commonly referred to as equity securities.

- a. Authorized Shares, total number of shares outstanding along with those that may be issued at some later date by a vote of the board of directors of the corporation
- b. Issued shares - amount of stock that has been sold or given for services..
- c. Treasury stock - shares that were authorized but not issued or issued and repurchased by company.-- Has no voting rights.
- d. Outstanding stock - number of shares issued to the public minus treasury stock.

IPO - initial public offering - corporations first distribution of stock to public.

New Issues- securities being offered to the public for the first time.

If a new issue consists of additional securities to be issued by a corporation that is already public, it is called a Primary Offering.

Securities and Exchange Commission Act of 1933 - SEC reinforces this act which prevents fraud in the sale of securities. Securities must be registered and must provide purchasers with a prospectus that states: the SECURITIES AND EXCHANGE COMMISSION does not pass on the adequacy or accuracy of information

but the material filed with the SEC cannot contain any misleading information.

Filing date: The day registration statement is received by the SEC is called the filing date.

SEC reviews information, some of which is required is:

- a. Description of issuer's business, shareholdings of senior officers, directors and underwriters and identification of people who hold at least 10% of company's securities.
- b. Biography of officers and directors
- c. Company's capitalization - how funds are brought in - through stock and bond offerings
- d. Specific uses of the proceeds
- e. Certified financial statements

The Securities and Exchange Commission Act of 1933 is designed to provide purchasers of new issues of securities with information regarding the company and to prevent fraud in the sale of said securities. In the event the SEC sees a deficiency or misrepresentation, it can postpone effective date or stop order -- which prohibits the sale of securities.

Investors can sue officers, directors, principal stockholders & underwriters if registration statement has material omissions, errors, or misrepresentation of facts.

During cooling off period, a preliminary prospectus or "red herring" is prepared by corporation called "red herring" because prospectus has a cover page with red border telling potential investors that a registration statement has been filed, but isn't effective yet.

Also during cooling off period, issuer will "Blue Sky" , that is , register the issue in the states where the underwriter plans to sell the Securities and Exchange Commission. A state may approve or disapprove the sale of securities within its borders.

Immediately prior to the issuance of the final prospectus, due diligence meeting is held. Purpose of meeting is to review aspects of planned underwriting, specifically the issuer's and underwriters exercise of due diligence in meeting federal and state laws.

The following steps are as follows in registering securities.

- a. File registration statement with Securities and Exchange Commission
- b. Blue Sky the Issue
- c. Issue Preliminary Prospectus
- d. Due Diligence Meeting
- e. Issue Final Prospectus

Final prospectus must be distributed to any customer for 25 days from effective date. For OTC Securities not eligible for listing on NASDAQ, prospectus delivery

required is 90 days if the corporation has not previously issued stock to the public or 40 days if stock has been issued.

There are **Exempt Securities**

- a. U.S. Government and U.S. Gov. Agency Securities
- b. Municipal Securities
- c. Securities issued by non-profit organizations

*They are not exempt from anti-fraud provisions of the Act.

Regulation D

Securities and Exchange Regulation D exempts registration for private placements of Securities and Exchange Commission if:

- a. Issuer believes buyer is a sophisticated investor-
- b. Buyer must have financial information in memorandum form
- c. Issuer is assured buyer does not intend to make a quick sale of the securities.

d. Securities may not be sold to more than 35 non-accredited investors. Accredited Investor-- financial institution, (bank), tax-exempt plan, private business, director, executive officer or general partner of the issuer or an individual who has a net worth of one million or a gross income of \$200,000 for two years and will continue.

Relevant Regulation

a. Rule 147- Intrastate offering exemption for securities sold within borders of one state-(see page 9.)

b. Small Issue exemption –

- Regulation A- a new issue of \$5 million or less during a 12 month period and is exempt under the Act (Rule 147). Issuer must file an offering statement with the Securities and Exchange Commission.

c. Rule 144 -- exempts persons from the definition of underwriter.

Concerned with sale of restricted of stock and affiliate stock.

(Restricted stock -- not registered, usually acquired through a private placement.

Control stock -- acquired by an affiliated person; that is, an officer or director.

Restricted stock - purchaser must hold stock for two years.)

Control stock -- no holding period.

d. Rule 144A-- provides an exemption for the sale of restricted stock between qualified institutions (financial institutions that have at least \$ 100 million invested in Securities and Exchange Commission not affiliated with the entity.

(Certain Securities and Exchange Commission not covered under Rule 144A. The exemption is primarily meant to facilitate the trading of securities involved in the private placement market.

e. Shelf Registration -- when Securities and Exchange Commission can be sold on a delayed or continuous basis. The advantage is it allows issuing company flexibility to

State Registration ---- in addition to the Securities and Exchange (SEC) Registration, corporation must comply with state laws.

1. Registration by notification; letter filed with State Administration

coordination--done simultaneously with federal regulation

2..Qualification--must meet state requirements

Investment Banking -- underwriting syndicate

Object of investment banking is to raise capital. Sometimes, proceeds represent new funds, which others are refinancing their capital structure

a. Underwriter, i.e. a banker, assumes risk by buying the new issue from the corporation and reselling it to the public. Underwriting "Spread Agreement Among Underwriters" --details the liabilities and the compensation.

b. Selling Group -- assist in distribution comprised of BD's who have no financial liability.

In general, IPO of stock tends to have high spreads, due to the high risk.

Types of Underwritings

1. Firm Commitment-- when the underwriter agrees to buy entire issue and absorb any Securities and Exchange Commission not sold.

2. Best Efforts-- when the underwriter acts as agent for issuer but unsold shares will be returned to the corporation.

3. All-Or-None-- if the entire issue is not sold, the part that is sold will be canceled and money will be returned to the subscribers.

A. Variation-- Mini-Maxi underwriting: example: corporation tries to sell 10 million shares of stock. It requires 70% of the offering. It must receive seven million dollars or entire issue will be canceled!

Tombstone Advertisement (P14) -- announces the sale of Securities and Exchange Commission; manager's name is listed and firms are listed by size of participation.

Contains standardized clause -- "it is not an offer to sell, or a solicitation to buy. Offering is made only by a prospectus."

Sales of Hot Issues

Hot Issue -- New Issue of stock that is in great demand and is oversubscribed.

Firms are restricted in the sale to:

1. A Broker Dealer's proprietary acct.
2. Accounts of officers, directors, partners, employers of Company
3. Senior officers of a bank, insurance company, or any employee involved in securities department.

Free-riding and withholding -- member firms may not withhold securities that are part of a new issue if they have unfilled public orders. Causes loss of confidence in investing public in the integrity of broker dealers should use their privileged position for their own benefit.

Stabilization -- only form of price manipulation permitted by the Securities and Exchange Commission:--* It allows the managing underwriter to bid for the Securities of a hot issue, at or below the public offering price. This usually ends when all the shares of the new issue are sold.

SECTION 2 -- The Securities secondary market

After Securities are sold in primary market, they trade in the after market, or "secondary market". In the secondary market, proceeds of sales go to investors and dealers, not the companies that issued the securities.

The secondary market includes stocks traded on both the exchanges and the over-the counter market (OTC).

An exchange represents an auction market consisting of competing buyers and sellers.

The OTC market represents a negotiated market where one buyer negotiates with one seller.

PRICE QUOTES

A quotation for a securities is made up of a bid and an asked.

a. Bid price -- represents the highest price a buyer is willing to pay for the particular security.

(Customers selling securities in the secondary market will receive the bid price.)

b. Asked price, also referred to as the offering price, represents the lowest price that a seller is willing to accept for his shares. Customers buying securities in the secondary market will pay the asked price.

Securities are quoted in full points and are broken down into eighths of a point. Each point is equal to \$1.00 and each 1/8 of a point is equal to 12.5 cents.

The difference between the bid and asked is called the spread.

Example; A stock is quoted bid 18 - asked 18 1/2. A customer wishing to purchase this stock \$18.50. A customer wishing to sell this stock would receive \$18. The spread is 1/2 point or 50 cents.

Stocks that are heavily traded will normally trade within a narrow range; however, stocks that are thinly traded typically have much wider spreads.

PRINCIPAL vs. AGENT

In dealing with securities a broker-dealer may act in either of two capacities: principal or agent--most securities firms at times act in both capacities--called a "BROKER DEALER".

A. The term "principal" is synonymous with the term "DEALER". A dealer buys and sells for its own account, meaning, that customers buy stock from a brokerage firm, the brokerage firm acts as a dealer. The customer is receiving Securities and Exchange Commission from the dealer's own inventory. The firm earns a profit by marking up the price of the stock over the market price.

B. "Agent" means BROKER. An agent buys or sells securities for a customer and charges a commission. In this case, the firm never owns the securities.

SETTLEMENT DATES

The settlement date is the date where a transaction must be cleared. This happens when a buyer pays for securities -- or a seller delivers securities and receives the proceeds of the sale. Most purchases and sales of securities are transacted on a regular-way basis. For corporate Securities and Exchange Commission such as; corporate bonds, preferred stock, common stock, and municipal Securities and Exchange Commission, the settlement date is three business days from the trade date.

Treasury Securities and option contracts settle regular-way on the next business day. Transactions done on a cash basis settle on the same day as the trade.

A. An alternate type of settlement is "Seller's Option" In this type of settlement, the seller is given the right to deliver securities in no less than six business days or no more than sixty calendars.

B. "When issued" transactions involve securities that have been authorized to trade but have not yet been issued.

SECURITIES AND EXCHANGE COMMISSION EXCHANGE ACT OF 1934

--- concerned with the trading of Securities and Exchange Commission's once they have been issued, with the regulation of exchanges, and with the regulation of broker-dealers.

The SECURITIES AND EXCHANGE COMMISSION enforces these securities laws. Members (Commissioners) of the SEC are appointed by the President, with the advice and consent of the Senate. Commissioners of the SECURITIES AND EXCHANGE COMMISSION are appointed to terms of 5 years.

REGISTRATION AND REPORTING REQUIREMENTS

THE SECURITIES AND EXCHANGE COMMISSION EXCHANGE ACT of 1934 requires stock exchanges to register with the SECURITIES AND EXCHANGE COMMISSION, because the SEC requires that the exchange have strict rules for disciplining its members and that the exchange file required reports periodically and annually.

A corporation is REQUIRED to register with the SECURITIES AND EXCHANGE COMMISSION once the amount of its total assets and the number of shareholders reach a specified level. This registration is in addition to the registration of the issuer's Securities and Exchange Commission under the Securities and Exchange Commission Act of 1933 when they are first offered to the public.

All Broker-dealers and registered representatives doing interstate business or using mails or any other instrument of interstate commerce must file an annual report with the SEC. In addition, all public companies must distribute an annual report to their shareholders.

PROXIES

A proxy is a person who has been given power of attorney from a shareholder of a company who can not appear in person to vote on corporate matters. The SECURITIES AND EXCHANGE COMMISSION requires that a proxy statement containing information on matters to be voted on be provided to shareholders. Proxies must be filed with the SECURITIES AND EXCHANGE COMMISSION.

A proxy contest is a technique whereby one company attempts to acquire another company by convincing its shareholders to vote out the present management. If a registered representative advises a customer on how to vote in a proxy contest, he or she may be considered a participant and be required to file information schedules with the SEC. If the registered representative will not benefit from the advice in any way, no filing is required.

MANIPULATION

Manipulation involves buying or selling a securities to unfairly influence its market price. Common forms of manipulation are tips, rumors,, and the distribution of market letters that misrepresent facts. It is illegal to omit material facts, which would make other statements "misleading". In addition, other forms of manipulation include illegal market devices such as matched orders and pool activities designed to raise or depress the price of securities.

Matched orders involve two persons acting in concert to manipulate the price of a security

Pools or syndicates formed for the purpose of raising or lowering the price of a security is also illegal.

These rules of manipulation apply as well to securities of the US Government and those of municipalities. These securities are exempt from the other provisions of the Act. If an individual suffers damages because of the manipulation of a price of a stock, the individual may sue the manipulator for recovery of the damages. Action must be taken within three years of the activity and within one year of discovery.

SHORT TENDERING OF SECURITIES AND EXCHANGE COMMISSION

Rule 10b-4 of the Act prohibits short tendering of securities. This is the use of borrowed stock to respond to a tender offer. A tender offer is an offer to buy stock of a corporation, usually at a price above the current market price of the shares. Its objective is typically to take control of the "target" company. Investors may only respond to a tender offer with stock that they own.

TRADING BY PARTICIPANTS IN A DISTRIBUTION

According to Rule 10b-6, a broker dealer involved in underwriting a security may not solicit orders in the securities secondary market while the distribution is taking place. Only unsolicited buy and sell orders, handled on an agency basis, are permitted.

CAPITAL REQUIREMENTS

a. SEC 15c3-1 (Net Capital Rule), a brokerage firm is required to meet minimum standards of liquidity. The rule is designed to afford protection for customers of the firm A brokerage firm maintain a minimum dollar amount of net capital; the specific amount depends on the type of business the broker-dealer conducts.

b. Rule 15c3-3 is the "Customer Protection Rule." It provides for the establishment of a reserve bank account for the protection of customers. A broker-dealer is required to promptly obtain and maintain physical possession or control of all securities that belong to its customers. In addition, this rule deals with the completion of sell orders on behalf of customers, whereby if a customer fails to deliver stock that has been sold within 10 business days after the settlement date, the Broker-dealer must buy the stock in the market to satisfy delivery.

SHORT SALES

The Securities and Exchange Act of 1934 regulates short sales of securities. A short sale involves the sale of a stock that is not owned by the seller. The investor borrows the securities for delivery at a future date. The investor typically sells short in anticipation of a decline in the price of a stock. (See page 2-7) This short sale rule is designed to prevent the artificial depression of the price of a stock as occurred in the United States in 1929.

INSIDERS

An insider, as defined by the SE Act of 1934, is a director, officer, or owner of 10% or more of the stock of a corporation (& their family members). These people are required to report to the SEC within 10 days of becoming insiders, and are also required to report any changes in their position no later than the tenth day of the month following the change. Insiders are not permitted to make "short-swing profits" in the stock of the corporation. If an insider sells the stock at a profit within 6 months of its acquisition, or sells stock for a profit which was held 6 months or longer and then repurchases it within 6 months of the sale, the corporation may sue for recovery of the profit. Insiders are PROHIBITED from using inside information for their own gain. This applies to any people who have access to inside information such as clerical personnel, attorneys, and auditors. Before these people could act on information. They obtain, the information. Would have to be distributed to the public via a press release in a widely disseminated medium, and the press would have to distribute the information to the public. The SE Act of 1934 requires BD's to establish, maintain, and enforce written procedures to prevent the misuse of material nonpublic information by any person associated with the BD. The SECURITIES AND EXCHANGE COMMISSION is granted the authority to establish rules and regulations as deemed appropriate in the public interest or for the protection of investors.

* If the SECURITIES AND EXCHANGE COMMISSION determines that any person has or is about to engage in any action that violates Securities and Exchange Commission law, the SECURITIES AND EXCHANGE COMMISSION may seek an injunction in any federal court. Violations of the SE Act of 1934 or SECURITIES AND EXCHANGE COMMISSION rules and regulations, including false or misleading statements in any report or application, are subject to criminal penalties. The maximum fine for a person is one million dollars -- or imprisonment for 10 years -- or both. For a business, the fine is 2.5 million dollars. If a person committing the violation can prove he was not aware of the rule, a fine, but not prison, may be levied against the offender. According to the Insider Trading and Securities and Exchange Commission Fraud Enforcement Act of 1988, if the SECURITIES AND EXCHANGE COMMISSION determines that a person has violated the SE Act of 1934 by purchasing or selling Securities and Exchange Commission while in the possession of material nonpublic information, OR has communicated material nonpublic information to another person, the SECURITIES AND EXCHANGE COMMISSION may bring action in a federal court. The court has power to impose a civil penalty on the person using the information. And, under certain circumstances, on the person who directly or indirectly controls such person.

REGULATION T

Regulation T of the Act gave the Federal Reserve Board (FRB) the power to establish margin requirements for securities. The FRB is an independent federal agency that controls the amount of money and credit in the economy. The current margin requirement under Regulation T is 50%, which means that customers of brokerage firms who purchase securities deposit 50% of the total market value. The brokerage firm may lend the customer the remaining 50%.

Securities that may be purchased on margin are called "marginable Securities and Exchange Commission". This includes any stock listed on an exchange or on NASDAQ, and those over-the-counter stocks approved for margin by the Federal Reserve Board.

New issues may be purchased on margin. Under Regulation T, the FRB can set payment dates for customers. Customers purchasing securities in a cash or margin account must pay for their purchase within 7 days. If payment is not made within the required time period, the customer's account is frozen for 90 days. During this time, no credit may be extended to the customer. In some instances, an extension may be granted. The request is made to the NYSE or the NASD (for OTC Securities) (SEE Pages 2-10.)

SECTION 3

New York Stock Exchange -- founded in 1792; called the "Big Board" or "the Exchange". The NYSE acts as a model for the other national exchanges:

American Stock Exchange

Boston " "

Chicago " "

Midwest " "

Pacific " "

Philadelphia "

LISTING REQUIREMENTS

At least 1,100,000 shares publicly held with a market value of at least \$18,000,000

A minimum of 2,000 round lot shareholders (100 shares or more) or a total of 2,200 shareholders

An average monthly trading volume of at least 100,000 shares for the most recent six months

Minimum pre-tax earnings of 2.5 million for the latest fiscal year

*Solicitation of proxies is not a requirement of the SE Act of 1934, but is required for listing on the NYSE. A listed company that doesn't solicit proxies is subject to having its stock delisted. Stock can also be delisted

CONSULTING

Consulting

To recap, the following steps are usually taken in laying the groundwork for bringing an issue public:

File registration statement with Securities and Exchange Commission

Blue Sky the Issue

Issue Preliminary Prospectus

Due Diligence Meeting

Issue Final Prospectus.

Earlier we discussed in detail the steps leading up to the issuance of the final prospectus so we felt that it would be *apropos* to address the most difficult aspect of the process independently. This can be very painful for all of the people involved because no one is quite sure what the rules really are. We have been told that the SEC gives all of its examiners a secret book that details exactly what the final prospectus should contain but we have never met anybody that has actually seen it. Supposedly, each of the SEC representatives carries this book about him wherever he goes.

Some have said it is biblical in nature and the agent is to read it at all hours that he is not on the job. This book is a roadmap advising the agent on how to best make the issuer totally miserable. When exciting new methods of torturing companies new to the process are discovered, a new edition of the book is immediately published containing this important information so that it can be shared by the field staff. Some embittered issuers have stated that the SEC must be rewarding examiners who create new impediments with substantial bonuses.

The final prospectus must be promptly distributed to prospective buyers of the issue after the effective issue's date. Once the purchaser of the shares in the offering has had time to peruse the final document, he has the right to rescind his purchase literally for any reason whatsoever. In practice this occurs only when there are substantial differences between statements made by the broker and the facts that appear in the prospectus. Even if every client purchasing stock in the IPO, if it were a firm deal, were to rescind it would not effect the company in that they received good funds from the underwriter at the time the deal became effective.

Many people can't tell whether they have been told the truth or not by reading the prospectus because it is written in a language which at best is must be considered most unusual. Knowledgeable people have said that it is a cross between Sanskrit and Esperanto which we are told, the SEC believes is the language of the future. Having qualified interpreters available to determine what was meant in these languages has not been too successful in court. The next hurdle the is the most difficult,

Exempt Securities

These are securities that are not subject to the registration requirements of the 1933 Securities Act. Exempt securities also include securities that do not have to follow certain provisions of the Securities Exchange Act of 1934 in terms of margin, registration of deals, certain reporting requirements, and the identity of market makers.

U.S. Government and U.S. Government. Agency Securities

Municipal Securities

Securities issued by non-profit organizations

Bank Securities

They may be exempt, but we are not sure what that means. It may have something to do with registration the fact that they can be freely offered without a regulatory authority passing on them. In the particular case of Government securities, we think that the term exempt means that the government is not going to lie in an offering memorandum regarding the placement of their securities and a buyer shouldn't worry too much. In other words, if you can't trust Uncle Sam, who can you trust?

At the same time, salesmen recommending government securities have several problems. First, there is not much profit in these instruments for the broker. Second, it is hard to get a customer once invested in governments to switch into a penny stock on which the broker makes a lot of money. Therefore, when all is said and done, the U. S. Government has taken the position that you can call its securities whatever you want, but don't call them late for dinner.

For some period of time firms that dealt exclusively in the U. S. government arena didn't even have to be registered as a broker. Some people, such as the more prestigious brokers and banks, abused their privileges and did bad things in the government market, treating it more as their territory than the Government's. The Government became upset at losing turf and was forced to punish some of them severely. They made the government look bad. These are institutions you do business with everyday.

The government said, even though our securities are exempt, you cannot go around breaking securities laws whenever you want. After all, the public is still protected by the anti-fraud provisions in the act aren't they? Well the bad guys said, awe come-on, when you needed your merchandise moved you didn't mind our rigging the market now and then, now that you don't need help any more you're becoming sassy. What the bad guys said is mostly true.

Now municipal bonds are something else. They are almost universal free from Federal Taxation. Because of all the rights granted the states in the constitution, states and their subdivisions could independently do their own financing and not have to worry about paying assessments to the federal government. Because of this quirk, the states, cities, municipalities and taxing districts were able to pass along this benefit to the buyers of their bonds. Municipal bonds of an equivalent rating with that of the U. S. Government would sell at a price equal to the current federal income tax rate deducted from the equivalent government bond. In other words you have to compare apples with apples and not with oranges. A 20-year Virginia general obligation compared with a 20-year Treasury bond.

In any event, the non-federal taxing authorities found a good idea. They would raise a lot of money by telling people that they were going to do something or other and then they wouldn't do it. (After all the bonds were exempt, weren't they?). Instead, they would buy U. S. Government paper with the proceeds, thus making a profit on the difference between their interest cost on debt and the rate they received from Uncle Sam. This caused taxpayers in states that weren't smart enough to do illegal things to ship money into states that were engaged in these activities. Luckily, I always lived in a state that knew how to do this. They fact that they lied as to what they were going to do with the money seemed to be OK because they were the government. I guess that seems all right, but I'm really not sure.

Another thing that the non-federal tax accessing bodies can do that seems strange is that they can sell bonds that represent financing for private industrial concerns. These strange bonds are called industrial revenues. States and other taxing authorities interesting in attracting industry can give companies showing interest in their location various benefits. These could include tax abatements, free land, plant and machinery, a cash bounty for each employee they hire along with a never

ending list of additional goodies if the facility will ultimately hire enough residents, produce enough taxes and become a good enough citizen. The package given to various Japanese auto companies by various states to set up manufacturing literally went on for pages and pages. I have often wondered why no American company ever qualified for something like that but Doctor Bob said it has something to do with the CIA and it is best not to pry.

To most company's, the most singly beneficial part of the offering package is the ability to get Industrial Revenue Status. This allows the company to issue a tax-free bond and rates under those of the competition that is only paid back from the particular revenue of the project being financed. Often startup or companies with poor credit can raise money through this method that would be unavailable under any other scenario.

Primarily, because of these strange characteristics, many people have lost their savings in these investments. Vietnam veterans and old people have been particular targets of inventive financiers who create companies as fast as nefarious brokerage houses can move the paper that they generate. To some degree a damper has been put on this activity after everyone's money was lost so I guess I shouldn't even have brought it up but I still feel sorry for some of those people.

Charities that qualify for tax exempt status, are able to raise money with reasonable latitude. Recently one organization offered investors the opportunity of donating to a fund that would match whatever they put up dollar for dollar. Thus, the potential patrons were told they would receive a double deduction from the internal revenue service. With taxes (including federal income taxes) approaching 50% in some states, money could be given to charity and when the tax benefits were added in, there literally would be no cost to the donor and he would be held in great esteem in his community. Many important people donated to this cause because they wanted to be held in greater esteem than they already were. When the whole thing turned out to be a fraud, they became liable for unpaid taxes, and lost whatever esteem they had previously garnered and probably a little more for being such idiots to believe in being able to get something for nothing. The guy is that ran the charity is going to be in jail for a long time but that won't help everybody who got screwed.

Most of the money we donate to charity is never used for the purpose the donor intended. By far the largest percentage as a rule goes for general and administrative expenses, so that the people running the charity can have nice homes, big cars and send their kids to college so that they can become legitimate when they graduate. I guess that's why charities are exempt. If we knew that none of the money was going where we intended, we probably wouldn't be so generous and these kids couldn't go to college. We think that continued exemptions for charities is probably a good idea, Uncle Louie runs a not-for-profit and maybe someday I'll need a good job.

Bank Securities are also exempt. This may be because most of the crash of 1929 was blamed on the banks and when the securities laws were written in 1933 and 1934 it was thought best to stay totally clear of anything remotely connected with banking because it would give the brokerage industry a bad name. Brokers have gotten a bad name on their own and many of the exemptions in the 1933 and 1934 acts are no longer required.

It was also felt that banks needed more latitude in telling their stories so that they could raise money. If banks had to disclose everything, the SEC felt that no one would ever put money into that kind of security. They felt it best to allow the banks to make up whatever story they wanted for the good of making the industry health again. The banks became very adept at making up stories and raised substantial sums of money.

Regulation D

The Securities and Exchange Regulation D exempts registration for private placements of Securities and Exchange Commission if:

Issuer believes buyer is a sophisticated investor- I think this is one of the more important definitions that we will deal with. Notice that the discretion as to the buyers sophistication is left to the Issuer. This seems a little like having the fox guard the chicken coupe. I can just picture the president of Blodget Widgets, a company that is down to its last \$20 in the bank, saying to an investor holding a check for \$ 1 million, "I don't believe that you are sophisticated enough to invest in my company". It is possible that this has occurred in the distant past, but it was not the action of a company officer that caused the event; it was more likely the corporate counsel that was afraid to lose his license to practice. You can make book on the fact that the attorney never did any work for Blodget again.

Another confusing aspect of this regulation is the fact that the going definition of an accredited person is one who earned \$200,000 during the previous two years and has a net worth of \$1 million. I'm not sure that this is a good definition of a sophisticated investor. Doctor Bob is probably worth a whole lot more than that and he certainly earns more than \$200 thousand a year, but I have never seen anybody worse with money.

I mean this guy puts his money into every hair-brained investment that comes down the pike. You may remember that he was the guy that said buy comic books; comic books are going through the roof. That was just before they collapsed. Next he started buying something called commemorative plates that were also going to make him a lot of money. The plate market fell apart when the moving people were moving them into the warehouse, the guy dropped them on the pavement. Then he invested in a company that looked for sunken treasure, and they actual found the stuff, but the state impounded it. Doctor Bob still visits his treasure in the state nautical museum though and thinks of what might have been.

Ultimately, things got so bad that they had to appoint a conservator for Doctor Bob so he wouldn't keep messing up. Well, in spite of the fact that the court won't let him sign his own name to a check for anything but groceries, Doctor Bob can still fill out private placement memorandums and qualify as a sophisticated investor in the eyes of the securities laws of the U. S. Government. Things keep going from bad to worse for him. Yesterday the fella in the white jacket said that Doctor Bob couldn't write with anything that had a sharp point anymore. How is he going to write complicated prescriptions?

Buyer must have financial information in memorandum form. This too is extremely important. It makes a lot of sense that they get all of this information, except for one thing, the financials are not necessarily done by an accountant. As a matter of fact for the most part, they are created by highly imaginative people that could have found more successful careers writing science fiction. They weave stories that would make the characters in Alice in Wonderland stand up and take notice.

Almost all private placement memoranda show a series of projections that have no basis in fact in the real world; they predict that the issuing company will have a profit somewhat in excess of the combined gross national products of the European Community by the year 2004. Many people with great intellect (among them Doctor Bob) place a lot of faith in these projections. It was once estimated that if you added all of the projected after-tax income to be generated by companies doing private placements in 1996, they would show earnings of more than the estimated gross domestic product of China, The United States and Japan in 2050. These kind of statistics make a person less than sanguine when approaching financials that appear in many of the private placement memoranda.

Issuer is assured buyer does not intend to make a quick sale of the securities. This one is a real corker. The private placement memorandum contains a statement that the buyer is not going to turn around and sell the offering immediately. We don't understand why that is of any consequence, other than as a subliminal message by the government saying, "your odds of ever seeing a nickel on this investment are next to zilch. Don't get any ideas that you're going to be able to turn this thing around for a quick profit." We would ask the government a more germane question. To whom would I sell this thing if I could sell it at all? Maybe the government knows people that are buying up all of these gems and they are subversive or something. Doctor Bob would certainly like to meet them.

Exit Strategies

Things tend to get so bad in these deals that for the most part we won't do them at all unless there is an exit strategy. What this means is that I have no interest in becoming a permanent minority stockholder in a company run by a bunch of people I know nothing about. If it is successful I don't want management filtering all of the profits out of the company in large salaries and expenses accounts. I am not interested in helping put their children through school by having the corporation pay interest on classes of stock I don't own and I am not interested in having to go through extensive litigation to get what I was promised in the first place. What we insist upon is management's agreement to a definitive exit program, in writing, before we even think of making the investment.

There are many ways that it can be done such as guaranteeing to do a public offering in which your shares are freed up as part of the registration process. For legal purposes, these intentions should be spelled out, chapter and verse within the private placement itself. This will not help a lot, because if the deal is a bummer anyway, nothing is going to save you from losing your money. One major American brokerage firm admittedly sold its customers over a billion dollars worth of questionable securities and is now after getting caught is trying to figure out how much they have to give back. An exit strategy only protects you from losing all of your money if the deal is a success and even then your odds are poor.

Securities may not be sold to more than 35 non-accredited investors. Sometimes this statement is true and sometimes it isn't. In the deals that you are likely to run across it is probably true. In actuality, this is not what the SEC means and it is somewhat strange that it has become so convoluted over time. While it is true that most transactions cannot be sold to more than 35 non-accredited investors, it is also the fact that it cannot be shown to more than 35 non-accredited investors. Doctor Bob was telling me about a Temperance LDoctor Bob was saying that this guy got up at the League meeting and started talking about all the gold laying all over the place and that everyone could be rich and we could spread the word on alcoholism to the far corners of the earth with all the money we would make. Doctor Bob got a warm and fuzzy feeling from the excitement and indicated that he had a large tax loss carry-forward and would be using his gains to offset his substantial losses of past years.

The rest of the audience was mostly elderly women who were living on social security pensions. Usually there are over a hundred at any given meeting and with an opportunity like this you can bet that at least that many were present. Many of them saw the last of their cash go down the drain on Monaco Gold and yet, the transaction was totally illegal relative to the Securities Act. It would also have been illegal under the "Blue Sky" laws of the state in which the offering was made. Once a general solicitation was made to over thirty-five people they had closed the books on taking any money at all from unaccredited investors. We are fairly certain that the intent of this regulation is bent out of shape on a regular basis.

Relevant Regulation

Rule 147- Intrastate-offering exemption for securities sold within borders of one state.

Small Issue exemption -- Regulation A- a new issue of \$5 million or less during a 12 month period and is exempt under the Act (Rule 147). Issuer must file an offering statement with the Securities and Exchange Commission.

Rule 144 -- exempts persons from the definition of underwriter. Actually, Rule 144 frees up the stock that you got in that private placement issue. As you remember, we signed essentially a lock-up agreement when we purchased the private placement by agreeing to hold the securities. Even if we had not agreed to that, companies have to file registration statements governing their securities' ability to be bought and sold in the marketplace. Historically these rules allowed sales after the securities were held for a period of two years if the company was a filing company. If the company was not a filing company, the securities had to be held for three years or longer.

In spite of the fact that you may well, own a security that you bought in a private placement 20 years ago you can negotiate away the shares' fungibility. For example, management negotiates an IPO with an underwriter who as a precondition for the deal has management agree to "lock up" all of the potentially free trading securities in the company. The lock up is a contractual agreement stating that although you have the right under securities laws to sell your stock whenever you want to, you are waiving that right and for the purpose of interesting us in doing your IPO and you must agree to hold it for another 18 months.

Often your alternative to not signing the lockup is either sitting around for another twenty years waiting for the next offer, which if you are lucky will be pretty much under the same terms and conditions as what you are not agreeing to now. That probably won't be something to worry about, without the public offering the company will not have enough money to survive and go out of business. This happened regularly to Doctor Bob.

The underwriters position is that I am not going to do two underwritings, the first of which is the sale of the shares of your company to my clients and then after that is finished, also find a home for all of the selling shareholders of your company in the open market. If you don't like this approach and your shareholders are unwilling to hold their stock just a little longer to insure the company's success, why the hell should I.

Insiders

There are certain people that can hold on to their stock forever and yet without a registration statement will be restricted to some degree as long as they own the shares and are affiliated with the company. These are shares owned by officers, directors and affiliated persons of the company, as well as holders of 10% or more of the corporation's shares. These folks are insiders. For the most part they may not sell more than 1% of the outstanding shares in the company every quarter.

This may not seem like a lot, but to guys like Bill Gates, who files to sell every quarter, you are not talking about chum change. Gates' quarterly sales amount to hundreds of millions of dollars, the number of hundreds of millions depends on what price the stock is selling at when his quarterly prerogative comes due. For the foreseeable future we believe that Bill Gates will be able to sell over \$1 billion per year of Microsoft shares per year and not materially effect the price of the stock or his percentage ownership in the company.

Investment Banking

Object of investment banking is to raise capital. Sometimes, proceeds represent new funds, which others are refinancing their capital structure. Investment Bankers is at term of art yet nobody had aptly defined to our satisfaction. Because it sounds respectable, some brokers call themselves Investment Bankers, but that term is usually left to those people on the street that have a little money to invest for themselves and know where a lot more is buried. We think of it as a term of endearment for the many years most of us toiled as executives and floor brokers for broker dealers. Investment Bankers are for the most part, people with some money searching potentially rewarding transactions for themselves and their associates. This field if it were located in England would probably be known more as Merchant Banking.

Underwriter, i.e. a banker, assumes risk by buying the new issue from the corporation and reselling it to the public. There are two basic types of underwriting, one is called a "best efforts" and other is called a "firm commitment". Neither is a guaranteed contract that anything is going to happen and when one friend of our attempted to borrow on his brokers firm commitment contract his banker called the police. These contracts have so many holes in them that they make limburger cheese seem solid. These are agreements that are as good as the people that are involved in them, thus, some firms on the street, anything they give is not worth the paper it is written on while with others nothing in writing is really critical.

A best effort type of financing usually consists of the underwriter taking the client out to dinner, asking for a \$50,000 retainer and having him agree that he will try really hard to get the deal done. To some underwriters, "really hard" consists of discussing the deal's merits with their mistresses, in others it may be just a case of waiting for a sign.

Usually the client has to pay for a road show, accountant and legal, all of which can amount to a substantial amount of money if the deal never happens. This occurs more often than the "street" would care to admit and usually the reasons are earth shattering, the most common heard on the street is the fact that the stars were not lined up in proper sequence and concluding the fund raising under those circumstances would have probably resulted an a global catastrophe. "It is best for us all to forget that we have ever heard of this deal", is the common pronouncement of horoscope driven underwriters. It is best to ask if you are in sink with the underwriter before giving him the money.

eague meeting he went at which they were pushing a Monaco gold mining investment.

Another all too often heard response to an underwriter's failure is the fact that the market is not acting well. It can be going up or down to conform to this anomaly. We have learned that if the market is going down, it may make sense to use this as an excuse for pocketing \$50,000 and not doing anything for it but when it is going up it become a more serious situation. An underwriter cornered by someone asking these types of questions will answer on of the following depending upon what business the Subject Company is in:

Only the cyclicals are performing well.

Only the non-cyclicals are performing well .

Only the blue chips are seeing any buying interest and it looks better than it is.

Only the non-blue chips are seeing any buying and your company is considered a blue chip.

The high-techs are hot and the cyclicals aren't going anywhere.

Your company is terrific but it just doesn't have enough sex appeal in this market.

Your company has a lot of sex appeal but the guys in your industry did so many deals in the last couple of months that the market became saturated.

Interest rates are so high; people are buying bonds not equities.

Interest rates are so low; people are buying proven companies with dividends and not speculating.

People are waiting to see if the new capital gains tax reduction takes place.

When I took your money, I didn't tell you that it was going to done in this decade.

Therefore, the deal didn't get done and the money is down the drain. However, the underwriter didn't really promise you anything either. All he said was that he would use his best efforts; I am sure he did. The guy you picked has been using his best efforts for the last 20 years and it hasn't been good enough to get a deal done yet.

Then we have the sure thing, the "firm commitment" underwriting that is issued by only the most blue nose, high quality brokerage firms in the country. I mean their firm commitment means they are on that day putting their capital at risk by buying the entire underwriting for their own account and redistributing to their clients and other broker dealers. You say that in retrospect when Goldman Sachs offered to give you a firm commitment you took the Best Effort of Ajax Concrete and Broker Dealer Services instead? You thought that best efforts meant that they would try harder. While Goldman probably would have completed the deal even at a loss in a bad market, many of the "better firms" on the street would look to their "out" clauses instead. Can't you see in the fine print's fine print where it says we will only do the deal if the principal of the client's firm is

caught in a tornado in a telephone booth on the day the deal is effective or at our discretion? Another "out" clause that is common besides the old tornado in the telephone booth excuse is old the "subject to market conditions" ploy. Every IPO has that clause in the body of the agreement and as we have seen, for the guy wanting to wiggle out of deal, it is the perfect excuse.

"You mean to tell me that a high grade firm doing a firm commitment deal would use the same flimsy excuse as the firm that was only doing a 'best efforts' deal?"

"You bet your bonnet he would bunkie! You think the guys on this street were born yesterday? "Every Rube thinks he can come to town and take the street for a ride, but tell you what we're going to do. You sit here and start calling every friend and relative and customer you have. Get them to buy seventy-five percent of the deal and we'll still do the rest of because we have a lot of confidence in your deal. Bunkie, you can even use my desk, but don't take long, now."

Several takeoffs on the "best efforts" form of deal are the "mini - maxi" and the "all or none". These apocryphal sounding visions are Wall Street works of art. The "mini - maxi" means, "I can't raise less than this or more than that." In many cases the accounting, legal, printing, and underwriting fees are included in the "less than this". Thus, all of the shareholders participating in the transactions have made many friends in the legal and accounting professions with their charity but they have not been left with much of a company. It would be wise not to invest in too many "mini-maxi's" or you could wind up keeping Doctor Bob company at the funny farm.

The "all or none" is a much kinder type of underwriting to shareholders, but it usually acts as a depth charge hitting a submarine amidstships as far as the target company is concerned. It has been estimated by the SEC that accounting, legal, and other costs run over \$300,000 in the average offering. Obviously the company wouldn't trying to go public if it didn't need the financing, so the principals begged, borrowed and stole the necessary \$50,000 non-refundable deposit for the underwriter. The underwriter had them hire a Big Six accounting firm that his son was apprenticing at, mind you not because his son is there but because it would look good on the title page. The law firm that the underwriter said was necessary to get the deal done asked for \$100,000 retainer and assigned the job to a \$400 an hour partner. "We need a firm that is reliable and can get the work out on time,"

Usually, about the same time that the principal at the brokerage firm announces that he can't do the whole deal and that you have to bring in the customers, he will have available in his handy, dandy pocket legal reference guide the names of attorneys that specialize in bankruptcy reorganizations, plans for victims of failed IPO's. I really believe that some
firREPRESENTATIVE CLIENT LIST

MANUFACTURING

Black Powder Acquisition Corporation
Blasch Precision Ceramics
Chelsea Ridge Homes, Inc.
Chemical and Technics Corporation
Computer Numerical Control
Crown Recreation, Inc.
Dais Corporation
Davis Acoustical Corporation
ESARCO International, Inc.
Garden Way, Inc.
Hamilton Printing, Inc.
Hendricks Mfg. Co. of NY, Inc.
IEH
Image Systems Technology, Inc.
Intermagnetics Corporation
Jefco Laboratories
Keystone Associates
Kintz Plastics, Inc.
Luscombe Aircraft Corporation
Mechanical Technology, Inc.
MEMPRO, Inc.
Motch Corporation
Motor Vehicle Protection Systems
MTW Corporation
Norwich Aero Products, Inc.
Optimum Air Corporation

Professional Building Systems, Inc.
Protech Armour, Inc.
Reflective Light Technologies, Inc.
Testamatic Corporation
Troy Shirtmakers Guild, Inc.
Vita Food Products, Inc.

TECHNOLOGY

Adirondack Technologies, Inc.
All-Pro Products, Inc.
AutoQuant Imaging, Inc.
Biovector Technologies, Inc.
BitWise Designs, Inc.
Business Link Communications
CMG Group, Inc.
COMMSOFT
Concept Systems, Inc.
Conversion Technologies, Inc.
Data Management Associates, Inc.
Docucon, Inc.
Foundation Technologies, Inc.
Glens Falls Communications Corporation
Heleonetics Corporation
ICUCOM Corporation
IFS International, Inc.
Image Labs, Inc.
Image Systems Technology, Inc.
Immersive Technologies, Inc.
Innogenetics, N.V.
Intelligent Computer Music Systems
Interactive Learning (ILINC)
International Ophthalmics, Inc.
JRS Technology, Inc.
Ligature, Inc.
Logical Net Corporation
Lync Systems, Inc.
Nesbit Systems, Inc.
NETLAN, Inc.
NeuralWare, Inc.
NYNEX Business Info Systems, Inc.
Park Meditech, Inc.
Phone Power, Inc.
PowerAdz Corporation
Publications Systems, Inc.
REM Technologies, Inc.
Shaker Computer & Management Service.
Spectra.Net Communications, Inc.
TalentFinder.Net, Inc.
Toxgon Corporation
Verax Systems, Inc.
XANCOMM, Inc.
RETAIL/ DISTRIBUTION
Albany Family Amusement Center
Boardman's Limited
Christopher's Men's Stores, Inc.
Gerald Genta of North America, Inc.
Harmanus Bleecker Restaurant Group
Harvest Restaurant Group, Inc.
RichMark International Corp.
Schatz Management Corp.
Smokey's Sportscards Development Corp.
Sportee, Inc.

Sungold Enterprises, Ltd.
Video Hut, Inc.

FINANCIAL SERVICES

Ameri-Life & Health Services, Inc.
Automotive Venture Fund, Inc.
Broadway Acquisition Partnership
Bankers Protective Life Insurance Company
Barrington Capital Corp., LP
Bradford National Life Ins. Company
Capital District Physicians' Health Plan
Cash Your Check, Inc.
Coastal Capital Partners, Inc.
Employee Family Protection, Inc.
Fleet Financial Group, Inc.
Gibbens Company
Goran Capital, Ltd.
Groos Bank, N.A.
Interamericas Investments, Inc.
Kelly Field National Bank
Kurchner Capital Management
LDH Holdings
Managed Comprehensive Care
New York Business Development Corporation
PAFCO General Insurance Company
Premium Payment Plan
Simmons International, Inc.
Southern National Financial Corporation Standard Management Corporation
UniSURE Corporation
Vital Management Corporation
Real Estate Development
Altamont Homes
Angel Fire Corporation
Briggs Construction Company
Carousel Hotel Company
Central Warehouse, Inc.
Chelsea Ridge Associates, Inc.
Financial District Associates, LP
Gerrity Realty
JM Development Corporation
Major AutoMalls, LLC
Morache/Keneally Dev. Corporation
New Concept Communities, Inc.
Outdoor Escapes Corporation
Saratoga Health Retreat
Springhill, Inc.
The Michaels Group, Inc.
Trident Marine International, Inc.
Ucellini/United Corporation

GOVERNMENT/NOT-FOR-PROFIT

501 (c) Insurance Services, Inc.
Business Council of NYS, Inc.
Business Services Corporation
Iron Workers District Council
NYS Industries for the Disabled
NYS Laborers' Health/Safety Trust Fund
NYS Messengers & Couriers Association
NYS Science & Technology Foundation.
Rensselaer County
Retail Council of NYS

Saratoga County
Saratoga Economic Development Corporation
United Auto Workers Local
Washington County
MISCELLANEOUS
AmeriCan, Inc.
C. T. Male Associates, PC
Business Services Corporation
Cambridge Valley Mushroom Farms
Collision Experts, Inc.
Community Funeral Management Corporation
Consolidated Automotive Recyclers, Inc.
Coromed, Inc.
Corporate Health Dimensions, Inc.
Exhibit Planning & Mgt., Inc.
Flight Video, Inc.
Grich Broadcasting Corp.
Kiddie Academy, Inc.
King Int'l. Road Materials, Inc.
Light and Power Productions, Inc.
Millwork Specialties
Multi-Care International, Inc.
NLS Commercial Printing, Inc.
Norsea Corporation
North American Recycling Corp.
Roberts Towing/Recovery Spec.
Seyfarth, Shaw, Fairweather & Geraldson
Spanish Broadcasting System, Inc.
Statewide Media Group
Team Classic Golf Services
TV2000 International
Unity Healthcare Holding Co., Inc.

Biographies

Robert W. Schwartz

Robert W. Schwartz founded the firm in 1985 and is a Managing Director. Mr. Schwartz specializes in corporate planning, finance and development. Prior to starting the firm, he was a founder, President and Chief Executive Officer of a venture-funded high tech telecommunications company. In addition, he was the President and Chief Operating Officer of an American Stock Exchange listed company, which he took public in 1979. He was also the Chief Financial Officer of a major manufacturer of outdoor power equipment. His earlier experience was with KPMG Peat Marwick as a management consultant and with IBM. Since starting the company, he has worked with over 200 businesses utilizing his experience in finance and general management to achieve their objectives. Mr. Schwartz holds a Bachelor of Science degree from Cornell University and has done graduate work at the State University of New York at Albany. He has served as a Director of several public and private companies as well as non-profit organizations and has been a frequent guest lecturer at local universities and professional organizations. He has also taught a graduate course on entrepreneurship at the University at Albany.

Thomas R. Sinopoli

Thomas R. Sinopoli is a Managing Director specializing in developing and implementing new marketing strategies, affirming target markets, clarifying product lines, evaluating distribution channels, reviewing pricing strategies, and designing and implementing promotional plans. He has extensive experience with both start-up companies and established organizations. Previously he handled international and domestic marketing with Enable Software and Drover Technologies and served as President of the Computer Systems Division of BitWise Designs, Inc. He has introduced new products and sold products for such companies as IBM, Savin, and Dennison Manufacturing. He has taught courses in marketing, management and advertising at Boston University. Mr. Sinopoli holds a Bachelor of Business Administration in Industrial Management from Adelphi University.

Frederic J. Buse

Frederic J. Buse is a Managing Director specializing in corporate and governmental finance. He has extensive experience in the insurance and banking industries as well as with technology based companies. Prior to joining SHG in 1995, he was the

Director of Unemployment Insurance of New York State. Previously, he managed a variety of assignments with The Lawrence Group, a mid-sized property and casualty insurance organization. Mr. Buse also gained much valuable experience as a senior manager with several high tech computer software start-up companies sponsored by AT&T and Eastman Kodak, and at Security New York State Corp., a Rochester, New York based bank holding company, now part of Fleet Bank. He holds a Bachelor of Science degree from Columbia University where he completed graduate study in economics, banking and finance. He is a member of the Society of Chartered Property and Casualty Underwriters and has served as a Director of a variety of private companies and not-for-profit organizations.

Stephen T. Wilson

Stephen T. Wilson is a Senior Vice President who has twenty-three years of extensive experience specializing in business valuation, corporate finance, acquisition/investment analysis, and financial management including financial analysis, planning, budgeting, and control. Most recently, he was the Chief Financial Officer for a public company, which manufactures products for the test, and measurement markets and provides contract technology development and engineering services. Prior experience includes managing financial reporting and banking relationships for a national insurance enterprise providing both underwriting and brokerage services. He also held various financial management positions with a major regional financial services holding corporation. His career began in public accounting with a "Big 6" firm. He holds a Bachelor of Science degree in accounting from the Pennsylvania State University, an MBA degree from Rensselaer Polytechnic Institute and is a CPA.

Patrick R. Hart

Patrick R. Hart is Managing Director-Midwest with a background in finance and 25 years of marketing experience with consumer product companies. In addition, he has been involved with start-ups, turn-around and restructuring ventures. He has extensive international experience and speaks fluent Spanish. Prior to joining the firm, Mr. Hart was the Chief Executive Officer and founder of a successful consumer products company recently acquired by a large publicly traded company. Mr. Hart was also the Chief Executive Officer of a large subsidiary of Studebaker-Worthington Corp. He has also served as a Director of a number of companies. Mr. Hart's early experience was with a "Big 5" accounting firm. He holds a Bachelor of Arts degree from Michigan State University and an MBA from Farleigh Dickinson University. He is also a long time member of T.E.C., an international organization of Chief Executive Officersms on the street are paid for as many deals that they don't do as they complete.