

# ***RESEARCH FOCUS FOR 2000***

**January 2000**

For the past several months we have been deciding where to focus our research efforts over the next year.

In order to formulate a plan for the next 12 months, we believe it is always important to understand what happened in the past year.

## ***Recap of 1999***

During most of 1999 the stock market remained narrow. Positive performance has been very hard to achieve. We recently reviewed the performance of 1763 companies with market caps greater than \$1 billion. For this year (12/31/98 – 12/17/99) the median stock was up by 13.5%. This means that only 50% of these stocks were up more than 13.5%. During the same period, 59% of the stocks were up and 41% declined in price. The smaller cap stocks fared even worse. In our study there were 5,432 companies whose market values were less than \$1 billion. Thus far in 1999, the median performance of these companies was a decline of 9.8%. Of these stocks 60% declined in price and 40% increased in price. Thus, investors in small cap stocks faced a very tough environment in 1999.

## ***Conclusion***

Does this kind of action foretell a bear market? Not necessarily, since it depends upon whether the action is irrational. Since the end of the bear market late last year, we think the stock market is attempting to sort out the winners and losers in an economy oriented around networking and telecommunications. There are clear excesses in the valuation differences between the winners and losers. Yet the basic focus of the market is sound.

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## ***Focus For 2000***

We believe the present environment offers excellent opportunities to the alert and patient investor. Our research focus for 2000 will be oriented around four themes:

<b><i>Networking (Internet/Intranet) Emerging Superstars</i></b>
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- ◆ Networking (Internet/Intranet) emerging superstars.
- ◆ Telecommunications infrastructure, wireline and wireless.
- ◆ Out-of-favor stocks likely to successfully embrace the networked world.
- ◆ Out-of-favor stocks with terrific business models.

Over the past two years we have been seeking to identify and invest in these types of stocks. The ideal prototype is a company with an already strong business base, strong management, and the ability to leverage the existing business in a networked world. Our ability to find and invest in several of these companies has been the key to our success in 1999. We expect to experience some follow-through performance in these stocks in the year 2000, although the pace of improvement may not be as great as 1999. We are continuing to look for emerging franchises in this area.

***Telecommunications Infrastructure  
Wireline and Wireless***

Recently Disciplined Growth Investors switched from analog cellular phones to the new digital Sprint PCS phones. In some cases our monthly bills dropped by 80%. Included in our new service we have call waiting and voice mail. The sound quality is vastly improved. Finally, long-distance calls are the same rate as local calls. Our phones are also equipped with mini-browsers for Internet access to be functional sometime in 2000. Quite a package. The massive cost declines clearly indicate that there will be a boom in PCS phones. We believe the explosion in data transmission, both over the wire and wireless, will pave the way for substantial growth in this area. The world will have to spend hundreds of billions of dollars to build an infrastructure to support the demand. The investment research work is tough because the technology is difficult to understand and the Federal Government is as yet unclear on its policies. Our ideal prototype is a company with proprietary technology and an emerging presence as a supplier to this industry.

***Out-of-favor stocks likely to  
embrace the new networking  
paradigm***

Since most stocks fared poorly in 1999, that means there are some great opportunities among the downtrodden stocks. In this area the investor faces a potential trap. There are many stocks selling at low valuations, but the company may not adjust its business strategies to the new paradigm. These stocks may remain in the doldrums for the remainder of this market cycle. On the other hand, there will be companies, which successfully embrace networking in their own industry. Many of these companies will derive a competitive advantage from their efforts. We can think of many opportunities in this area. A company with a great worldwide brand name may leverage that name over the worldwide web.

A manufacturing company may radically improve its supply system, cut its manufacturing costs, and beat its competitors. All types of industries will radically change their distribution systems. Some of the changes may not be easily apparent. Because the stocks are so depressed the investment rewards will be very high for those companies able to successfully embrace the new world.

Small cap stocks provide an unusual opportunity in this environment. In a world where the competitive landscape is changing comprehensively, past assets may be a drag on a company's ability to adapt. Size and scale may be less important than ability to adapt. In this environment the seeming disadvantage of small companies, i.e. their small footprints, may well make it easier for them to adapt.

***Out-of-favor stocks with great  
business models***

With or without the effects of a networked world we have been and still are attracted to companies, which can earn an excellent return on their capital. We shamelessly admit to being reminded of the importance of return on shareholder equity by the great Warren Buffet. Internet or not, there are great companies whose superior management holds shareholder capital as sacred. These managements "get it". Because of the intense focus on Internet stocks some of these "forgotten" stocks offer great value. We will seek to find these stocks.

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