

BY STEPHEN BRENNAN

The Outcast Portfolio

AFTER BEING BEARISH DURING MOST OF 2002, I have been an unrepentant bull this year despite war, disease and economic weakness. I remain bullish, and continue to believe that some of the best investing opportunities remain in the most unpopular investment themes. Indeed, the one common point shared by my 10 picks in this current column is unpopularity. That said, my flock of black sheep has not disappointed me. The combined investment recommendations of this column have risen 19 percent for the first six months of 2003, while the broad stock market, as measured by the S&P 500, has risen almost 11 percent.

TAKING YOUR MEDICINE

I am always surprised when someone tells me they have followed my recommendations for the simple reason that, like medicine, while the advice in this column is producing healthy results, it does not taste that good going down. Take for example the heavy

dose of technology stocks I have been prescribing: biotechnology (BBH), semiconductors (SMH), broadband (BDH) and software (SWH). After getting clobbered for over-investing in technology stocks, the last thing most investors wanted to do was invest in these sectors. That's a big reason I liked them. All four have handily outperformed the

broad market with respective returns of 46, 27, 25 and 17 percent since the beginning of the year. The 46 percent return from biotech really reinforces the point that great stock performance often comes from being in the right sector.

Outside of technology, my picks produced more mixed results. Helped by Enron and WorldCom, utility and telecom stocks were some of the least popular investments, and while my utility stock (XLU) recommendation is up 16 percent, the telecoms are just barely positive with a 2 percent return. Outside of the U.S., investors were fairly pessimistic on both Europe

and Japan. Although my Eurozone (EZU) pick is up 13 percent, Japan (EWJ) has only risen 5 percent. While I am still holding on to my two poor performers, in my April column I recommended replacing basic materials (XLB) and small cap stocks (IWM) with Internet stocks (HHH) and small cap growth stocks (IWO). Since April, Internet stocks and small cap growth stocks have risen 34 and 24 percent.

A METHOD TO MY MADNESS

While my method for picking investment sectors, styles and countries goes beyond simply selecting what is least popular, sentiment plays a big role. Take semiconductor and Internet stocks, for example. I did not start recommending these sectors until I believed that a lot of negativity was priced into the stocks and expectations were too low. Moreover, negative sentiment is often directly correlated to consolidation and cost cutting – two factors that I like very much as an investor. At this point in the year, I believe all these trends still have room to play out, and I'm sticking with all my picks.

In this column I have tried to keep things very simple. There are just 10 picks each originally weighted at 10 percent of this model portfolio. Within these picks are currently two regional picks (Europe and Japan), one style pick (Small Cap Growth) and seven sector picks (biotech, semiconductors, software, broadband, Internet, telecom and utilities) – an actual client portfolio is, of course, going to be a bit more complex. Although a relatively simple portfolio, this does represent a key component of my investment philosophy to balance risk with some diversification, while seeking outperformance by targeting specific investment themes. As is standard for the purpose of calculation I'm using the closing price on the last day of the year and quarter respectively. There are, of course, some execution and liquidity issues with buying any security. However, if you are investing and holding onto positions, rather than trading, these costs are not going to detract too much from your returns. So at the end of six months, I am planning on standing pat with my outcast portfolio, while still expecting strong returns over the next six months. ☺

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STEVE BRENNAN'S MODEL PORTFOLIO

Biotech HOLDERS	(BBH)
Broadband HOLDERS	(BDH)
Internet HOLDERS	(HHH)
iShares Russell 2000 Growth	(IWO)
iShares MSCI EMU	(EZU)
iShares MSCI Japan	(EWJ)
Select Sector SPDR-Utilities	(XLU)
Semiconductor HOLDERS	(SMH)
Software HOLDERS	(SWH)
Telecom HOLDERS	(TTH)