

FOCUS

Volume 16, Number 4 / October 6, 2003

The California conundrum

This is being written before the outcome of California's recall election is known. As to the pros and cons of the recall itself, we're not taking sides, nor are we endorsing any candidate in the event Governor Davis is removed from office. What we do know is that whomever takes office will face enormous challenges.

As we see it, there are two overarching issues that need to be addressed: taxes and business regulations. The tax problem stems in large part from the state's extremely progressive income tax structure. While taxing the rich appeals to many liberals, the problem it poses is that when the rich suffer an income drop, the state's revenues plummet, as happened the last three years. Only a flattening of the rate structure will address this part of the problem.

However, stifling regulations are forcing many businesses out of the state and others to implement massive layoffs. If this trend is not reversed, and soon, tax reform will be irrelevant because there will be no income to tax. Between exorbitant workman's compensation premiums, overtime pay for more than 8 hours a day (instead of 40 hours per week), mandatory paid family leave, and possibly mandatory health insurance, employers are leaving the state in droves or just closing down. Fidelity National, the country's largest title insurance company, is moving its headquarters to Florida. Countrywide Financial, based in Los Angeles, is downsizing in California and expanding to low-cost states like Texas. Angelo Mozilo, Countrywide's CEO, estimates that all the legislation recently signed by Gov. Davis (as a payoff to his union supporters) will increase the company's per-worker cost by \$4-5,000 annually.

Because the Democrats hold both houses of the state legislature, whoever is in charge after October will have a mess to clean up. As reported on MSNBC:

The current year's \$38 billion deficit was taken care of, in part, by putting off \$8 billion in costs until next year. And that's not all the next governor will have to worry about.

All the major contenders to replace Gray Davis have promised to roll back the \$4 billion car tax immediately.

A court has struck down \$2 billion in bonds that the state had planned to issue to cover this year's employee pension obligations. And the same thing could happen to another \$11 billion in deficit bonds.

"If the same ruling holds up and is applied to the deficit bond, you essentially have a fiscal meltdown at that point," said Daniel Weintraub, a newspaper columnist for the Sacramento Bee.

We think the biggest worry of all, though, is not getting any press: whoever is elected, or not recalled, we can be fairly sure that the ensuing lawsuits will create legislative gridlock. Stand by—things should get very interesting very quickly.

***The politics of
rich and poor***

When we hear arguments that the "rich" aren't paying their fair share, we cringe. First, the "rich" are arbitrarily defined as being those families earning something north of about \$90,000 annually, not uncommon in families with two breadwinners. The fact that many if not most of these families do not have the level of assets that we would normally associate with being "rich" is irrelevant to many in the media and to liberal policymakers. Moreover, we know a number of families whom we would consider "rich" whose incomes are below that figure. The math is simple: a \$2MM municipal bond portfolio today might yield \$75,000, and a \$1.5MM home doesn't produce any income. Thus, while rich in terms

of assets, such individuals would not be considered rich in terms of the standards used by most policymakers.

Another fact conveniently ignored by many is that the ranks of the rich and poor are not static. Americans for Tax Reform (ATR) has published on its web site an “Income Mobility Fact Sheet” based on data from the Census Bureau. Some highlights:

- Of the 34.2% of Americans who experienced poverty from 1996 to 1999, over half escaped within four months of entering it.
- Eighty percent left poverty within a year.
- Those briefly poor include college graduates who do not find jobs for several months, workers experiencing short periods of unemployment, and women taking maternity leave.
- Only 1 in 17 Americans who experienced poverty in this period was poor for its entirety.

ATR also cites a study by the Federal Reserve Bank of Boston which reported that 47% of families in the lowest income quintile in 1988 moved to a higher quintile by 1998, and 47% of those in the highest quintile moved to a lower one within 10 years. Similarly, a National Center for Policy Analysis study found that after a single year, 32% of individuals in the lowest quintile moved up, while 25% of those in the highest quintile moved down. Within 10 years, 67% of those in the lowest quintile moved up, while 61% had moved down.

ATR goes on to add: “Income group membership is strongly dynamic, and today’s ‘poor’ are tomorrow’s middle class and ‘rich.’ Most people who experience poverty [as defined by law, i.e., with incomes below some level—*ed.*] escape it within months, and most members of the top and bottom income quintiles see reversals of fortune within a decade. So, politicians who attack [Bush’s] tax cuts with rhetoric about

‘poor’ and ‘rich’ are disingenuous; members of one group may soon be members of the other, and today’s ‘poor’ stand to reap great tax benefits in the future.”

**Deviance=
Innovation**

A fascinating book came across our desk recently. *The Deviant’s Advantage—How Fringe Ideas Create Mass Markets*, by Ryan Mathews and Watts Wacker, posits that the ultimate source of innovation is deviance. According to the authors, a new product or convention that arises from a “deviant” act progresses along a path involving at least five stages: the “Fringe,” “Edge,” “Realm of the Cool,” “Next Big Thing,” and “Social Convention.” Assuming “it” achieves maximum market potential, it may move on to “Cliché,” and then become a new “Icon,” or an “Archetype,” or even disappear into “Oblivion.”

“Don’t let the words *deviant* and *deviance* scare you,” Mathews and Wacker caution. It’s merely “something or someone operating in a defined measure away from the norm.” An example sighted in the book is the Frisbee, the origin of which was a disposable pie plate. The Frisbie Baking Co. provided baked good to universities. One day a “deviant” student at Yale flung an empty pie plate at a co-ed. The pie plate, when tossed in an inverted position, was aerodynamic. One tossed pie plate led to another, and so on.

This could have been the end of the Frisbee in that it might have stayed at the Fringe, had it not been for W. F. Morrison and W. Franscioni. In 1948 they invented their own version of a Frisbie Baking plate out of plastic. Morrison and Franscioni parted ways, and the plastic disc stayed with Morrison, who named it the “Pluto Platter.” Morrison sold the Pluto Platter to Wham-O Toys, where it was once again renamed the “Frisbee.” Mattel (formerly Wham-O Toys) took the Frisbee from the Edge of the toy world all the way to Social Convention. In fact, the U.S. Navy studied the performance of Frisbees in wind tunnels in 1968. This is as far from

the Fringe as it gets.

The journey from the Fringe to Social Convention starts in the mind of (you guessed it) a deviant, someone distant enough from society at large so as to be essentially unnoticed. It's where the (deviant) "thing" has virtually no commercial marketability. The "thing" reaches Social Convention when the incarnation of deviance goes fully mainstream. In the authors' words, "it's when stock-car racing, once a redneck art form based in the South, becomes one of the fastest-growing spectator sports in the world." Even the casual reader is likely to come away from this book looking anew at all sorts of things!

Read the fine print!

The national "Do Not Call" registry has been in the headlines of late. As you can imagine, telemarketers aren't particularly happy about it, and they seem to be employing all kinds of dirty tricks to get around it. What follows is just one example of which we are aware.

Jackie Copple, Palo Alto real estate agent *par excellence*, recently published the following story in her newsletter. It seems that one of her clients received what appeared to be a promotional offer in the mail: "Vote for your favorite cola—Coke or Pepsi—and receive a complimentary 12-pack." At the very bottom of the card, in very tiny print, was the following statement: "By completing this form, you agree that sponsors and co-sponsors of this offer may telephone you, even if your number is found on a Do Not Call Registry or list." Sneaky devils, those telemarketers.

The bottom line: Always read the fine print, and if it sounds too good to be true, it probably is.

If it looks suspicious...

In the same vein, one of our Managing Directors received an email, purportedly from customer support at eBay, stating that "During our regular update and verification of the accounts, we couldn't verify your current information. ...Please update and verify your information by clicking below." The

link provided went to a site that looked like an eBay page but asked for all kinds of personal information like Social Security number, bank account numbers, pin codes, credit card numbers including the three-digit codes on the back, etc.

Knowing that eBay, like most other reputable e-commerce firms, would never ask for such information, our MD forwarded the suspicious message to the security folks at eBay (spoof@ebay.com) and to the Federal Trade Commission's watchdog group (uce@ftc.gov). If you receive any message asking for such information, we urge you to contact both the company involved and the FTC. Spam is bad enough, and hopefully it will be eliminated in time. "Phishing," as this type of activity is called, will probably never be eliminated and therefore requires extreme diligence by all of us.

***We're here to
serve, whatever
it takes***

One of the little known but much appreciated aspects of our service offering is the variety of things we do for clients that go far beyond asset management. Recently, we had the opportunity to assist a client with a very delicate task, and, with the client's permission, we hereby offer her story as an example of the lengths to which we will go to assist our clients.

Jane (a pseudonym), a widow, has been a client for several years. Some months ago, she started dating a very likeable gentleman (whom we'll call John), and they are now talking about a more permanent relationship. The challenge: her net worth is well into seven figures, while his is only in the mid six figures. When she announced to us that they were exploring a long-term relationship, we suggested to her that at a minimum she get a background investigation on John. With the assistance of the HR department at Silicon Valley Bank and that of one of our clients, an attorney, we identified two private investigators. She retained one of them, and, fortunately, her beau turned out to be exactly as advertised, a truly fine gentleman.

With that out of the way, we then addressed the bigger issue: how do two people with vastly disparate resources manage their finances so that they both feel like it is a win-win situation? We suggested that they seek the assistance of a counselor who specializes in such matters. Because Jane lives in the Southeast, this presented yet another challenge. Fortunately, our colleague in San Francisco, Judy Barber, MFT, of Family Money Consultants, LLC, gave us the name of a highly regarded therapist and counselor in the city where Jane lives. Jane spoke with the counselor, and she and John are now working with her to develop a strategy for their joint finances.

This example is just one of many we could cite. We want to thank “Jane” and “John” for allowing us to share their story with you.

***Inquiring minds
want to know***


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Inside Woodside

In addition to sitting as Trustee of the U.C. Berkeley Foundation and Chairman of its Investment Committee, Bob Beim was recently appointed to the Investment Advisory Committee of the U.C. Regents. In a similar vein, Morgan White has been appointed to a second three-year term on the Advisory Board of the Stanford Institute for Economic Policy Research. Both of these affiliations give us information and contacts that are invaluable in our practice.

As a reminder, our offices will be closed on Thursday and Friday, November 27-8, for Thanksgiving, and on Wednesday and Thursday, December 24-5, for Christmas. ❏

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The Bank has 11 offices throughout California and operates regional offices in Phoenix, Arizona; Boulder, Colorado; West Palm Beach, Florida; Atlanta, Georgia; Chicago, Illinois; Boston, Massachusetts; Minneapolis, Minnesota; New York, New York; Durham, North Carolina; Portland, Oregon; Philadelphia, Pennsylvania; Austin, Texas; Dallas, Texas; Northern Virginia; and Seattle, Washington. More information on the Bank can be found at www.svb.com

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