Volume 2 Number1

February 2004

Blue Collar Investment Advisor

BCIA

Wall Street

- DJ 10628
- S&P 500 1146
- NASDAQ 2054

Who is Looking Out For You

Who should you rely on for your investment advice? Many people use stockbrokers for help in managing their investments. At BCIA we do not trust our money being stewarded by anyone who has a conflict of interest with our financial goals. A stockbroker's primary obligation is to make money for his firm. This is done by buying and selling investments. The obligation to the customer is not the number one or even number two priority. You may have heard of the major settlement between the Securities and Exchange Commission (SEC) and numerous companies in the brokerage industry.

In whose favor do the scales tip Investors or brokers?

In an article by Philip J. Harmelink and William M. VanDenburgh of the University of New Orleans and Louisiana State University respectively, they discuss this dilemma. The article titled The CPA's Role In Guarding Clients' Investments, they state that "The typical broker relationship is in direct conflict with the objective of achieving higher financial returns."

They made this statement in light of the $1.4 billion in fines that the brokerage industry paid in 2003. The fines were levied for actions that were in direct conflict with investors. In the brokerage industry it is common for them to have analysts to perform their own investment research. This research is often carried out on companies that they have an investment banking relationship with. Investment banking describes the revenue that is generated by the brokerage firms from helping companies sell stock and bonds to the public. Imagine what these reports have to say about the companies that they receive revenue from. Many times the reports are glowing no matter what the companies prospects are. Merrill Lynch was caught with internal emails that trashed several stocks that their analysts were praising in public.

The firms retail clients are fed this research and the firms brokers will encourage trades in these companies. The SEC and the New York State Attorney General, Eliot Spitzer investigated many brokerages including Merrill Lynch, Piper Jaffray, UBS Warburg and others. What they found was appalling. The list of improprieties is too long to cover in a short article.

Research by brokerages on companies that they follow often has the same relationship as sexy women in cigarette ads. They look real nice but there isn't much truth to them. Out of he whose hand I eat, his song I sing. The analysts who performed this research were often compensated by how much investment banking business they could generate. Is a company more likely to do business with a company whose analysts' have nice things to say about their company or negative things? I don't even need to answer this question. A company that does not receive favorable coverage may

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not be inclined to continue their investment banking relationship.

Many times you get what you pay for. The brokerage industry can be a glaring exception. You can expect to pay much more for executing stock trades through a full service broker compared to a discount broker. Our preferred discount broker charges all of $7 per trade. The same trade through a full service broker averages $340. What do you get for this extra money? We will start out with, you may get more trades. Brokers derive 74% of their income from commission based trades. The more trades a broker executes for you, the more money he or she makes. In 2001 the average broker made $164,000, down from $199,000 in 2000. In both years the stock market went down. So did the value of your investments. Brokers still made a comfortable living. The average broker manages more than 500 accounts. Each account has an average value of $127,000 which totals to $66 million. With 500 clients and about 1800 to 2000 working hours per year, how many hours do you think a broker can devote to an account? Maybe three hours. It is hard to imagine a broker having your best interests in mind when he only has about three hours a year to spend on your account. A broker must also focus on the fact that he needs his clients generating transactions in order for him and his firm to make money. If you believe in a buy and hold strategy, you will not be of much use to a broker. Wall street loves to espouse the wisdom of a buy and hold strategy, they just don't want you to practice it.

Our favorite discount broker is Scottrade www.scottrade.com

What is one to do? BCIA recommends that you, yes you, manage your own investments. If you do not feel comfortable doing this then you may want to contact a fee only financial planner. There are many articles that will discuss what to look for in a financial planner. If you feel comfortable managing your own investments, you have two choices. You can learn how to research investment opportunities on your own or rely on independent third parties research (like BCIA). You can learn the basics of investing a little at a time and have a good chance of becoming a proficient investor.

There are many sources that you can tap into to learn more about investing. Peter Lynch, the famed fund manager for Fidelity, has written several books for beginning investors. His title, "Learn to Earn", has a great explanation of how the stock markets work. The classic text on investing by Benjamin Graham, "The Intelligent Investor", lays out principles for successful investing. Another great book on the process of researching investments is "Common Sense and Uncommon Profits" by Philip A. Fisher.

Here are two Great resources for learning more about investing

1. The American Association of Individual Investor.

http://www.aaii.com/

2. The National Association of Investment Clubs

http://www.better-investing.org/

In the pullout box to the left, we have listed two web sites that cater to investor who are intent on managing their own portfolio. They provide education and other tools to help you.

The answer to the question posed by the title of the article, "Who is Looking Out For You?", is you. There is no one better than yourself to look out for your investments. If you rely on someone else, you must be sure that they have your best interests at heart. Your CPA or a fee only financial planner are a good place to start looking. When you manage your money you eliminate the conflict of interest posed when relying on a broker and you eliminate the chance for theft or embezzlement. Read on for this months advice on what moves you need to make to manage your portfolio successfully.

OMI Corporation

America has a great dependence on foreign oil. We import 54% of our petroleum supply. Surprisingly, the country we import the largest amount of oil from is Canada. The US consumes about 19.6 million barrels per day. The Arab countries were only able to garner one of the top 5 slots on the chart below. With the continuing economic recovery and the emergence of rapid growth in China, India and other budding economies, worldwide oil consumption is increasing. This increase in production and consumption, leads to more shipping activity delivering this product.

OMI is a tanker company that hauls oil all over the world. They have one of the youngest fleets in the shipping industry. The average age of their ships is 5.8 years. The company will scrap two older single hull ships this year. This is a recurring event in the shipping industry. Most all new ships are double hull models. These ships are more resistant to being damaged to the point of losing their cargo leading to an oil spill. These scrapping will be matched by 4 new vessel deliveries in 2004. There has recently been much stricter regulations issued regarding the use of single hull ships and new guidelines for their removal from service. After the scrapping of the two ships and the delivery of the four ordered ships, the company will have a fleet of 38.

The company generated $319 million in revenue in 2003. This compares favorably with the $199 million in 2002. Net operating earnings were $99 million in 2003, compared to $39 million in 2002. This increase in revenue and earnings is the result of a sharp increase in day rates for the ships. Day rates are the rates that oil companies pay to the shipping companies to charter their vessels. These rates increased over 40% in 2003 due to increased demand on lower inventories. Rates are continuing to climb in 2004.

Major Sources of U.S. Petroleum Imports, 2001*
(all volumes in million barrels per day)

	Total Oil Imports	Crude Oil Imports	Petroleum Product Imports
Canada	1.79	1.32	0.47
Saudi Arabia	1.66	1.61	0.05
Venezuela	1.54	1.28	0.26
Mexico	1.42	1.38	0.04
Nigeria	0.86	0.81	0.04
Iraq	0.78	0.78	0
Norway	0.33	0.27	0.06
Angola	0.32	0.31	0.07
United Kingdom	0.31	0.23	0.08
Total Imports	11.62	9.15	2.47

* Table includes all countries from which the U.S. imported more than 300,000 barrels per day in 2001.

We were originally attracted to OMI because of the extremely low price they were selling at. They had assets (ships) that were worth about double what the company was selling for. This is an example of a value stock. Value stocks can be bought for other reasons than a low price compared to the book value of a company. The book value is the value of all of the assets a company has after all of the bills are paid. Our hope was that the price of the stock would rise to the book value of the company. This has already occurred.

Presently we are trying to decide if the company or the industry has made a change that would make this company worthy of a long term commitment. My guess is no. We are going to research this further and will keep you posted. With this said, the company appears to be on the cuff of having a knockout year in terms of earnings. For now, we feel comfortable holding on to this stock and adding more shares at a price near $10. If you see earnings in the $1.60 to $1.70 area this year, you may see the price rise up to the $20 range. At $10 a share, there is probably little downside without a rapid change in shipping rates. For this to happen, some event would need to occur that would rapidly reduce world oil consumption. OMI Corporation trades on the New York Stock Exchange with the ticker symbol OMM. If you buy now, we may decide to exit this stock sometime soon. Plan accordingly.

Earnings Season

Several of the companies in our portfolio have reported their 4th quarter and year end earnings. Overall the results were pretty favorable. Earnings for the S&P 500 were up 26% this past quarter compared to the fourth quarter of last year. For many technology companies the comparison is to extremely depressed earnings last year. It is no wonder that earnings are up such a large extent.

Last month's issue has descriptions of what each of these companies do. Each company will be covered in depth in a future issue as.

AFLAC- Reported strong operating earnings of $.48 per share for the fourth quarter compared to $.40 in the fourth quarter of 2002. This is a very healthy 20% increase. For the year operating earnings rose 21.2%. Aflac's business in Japan resulted in 5.9% points of the yearly increase being linked to the benefit from the stronger yen. The net 17.2% increase, removing the effect of the currency translation, allowed Aflac to beat their aggressive goal of a 17% increase on yearly earnings. For 2004 they project another 17% increase in earnings and they project a 15% increase in 2005. With strong earnings growth like this, Aflac should have equally strong investment returns. If they are not able to meet these targets, we may face a much less desirable outcome.

Amgen– This company looks to have 20% yearly earnings growth for the foreseeable future. They increased their earnings in the 4th quarter of '03 to $.46 from $.35. Their quarterly revenue rose to $2.35 billion from $1.77 billion. Amgen is looking forward to an expansion of the drug label for one of its products this year. It has a relatively young drug portfolio with the sales of several of its products experiencing rapid growth. One of Amgen's first generation drugs was licensed to Johnson and Johnson for sales in U.S. markets other than kidney dialysis. Amgen's second generation of this drug is now cannibalizing sale from its first version of this drug and from J&J's version. The net result is the combined sales for their two versions of this drug are still climbing rapidly and stealing market share from J&J's version.

Astronics– Had a less than stellar earnings report. Net sales for the 4th quarter were down 6%, from $8.8 million to $8.3 million. Their per share earnings dropped from $.08 to $.07 for the quarter. For the year their sales dropped from $42.9 million to $33.2 million. Earnings per share dropped from $.49 to $.10 on a per share basis. We are waiting for sales to ramp up as the Joint Strike Fighter program nears. There also is a strengthening of the commercial airline industry. One interesting item that bodes well for Astronics ties in with capital spending in China. China is building over fifty airports. This will spur the need for more planes; each of which will need formation lighting and cabin lighting.

Cell Genesys- Is one of the more speculative companies in the portfolio, and is another biotechnology company. I have a soft spot for biotech companies. Cell Genesys is developing cancer vaccines for several types of cancers. They are several years off from having a product which is why they only represent a small portion of the portfolio. I have owned them since 1999 and am real impressed with their technology. They stated in their quarterly conference call that they plan on initiating phase three clinical trial on one of their drug candidates sometime this coming summer. Phase three trials are the last experimental trials that have to be performed before a company can submit an application for approval to the Food and Drug Administration. The company has been preparing production capacity over the last few years, to make sure they have the ability to produce the drug in sufficient quantity to perform the trial.

Consolidated Tomoka– This is the best kept secret on Wall Street that I have been able to uncover. When you have something that comes as close as you can get to a sure winner you buy lots. That is what I have done with Consolidated Tomoka. They are a simple company that has a great business model and is worth way more than they are selling for. They own land that they sell off and re-invest into income properties. I am so excited about this company I have trouble containing myself. They are able to defer taxes on the land sales by treating them as a like kind exchange. This allows them to keep the money they otherwise would pay in taxes, working for the shareholders for many more years. We will talk more about them very soon.

Changes

During the past month we have made a few changes to our portfolio. We sold our position in Protein Design Labs. This company has risen pretty rapidly the past year. We sold with the intention of buying back if the price drops below where we sold. So far this has not occurred. We purchased shares of Peoplesoft in an arbitrage position. Arbitrage is taking advantage of discrepancy of prices in different markets. We explain how this concept works in more depth later in this newsletter. Lastly, we sold a stock we bought as a value play on the price of their assets, Calpine. We bought Calpine as low as $2.88 and sold at $6.10. Calpine has very complex accounting. Some the recent events and the manner in which they are being handled are raising suspicion. We would rather sell now and miss out on future gains then get caught up in a big accounting scandal. We are researching a particularly promising prospect that may offer us an opportunity to put the sale proceeds to work rather quickly.

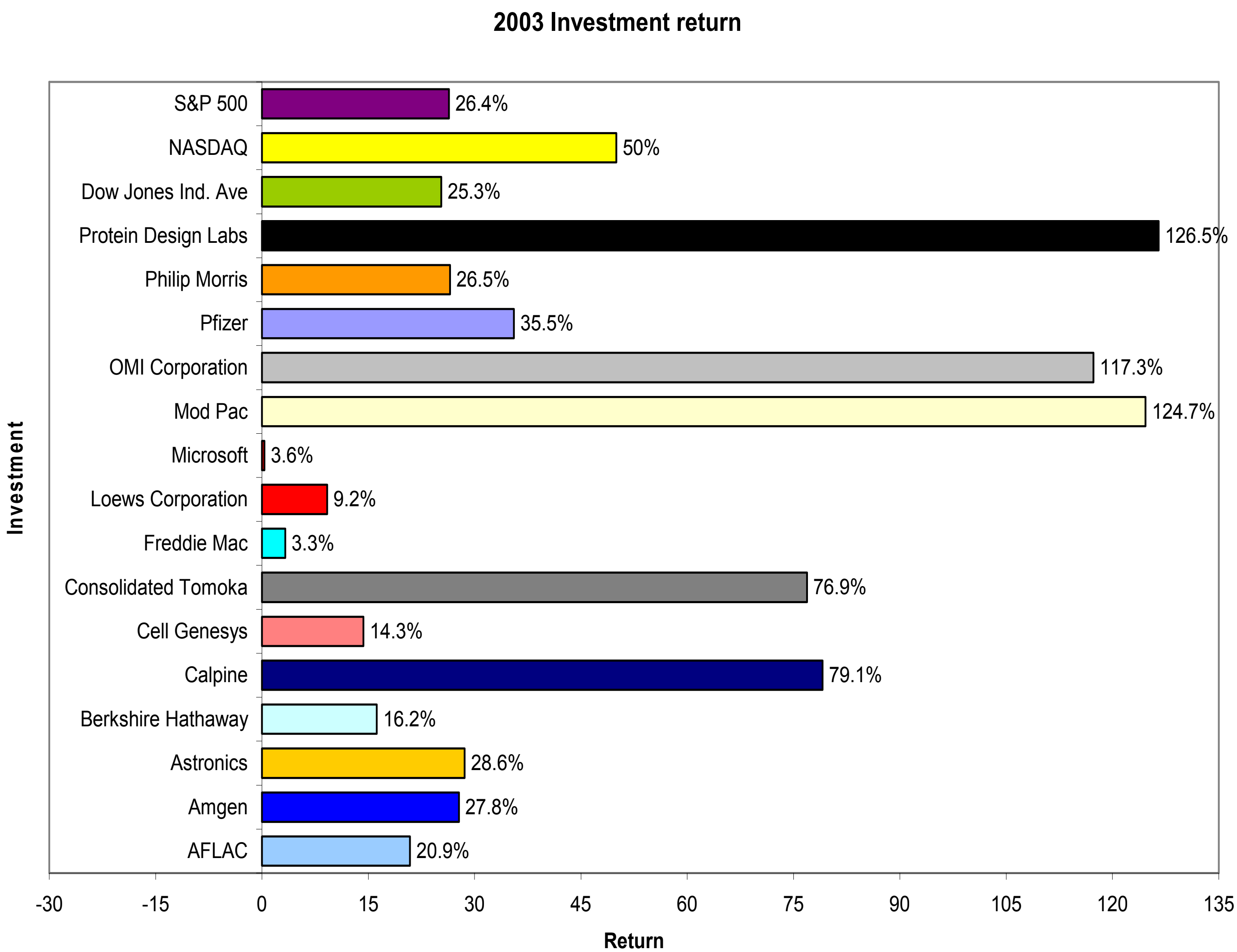
So far the BCIA portfolio is outpacing the S&P 500 average in 2004. At this point, we have achieved a 6.9% return compared to the 3.1% return of the S&P 500. We have sold off two positions and are holding 17% cash. It is never hard to hold cash when prices are high. A few companies are on our radar and we may have an addition to the portfolio in the near future.

You never know what will happen to the market as a whole. However, oftentimes shares can be accumulated over a 50% spread over the course of a year. The difference between the low price and the high price often vary this much. The prices you see now are not the low prices. Many of the companies we own will be trading at lower prices at some point during the year.

Company	Ticker Symbol	Porfolio Percentage	Current price	Buy Price (less than)
Aflac	AFL	3.50%	$40.26	Hold
Amgen	AMGN	5.50%	$64.67	$60.00
Astronics Corporation	ATRO	5.50%	$5.69	$5.25
Berkshire Hathaway B	BRK.B	19.00%	$3,063.00	$2,800.00
Cash		17.00%	$1.00	
Cell Genesys, Inc.	CEGE	3.50%	$12.97	Hold
Consolidated-Tomoka Land Co.	CTO	24.00%	$31.95	$35.00
Freddie Mac	FRE	11.00%	$64.37	$60.00
OMI Corporation	OMM	11.00%	$10.29	$10.00

The chart above shows our investments and the proportion of our portfolio they represent. As you can see we are heavily weighted towards four stocks. This is considered extremely risky by the popular investment community. We feel perfectly comfortable with it. Our trial issue on the website briefly delves into the issue of how you should build your portfolio. To achieve the same returns we will receive, you can buy all of the stocks we own in roughly the same proportion. You may be able to do better by purchasing the stocks we feel are worthy buys presently. These stocks are represented as the companies that are selling for less than our buy price. With the recent run up in prices, you may need to have a little patience to grab some of these stocks at reasonable prices.

2003 Performance



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Arbitrage

Arbitrage - 4% to 8% gains in a couple of months

Arbitrage is the ability to take advantage of what are usually temporary differences in price. Many investment opportunities are sold in multiple market. The U.S. stock exchanges sell share in foreign companies. For example you can buy shares of a Canadian company that trades on the New York Stock Exchange. You may be able to sell those shares for a couple of pennies difference in price on the Toronto Stock Exchange. The example can get more complex.

The method of arbitrage we use does not fit the classical definition. Like many other things we do, that suits us just fine. When we apply arbitrage it is usually in connection with a buyout. It works best when one company is buying another for cash. The best example presently is Oracle trying to buy Peoplesoft for $26. Peoplesoft is selling for $22. A profit of $4 per share could be made when the deal is completed. The only way arbitrage will work in this case is if the deal is actually completed. In this case, it is beginning to look like this deal may eventually fall apart due to regulatory concerns.

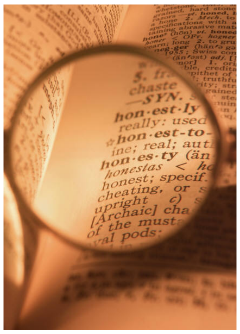
Every once in a while a peculiar arbitrage situation presents itself. One such occurrence occurred in 1954 with a company called Rockwood and Co., a chocolate products company. In the 1940's cocoa was selling for five cents per pound. By 1954 a temporary shortage caused cocoa to rise to 60 cents per pound. The company wanted to recognize some of the gain in the value of its inventory. If the company sold some of these beans, the would have to pay taxes at a then 50% rate. The tax code at the time provided an opportunity to eliminate the taxes on the sale of inventory if the company was to reduce the scope of their business. They decided to eliminate the production of cocoa butter. They allocated 13 million pounds of cocoa beans to this activity. The company offered to buy back its own stock in exchange for cocoa beans. You could buy shares of the company, trade them in at their office for 80 pounds of cocoa beans and then sell them in the commodities market. The only expense was subway fare. A tidy profit was made for those who were willing to carry cocoa beans on the subway to the commodities market.

Here are the details of one of our last arbitrage deals, or workout, that was completed in

Date	Security	Transaction Activity	Unit Cost Quantity	Dollar or Price	Amount
04/30/2001	Oro America	Purchase	200.00000	12.58	2,515.00
06/06/2001	Oro America	Purchase	500.00000	13.53	6,765.00
06/28/2001	Oro America	Sale	700.00000	13.96	9,775.00

2001. We bought shares of Oro America, a jewelry manufacturer. They were bought by another jewelry manufacturer for $14 a share in an all cash deal. You can see that we did not make a huge amount of money on this transaction. We paid $9280 for our shares and sold them for $9775, a gain of $495. This only represented a 5.3% return on our investment.

What made this deal great was that it closed so quickly. Often it takes four to six months to



Honesty Backed by Fundementals

Arbitrage (cont. from pg. 7)

close a deal. We only held our shares on average for 40 days. This had the affect of turning our 5.3% return into a 48% annual return. This is many times what you can expect from a deal of this type. We had nothing better to do with our money at this point in time due to the bear market we were in. This deal helped us keep our returns for the year positive as all of the market averages fell.

What made us buy into this deal in the first place? The acquiring company had tried previously to acquire Oro America. Oro America's CEO served on the other companies board of directors. We knew there was a very good chance the deal would go through.

Earlier we mentioned that our deals do not always meet the classic definition of an arbitrage. The price differences that we take advantage of is not realized in a matter of minutes. In the case of Oro America, we took advantage of the difference in the price that the company was being bought for and their price in the stock market.

Merger and buyout activity tends to evaporate in bear markets. It is just starting to pick up again now. We made an attempt to get in on the Peoplesoft buyout. It proved to be a mistake and we exited quickly. It was the third time that Oracle had raised their bid for Peoplesoft. Sometimes these deals go sour and it pays to be nimble when heading for the exits. We will be on the watch for more chances to put our money to work in productive arbitrage situations.

Outlook

Stocks have had a sizable jump the past six months. We do not even want to guess what is next. Mostly because we do not know. Nor do we care much what the stock market does. We are solely focused on the values that the market presents to us. Lately, we do not see as many as in the fall of 2001. In the next issue we will talk about some of the companies that we are following and which are candidates, if any, to add to our portfolio. Don't get too excited. You know about the race between the turtle and the hare? In the stock trading equivalent, we would finish a considerable distance behind the turtle. We aren't going to help you build your wealth by our flurry of activity.

With that said, we have a candidate in Ultralife Batteries that may fit the bill. Their symbol is UBLI if you are interested in taking a look. I hope this doesn't ruin the suspense. Until next month.

Brett Davidson

BCIA

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